

WILLIAM PENN BANCORP INC  
Form 10-K  
September 28, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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**FORM 10-K**

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended June 30, 2009

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 0-53172

**WILLIAM PENN BANCORP, INC.**

(Exact Name of Registrant as Specified in its Charter)

**United States**

(State or Other Jurisdiction of

Incorporation or Organization)

**37-1562563**

(I.R.S. Employer

Identification No.)

**8150 Route 13, Levittown, Pennsylvania**

(Address of Principal Executive Offices)

**19057**

(Zip Code)

Registrant's Telephone Number, including area code (215) 945-1200

Securities Registered Pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

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**Common Stock, \$.10 par value**  
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  YES  NO

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  YES  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  YES  NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.  X

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company  X

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was \$13.6 million as of December 31, 2008 based on the last sale (\$13.60 per share) reported on the OTC Bulletin Board<sup>SM</sup> as of that date. Solely for purposes of this calculation, the term "affiliate" refers to all directors and executive officers of the registrant, the registrant's stock benefit plan trusts and all shareholders beneficially owning more than 10% of the registrant's common stock.

As of September 25, 2009, there were issued and outstanding 3,641,018 shares of the registrant's common stock.

**DOCUMENTS INCORPORATED BY REFERENCE**

1. Portions of the Registrant's Annual Report to Shareholders for the fiscal year ended June 30, 2009 (Parts I & II)
2. Portions of the Registrant's definitive Proxy Statement for the 2009 Annual Meeting of Shareholders. (Part III)

**WILLIAM PENN BANCORP, INC.**

**ANNUAL REPORT ON FORM 10-K**

**for the fiscal year ended June 30, 2009**

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**PART I**

**Forward Looking Statements**

When used in this discussion and elsewhere in this Annual Report, the words or phrases “will likely result,” “are expected to,” “will continue,” “is anticipated,” “estimate,” “project,” “intend” or similar expressions are intended to identify “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. We caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and to advise readers that various factors, including regional and national economic conditions, unfavorable judicial decisions, substantial changes in levels of market interest rates, credit and other risks of lending and investment activities and competitive and regulatory factors could affect our financial performance and could cause our actual results for future periods to differ materially from those anticipated or projected.

We do not undertake and specifically disclaim any obligations to update any forward-looking statements to reflect occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

**Item 1. Business**

**The Company.** On April 15, 2008, William Penn Bank, FSB (the “Bank”) completed a reorganization from the mutual to the mutual holding company structure and became a wholly-owned subsidiary of William Penn Bancorp, Inc. (the “Company”), a federally chartered corporation. As part of the transaction, the Company sold 1,025,283 shares of its common stock, \$.10 par value, to the public at \$10.00 per share (including 87,384 shares purchased by the Bank’s Employee Stock Ownership Plan with funds borrowed from the Company) and issued 2,548,713 shares to William Penn, MHC. In addition, the Company contributed 67,022 shares to the William Penn Bank Community Foundation. Prior to consummation of the reorganization, the Company had no assets or liabilities. Accordingly, the Company’s financial statements consist of those of the Bank for periods prior to April 15, 2008.

Our executive offices are located at 8150 Route 13, Levittown, Pennsylvania 19057 and our main telephone number is (215) 945-1200.

**The Bank.** Originally founded in 1870, the Bank is a federally chartered savings bank. The Bank’s primary business consists of the taking of deposits and granting of mortgage loans to customers generally in the Bucks County, Pennsylvania area. The Bank is supervised and regulated by the Office of Thrift Supervision and its deposits are insured to applicable limits by the Federal Deposit Insurance Corporation. The Bank is also a member of the Federal Home Loan Bank of Pittsburgh.

William Penn Bank, FSB conducts a traditional community bank operation, offering retail banking services, owner-occupied and non-owner-occupied one- to four-family mortgage loans, multi-family and non-residential real estate mortgage loans, construction and land loans, deposit loans, home equity and second mortgage loans, home-equity lines of credit and other consumer loans. William Penn Bank, FSB operates from its main office in Levittown, Pennsylvania and branch offices in Morrisville and Richboro, Pennsylvania. William Penn Bank, FSB maintains a website at [www.willpenn.com](http://www.willpenn.com).



## Market Area

Our business of attracting deposits and making loans is primarily conducted within our market area of Bucks County, Pennsylvania and the surrounding counties. We focus on the 90-mile radius surrounding our offices. Bucks County was historically dependent on the steel industry. The local economy has changed and is now diverse, without any particular concentration of industry. Much of the areas in which we conduct business can be characterized as outlying commuter suburbs for the Philadelphia as well as the greater New York City area job markets.

As part of our business planning, we have examined the specific demographic conditions of the areas immediately surrounding each of our three offices. This examination showed that our Levittown market has lower levels of education, a lower percentage of white-collar workers, lower average household income and fewer overall households than average Bucks County levels. The Levittown market has approximately 4,200 households and is projected to experience a modest decline in households and population through 2011. The predominant age bracket for this market area is 45 to 54 years old. Examination of our Morrisville market revealed higher levels of education and white-collar workers but lower average household income and fewer overall households than average Bucks County levels. The Morrisville market has approximately 5,800 households and is projected to experience a modest decline in households and population through 2011. The predominant age bracket for this market area is 35 to 44 years old. Our Richboro market was determined to have higher levels of education, white-collar workers, household income as well as more overall households than average Bucks County levels. The Richboro market has approximately 4,200 households and is projected to experience slight growth in households and population through 2011. The predominant age bracket for this market area is 45 to 54 years old. The Levittown and Morrisville market areas are believed to have small potential as retail deposit and loan markets with below average propensities for most deposit and loan products while the Richboro market area is believed to have average potential as a retail deposit and loan market with above average propensities for most deposit and loan products. Each of the three market areas has a higher number of businesses per square mile than the Bucks County average, with the different concentrations in Levittown, Morrisville and Richboro being construction, personal services and the health industry, respectively.

## Lending Activities

**General.** Our loan portfolio is primarily comprised of one- to four-family residential real estate loans. We are a reputation lender and feel we have built a niche in our market area for providing financing on what we believe are high quality credits that are, for various reasons, ineligible for resale in the secondary market. For example, we originate a significant amount of mortgages on non-owner-occupied properties (which are generally referred to as "investor loans"). At June 30, 2009, we had approximately \$65.7 million of loans on non-owner-occupied, one- to four-family residences ("investor loans"), representing approximately 29.6% of Total loans. This \$65.7 million of one- to four-family investor loans includes \$61.1 million of first mortgages, \$734,000 of second mortgages and \$3.9 million of construction loans. Loans on one- to four-family residences are generally considered to have less credit risk than other types of real estate lending, but a non-owner-occupied property puts the loan on that property into the category of "investor loans" and these loans are generally considered to involve a higher degree of credit risk than the financing of owner-occupied properties since repayment may depend on the rental income from such properties.

A part of our management of interest rate risk we generally seek to avoid originating fixed-rate, 30-year loans unless we have a commitment for the resale of such loans in the secondary market. Competitive conditions have limited our resale ability and thus we continue at present to be predominantly a portfolio lender focusing on adjustable-rate loans and fixed-rate loans with terms of 20

years or less.

We have in the past intentionally reduced mortgage lending because of the yield curve's impact on the pricing of short-term assets relative to long-term assets. We now anticipate embarking on a proactive growth strategy. We anticipate, however, that we will continue to limit our origination of fixed-rate, 30-year loans unless we have a commitment for the resale of such loans in the secondary market because that strategy remains a component of our management of interest rate risk. We expect therefore to continue to focus on the origination of adjustable-rate loans and fixed-rate loans with terms of 20 years or less. The mix of adjustable-rate loans to fixed-rate loans will be dependent on what is in demand by customers, and we plan to continue to retain loans with terms of 20 years or less regardless of whether the loans are fixed or adjustable rate. We intend to increase our origination of multi-family and nonresidential mortgage loans going forward as we grow the overall loan portfolio. Our multi-family and nonresidential real estate lending consists primarily of mortgage loans for the acquisition or refinance of small apartment buildings, service/retail and mixed-use properties, churches and non-profit properties, professional facilities and other commercial real estate. We do not anticipate changing the type of multi-family and nonresidential lending that we have done in the past; our intention is do a greater volume of the same type of lending. We do not at the present time originate non-real estate commercial loans or lines of credit to businesses and we have no current intention of expanding our lending activities into that type of commercial lending.

The majority of our loans are to borrowers who reside in Bucks County and could be expected to be similarly affected by economic conditions there.

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**Loan Portfolio Composition.** The following table analyzes the composition of the Bank's portfolio by loan category at the dates indicated.

	<b>At June 30,</b>											
	<b>2009</b>		<b>2008</b>		<b>2007</b>		<b>2006</b>		<b>2005</b>			
	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>
	<b>(Dollars in thousands)</b>											
Real estate mortgage												
One- to four-family	\$ 142,499	62.36 %	\$ 129,709	62.04 %	\$ 117,338	61.82 %	\$ 117,335	62.41 %	\$ 122,821	63.92 %		
Home equity and second mortgage	7,276	3.18	8,394	4.02	8,791	4.63	9,022	4.80	6,216	3.24		
Multi-family	10,268	4.49	12,229	5.85	10,829	5.70	11,137	5.92	8,385	4.36		
Nonresidential	35,366	15.48	30,262	14.48	27,397	14.43	25,298	13.46	26,943	14.02		
Land	3,999	1.75	4,041	1.93	4,010	2.11	4,254	2.28	4,508	2.35		
Construction	14,205	6.22	15,466	7.40	11,111	5.85	9,822	5.22	10,831	5.64		
Consumer	2,347	1.03	2,450	1.17	2,762	1.46	3,613	1.92	5,383	2.80		
Home equity lines of credit	12,142	5.31	6,161	2.95	7,162	3.77	7,096	3.77	6,591	3.43		
Savings account loans	420	0.18	336	0.16	428	0.23	422	0.22	457	0.24		
Total loans	228,522	100.00 %	209,048	100.00 %	189,828	100.00 %	187,999	100.00 %	192,135	100.00 %		
Less:												
Loans in process	(5,562)		(9,144 )		(6,668 )		(4,081 )		(6,206 )			
Unearned loan origination fees, net	(841)		(969 )		(1,116 )		(1,231 )		(1,465 )			
Allowance for loan losses	(2,180)		(1,910 )		(1,840 )		(1,675 )		(1,500 )			
Total loans, net	\$ 219,939		\$ 197,025		\$ 180,204		\$ 181,012		\$ 182,964			

**Loan Maturity Schedule.** The following table sets forth the maturity of the Company's loan portfolio at June 30, 2009. Demand loans, loans having no stated maturity, and overdrafts are shown as due in one year or less. This table shows contractual maturities and does not reflect repricing or the effect of prepayments. Actual maturities may differ.

<b>At June 30, 2009</b>							
	<b>One to Four Family (In Thousands)</b>	<b>Construction and Land</b>	<b>Non- Residential and Multi- Family</b>	<b>Home Equity and Second Mortgage</b>	<b>Home Equity Lines of Credit</b>	<b>Consumer Loans and Savings Account Loans</b>	<b>Total</b>
Amounts Due:							
Within 1 Year	\$ 15	\$ 16,845	\$ 13	\$ 89	\$ 87	\$ 1,010	\$ 18,059
After 1 year							
1 to 3 years	1,274	858	140	476	-	590	3,339
3 to 5 years	5,587	-	1,213	957	108	1,016	8,881
5 to 10 years	21,992	-	7,995	1,778	438	85	32,288
10 to 15 years	32,880	501	14,077	2,790	11,509	-	61,757
Over 15 years	80,751	-	22,196	1,186	-	66	104,199
Total due after one year	142,484	1,359	45,621	7,187	12,055	1,757	210,463
Total	\$ 142,499	\$ 18,204	\$ 45,634	\$ 7,276	\$ 12,142	\$ 2,767	\$ 228,522

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The following table sets forth the dollar amount of all loans at June 30, 2009 due after June 30, 2010 which have fixed interest rates and floating or adjustable interest rates.

	<b>Fixed Rates</b> <b>(In thousands)</b>	<b>Floating or Adjustable Rates</b>	<b>Total</b>
Real estate mortgage			
One- to four-family	\$ 79,250	\$ 63,234	\$ 142,484
Home equity and second mortgage	6,860	327	7,187
Nonresidential and multi-family	24,833	20,788	45,621
Construction and Land	1,359	-	1,359
Home equity lines of credit	-	12,055	12,055
Consumer loans and savings account loans	186	1,571	1,757
Total	\$ 112,488	\$ 97,975	\$ 210,463

**Residential Lending.** Currently, our main lending activity consists of the origination of residential real estate loans, including single-family homes and residences housing up to four families. Our primary lending territory is Bucks County and surrounding counties. All mortgage loans in excess of 80% loan-to-value must have private mortgage insurance that covers us for any loss on the amount of the loan in excess of 80% in the event of foreclosure.

Our underwriting policies permit the origination of one-to four-family first mortgage loans, for primary residence or vacation home, with a loan-to-value of up to 95%. We also offer an affordable housing/first time home buyer program, which uses the 95% loan-to-value limit but permits the borrower to have equity in the real estate of as little as 3%. This program also provides that in low- to moderate-income census tracts of our Community Reinvestment Act lending area we can permit a 100% loan-to-value. We originate leasehold mortgages with a loan-to-value of up to 70%. We offer mortgage loans on non-owner-occupied, one- to four-family properties (investor loans) with up to a 80% loan-to-value ratio and no more than a 20-year term if the rate is fixed.

We offer fixed-rate mortgages with terms of 10, 15, 20 or 30 years. We originate adjustable-rate mortgages, or ARMs, at rates based upon the constant maturity yield of one year U.S. Treasury securities with up to 30-year terms. We currently offer either one, three, five and seven year ARMs with rates resetting on an annual basis, beginning either after the first, third, fifth or seventh year as the case may be. These loans have a two percentage point cap on annual rate adjustments. The maximum rate adjustment over the life of the 3/5 and 7 year ARMs is six percentage points. The maximum rate adjustment over the life of the one-year ARMs is seven percentage points.

Property appraisals on real estate securing one- to four-family residential loans are made by state certified or licensed independent appraisers. Substantially all of our residential mortgages include "due on sale" clauses, which give us the right to declare a loan immediately payable if the borrower sells or otherwise transfers an interest in the property to a third party.

**Home Equity Lending.** We offer home equity loans and home equity lines of credit with loan-to-value amounts up to 80% for first liens and for second liens and 70% for properties with two or more intervening liens. Fixed-rate home equity loans have a maximum term of 20 years. We offer an interest-only home equity loan with an 18-month term. Our home equity line of credit has a five-year draw period during which the borrower may obtain advances on the line of credit, followed by a ten-year repayment



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period. The minimum periodic payment on the home equity line of credit during the draw period may be interest only. Lines of credit have a rate floor of the lower of the initial rate or 4.75% and an adjustment cap of 18% over the life of the loan but no annual adjustment cap. Adjustable rates on our home equity loans and lines of credit adjust monthly and are based on the prime rate.

The Automated Valuation Models (AVM) is used for home equity loans and lines of credit in amounts of \$100,000 or less or with loan-to-values of less than 70%. Should the AVM not provide sufficient value to support the request, a full appraisal may be requested by the borrower at the borrower's

expense.

**Construction and Land Loans.** We originate construction loans, land acquisition loans and land development loans. Construction loans may be for residential or nonresidential projects. Land loans are originated with a 70% loan-to-value limit, land development loans have a 75% limit and construction loans have an 80% limit on the appraised value of the completed project. The construction phase may be no longer than 18 months. A land loan may have a 24-month, interest-only term or may be a three-year balloon loan with a 15-year amortization schedule. Financing is available for owner-occupied residences, and we also provide financing to builders and real estate developers. Approximately 90% of our construction and land loan portfolio represents loans to builders and developers. We occasionally make loans to builders for the construction of residences for which they do not yet have buyers.

Construction and land acquisition and development loans are generally considered to involve a higher degree of credit risk than residential mortgage lending. If the initial estimate of construction cost proves to be inaccurate, we may be compelled to advance additional funds to complete the construction with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If we are forced to foreclose on a project prior to completion, there is no assurance that we will be able to recover all of the unpaid portion of the loan. Moreover, we may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time. In addition, these loans may result in larger balances to single borrowers, or related groups of borrowers, and also generally require substantially greater evaluation and oversight efforts.

**Multi-Family and Nonresidential (Commercial) Mortgages.** Our nonresidential real estate lending consists primarily of mortgage loans for the acquisition or refinance of service/retail and mixed-use properties, churches and non-profit properties, professional facilities and other commercial real estate. The maximum loan-to-value ratio on all multi-family properties or on office/professional properties under \$200,000 is 80%. All other nonresidential properties have a 75% limit. The maximum term on a fixed-rate loan is 20 years. We offer a 30-year term on an adjustable-rate loan.

We will provide multi-family and nonresidential financing for both owner-occupied properties and for investor properties. We do not at the present time originate non-real estate commercial loans or lines of credit to businesses.

Unlike single-family, owner-occupied residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment and other income, and which are secured by real property whose value tends to be more easily ascertainable, multi-family and nonresidential real estate loans typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business or rental income produced by the property. As a result, the availability of funds for the repayment of these loans may be substantially dependent on the success of the business or rental property itself and the general economic environment. These loans, therefore, have greater credit risk than one to four family residential mortgages or consumer loans. In



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addition, these loans generally result in larger balances to single borrowers, or related groups of borrowers, and also generally require substantially greater evaluation and oversight efforts.

**Consumer and Personal Lending.** Our consumer lending products include loans for new and used autos, savings account loans as well as secured and unsecured personal loans and lines of credit.

Savings account loans have a rate equal to the account rate plus 2% and there is no term limit on these loans. Secured personal loans may have terms up to seven years, and unsecured personal loans may be up to three years. We accept securities as collateral for secured personal loans.

Consumer lending is generally considered to involve a higher degree of credit risk than residential mortgage lending. The security if any for consumer loans often consists of rapidly depreciating personal property like automobiles. Consumer loan repayment is dependent on the borrower's continuing financial stability and can be adversely affected by job loss, divorce, illness or personal bankruptcy. The application of various federal laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered on consumer loans in the event of a default.

**Loans to One Borrower.** Under federal law, savings institutions have, subject to certain exemptions, lending limits to one borrower in an amount equal to the greater of \$500,000 or 15% of the institution's unimpaired capital and surplus. Accordingly, based on our financial condition as of June 30, 2009, our loans to one borrower regulatory lending limit was approximately \$6.7 million. Our largest borrower at that date had 3 loans outstanding with an aggregate balance of \$5.7 million, representing mortgages secured by liens on commercial real estate. The Board of Directors evaluates the creditworthiness of large borrowers on a case-by-case basis, and the Board is willing to lend up to the regulatory limit for what it determines to be quality loans.

**Loan Originations, Purchases and Sales.** Our customary sources of loan applications include repeat customers, referrals from realtors and other professionals, and "walk-in" customers. Historically, we have primarily originated our own loans and retained them in our portfolio. We also obtain loan customers through local mortgage brokers. All such loans are underwritten in accordance with our normal underwriting standards prior to origination. From time to time, we also purchase participations in loans originated by other financial institutions.

**Loan Commitments.** We give written commitments to prospective borrowers on all residential and non-residential mortgage loans. The total amount of commitments to extend credit for mortgage and consumer loans as of June 30, 2009, was approximately \$5.2 million, excluding undisbursed portions of construction loans totaling \$5.6 million. We also had \$15.0 million of unfunded commitments on lines of credit as of that date.

**Loan Approval Procedures and Authority.** Lending policies and loan approval limits are approved and adopted by the Board of Directors. Lending authority is vested primarily in the Board of Directors and, to a lesser extent, a loan committee comprised of senior officers may approve loans up to \$500,000 if the loan is substantially in compliance with the applicable lending policy. Prior Board approval is required for all loans in excess of \$500,000 and the Board generally ratifies all loans at its twice-monthly meetings.

### Asset Quality

***Loan Delinquencies and Collection Procedures.*** When a loan is 90 days delinquent, the Board may determine to refer it to an attorney for repossession or foreclosure. Reasonable attempts are made to collect from borrowers prior to referral to an attorney for collection. In certain instances, we may modify

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the loan or grant a limited moratorium on loan payments to enable the borrower to reorganize his or her financial affairs, and we attempt to work with the borrower to establish a repayment schedule to cure the delinquency.

With respect to mortgage loans, if a foreclosure action is taken and the loan is not reinstated, paid in full or refinanced, the property is sold at judicial sale at which we may be the buyer if there are no adequate offers to satisfy the debt. Any property acquired as the result of foreclosure or by deed in lieu of foreclosure is classified as real estate owned until it is sold or otherwise disposed of. When real estate owned is acquired, it is recorded at the lower of the unpaid principal balance of the related loan or its fair market value less estimated selling costs. The initial writedown of the property is charged to the allowance for loan losses. Adjustments to the carrying value of the property that result from subsequent declines in value are charged to operations in the period in which the declines occur.

Loans are generally placed on non-accrual status when they are 90 days delinquent or more, however loans may be placed on a non-accrual status at any time if, in the opinion of management, the collection of additional interest is doubtful. Interest accrued and unpaid at the time a loan is placed on non-accrual status is charged against interest income. Subsequent payments are either applied to the outstanding principal balance or recorded as interest income, depending on the assessment of the ultimate collectibility of the loan.

**Non-Performing Assets.** The following table provides information regarding loans past due 90 days or more, all of which were accounted for on a non-accrual basis.

	<b>At June 30,</b>				
	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
	<b>(Dollars in thousands)</b>				
One- to four-family mortgage loans	\$ 1,280	\$ 1,180	\$ 867	\$ 402	\$ 574
Multi-family mortgage loans	203	—	—	—	—
Nonresidential loans	-	1,122	841	—	—
Construction loans	-	649	245	—	145
Consumer loans	-	—	—	—	34
Home equity lines of credit	-	38	111	—	138
Total non-performing loans	\$ 1,483	\$ 2,989	\$ 2,064	\$ 402	\$ 891
Real estate owned	\$ 206	—	—	—	—
Total non-performing assets	\$ 1,689	\$ 2,989	\$ 2,064	\$ 402	\$ 891
Total non-performing loans to total loans	0.67 %	1.50 %	1.13 %	0.21 %	0.48 %
Total non-performing loans to total assets	0.48 %	1.06 %	0.77 %	0.15 %	0.34 %
Total non-performing assets to total assets	0.55 %	1.06 %	0.77 %	0.15 %	0.34 %

We had no real estate owned or other repossessed assets as of any of the dates shown in the table above except \$206,000 as of June 30, 2009. We did not have any troubled debt restructurings (wherein the borrower is granted a concession that we would not otherwise consider under current market conditions) as of the dates shown in the above table.

As of June 30, 2009, there were no loans not reflected in the above table as to which known information about possible credit problems of borrowers caused management to have serious doubts



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about the ability of such borrowers to comply with present loan repayment terms and which may result in such loans being disclosed as non-performing in the future.

During the year ended June 30, 2009, gross interest income of less than \$117,000 would have been recorded on loans accounted for on a non-accrual basis if those loans had been current, and \$52,000 in interest on such loans was included in income for the year ended June 30, 2009.

**Classified Assets.** Management, in compliance with federal guidelines, has instituted an internal loan review program, whereby weaker credits are classified as special mention, substandard, doubtful or loss. It is our policy to review the loan portfolio, in accordance with regulatory classification procedures, on at least a quarterly basis. When a loan is classified as substandard or doubtful, management is required to evaluate the loan for impairment. When management classifies a portion of a loan as loss, a reserve equal to 100% of the loss amount is required to be established or the loan is to be charged-off.

The following is a summary of information pertaining to impaired loans:

	<b>Year Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>
Impaired loans without a valuation of allowance	\$ 1,713	\$ —
Impaired loans with a valuation allowance	4,155	4,123
Total impaired lans	\$ 5,868	\$ 4,123
Valuation allowance related to impaired loans	\$ 561	\$ 888

An asset that does not currently expose the Bank to a sufficient degree of risk to warrant an adverse classification, but which possesses credit deficiencies or potential weaknesses that deserve management's close attention is classified as "special mention."

An asset classified as "substandard" is inadequately protected by the current net worth and paying capacity of the obligor or the collateral pledged, if any. Assets so classified have well-defined weaknesses and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

An asset classified as "doubtful" has all the weaknesses inherent in a "substandard" asset with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of a loss on a doubtful asset is high. That portion of an asset classified as "loss" is considered uncollectible and of such little value that its continuance as an asset, without establishment of a specific valuation or charge-off, is not warranted. This classification does not necessarily mean that an asset has absolutely no recovery or salvage value; but rather, it is not practical or desirable to defer writing off a basically worthless asset even though partial recovery may be effected in the future.



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As of June 30, 2009, 2008 and 2007 our classified loans were as follows.

	<b>At June 30,</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
	<b>(In thousands)</b>		
Special Mention	\$ 6,533	\$ 3,001	\$ 3,001
Substandard	1,689	2,989	2,516
Doubtful	—	—	—
Loss	—	—	—
<b>Total</b>	<b>\$ 8,222</b>	<b>\$ 5,990</b>	<b>\$ 5,517</b>

Special mention loans at June 30, 2009, 2008 and 2007 were comprised of one \$3.0 million loan secured by a tract of land in Wildwood, New Jersey and 3 construction participation loans for the year ended June 30, 2009.

**Allowance for Loan Losses.** The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is maintained at a level by management which represents the evaluation of known and inherent losses in the loan portfolio at the consolidated balance sheet date that are both probable and reasonable to estimate. Management's periodic evaluation of the adequacy of the allowance is based on the Bank's past loan loss experience, known and inherent losses in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows expected to be received on impaired loans.

The Bank's loan loss experience in recent periods has been low. Over the last five fiscal years, the Bank had loan charge offs totaling \$279,000 and recoveries totaling \$16,000. Provisions to the allowance in recent periods have been more influenced by current economic conditions than by the Bank's recent loss experience. The allowance has also been affected by management's decision to raise the Bank's reserve on a land loan secured by a tract of land in Wildwood, New Jersey due to the ongoing concerns about the financial condition of the borrower on this loan. Monthly payments were current as of June 30, 2009, however payments are being received not from the borrower but from the borrower's business partner, who could cease payment at any time as he is not a party to the loan agreement and has no legal obligation to make payments on this loan. The most recent appraisal the Bank has on this property was prepared in 2004, and although that "as is" appraisal for this undeveloped site was greater than the outstanding balance of the loan, the Bank has designated the loan as special mention in light of the uncertainty related to the development of the property. The issues that could impede the development include zoning, wetlands preservation, site improvements and environmental cleanup.

The allowance consists of specific and general components. The specific component related to loans that are classified as either doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors.



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A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential mortgage loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Although specific and general loan loss allowances are established in accordance with management's best estimate, actual losses are dependent upon future events and, as such, further provisions for loan losses may be necessary in order to increase the level of the allowance for loan losses. For example, our evaluation of the allowance includes consideration of current economic conditions, and a change in economic conditions could reduce the ability of our borrowers to make timely repayments of their loans. This could result in increased delinquencies and increased non-performing loans, and thus a need to make increased provisions to the allowance for loan losses, which would be a charge to income during the period the provision is made, resulting in a reduction to our earnings. A change in economic conditions could also adversely affect the value of the properties collateralizing our real estate loans, resulting in increased charge-offs against the allowance and reduced recoveries, and thus a need to make increased provisions to the allowance for loan losses. Furthermore, a change in the composition of our loan portfolio or growth of our loan portfolio could result in the need for additional provisions.

In addition, as an integral part of its regulatory examination process, the Office of Thrift Supervision periodically reviews our loan and foreclosed real estate portfolios and the related allowance for loan losses and valuation allowance for foreclosed real estate. The Office of Thrift Supervision may require the allowance for loan losses or the valuation allowance for foreclosed real estate to be increased based on their review of information available at the time of the examination, which would negatively affect our earnings.

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The following table sets forth information with respect to activity in the Bank's allowance for loan losses for the periods indicated.

	For the Year Ended June 30,				
	2009	2008	2007	2006	2005
	(Dollars in thousands)				
Allowance balance (at beginning of period)	\$ 1,910	\$ 1,840	\$ 1,675	\$ 1,500	\$ 1,350
Provision for loan losses	531	70	156	186	149
Charge-offs:					
One- to four-family mortgage loans	—	—	—	—	—
Construction loans	100	—	—	—	—
Commercial	156	—	—	—	—
Consumer loans	5	—	—	13	4
Total charge-offs	261	—	—	13	4
Recoveries:					
One- to four-family mortgage loans	—	—	—	—	—
Construction loans	—	—	—	—	—
Commercial	—	—	—	—	—
Consumer loans	—	—	9	2	5
Total recoveries	—	—	9	2	5
Net (charge-offs) recoveries	(261)	—	9	(11)	1
Allowance balance (at end of period)	\$ 2,180	\$ 1,910	\$ 1,840	\$ 1,675	\$ 1,500
Total loans outstanding	\$ 222,960	\$ 199,904	\$ 183,160	\$ 183,918	\$ 185,929
Average loans outstanding <sup>(1)</sup>	\$ 216,095	\$ 186,244	\$ 182,672	\$ 185,954	\$ 184,451
Allowance for loan losses as a percent					
of total loans outstanding	0.98 %	0.96 %	1.00 %	0.91 %	0.81 %
Allowance for loan losses to non-performing loans	147.00 %	63.90 %	89.15 %	416.67 %	168.35 %
Net charge-offs to average loans	0.12 %	0.00 %	0.00 %	0.00 %	0.00 %

(1) Average balances are derived from month end balances. Management does not believe that the use of month end balances rather than daily balances has caused any material differences in the information presented.

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**Allocation of Allowance for Loan Losses.** The following table sets forth the allocation of the Bank's allowance for loan losses by loan category and the percent of loans in each category to total loans receivable, net, at the dates indicated. The portion of the loan loss allowance allocated to each loan category does not represent the total available for future losses which may occur within the loan category since the total loan loss allowance is a valuation allocation applicable to the entire loan portfolio.

	At June 30, 2009		2008		2007		2006		2005	
	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans
<b>At end of period allocated to:</b>										
Real estate mortgage										
One- to four-family	\$ 918	62.36 %	\$ 273	62.04 %	\$ 279	61.82 %	\$ 264	62.41 %	\$ 275	63.92 %
Home equity and second mortgages	26	3.18	20	4.02	18	4.63	18	4.80	12	3.24
Multi-family	90	4.49	30	5.85	162	5.70	166	5.92	125	4.36
Nonresidential	422	15.48	575	14.48	503	14.43	376	13.46	385	14.02
Land	451	1.75	618	1.93	489	2.11	498	2.28	366	2.35
Construction	169	6.22	170	7.40	67	5.85	71	5.22	48	5.64
Consumer	23	1.03	45	1.17	89	1.46	108	1.92	268	2.80
Home equity lines of credit	44	5.31	15	2.95	20	3.77	14	3.77	20	3.43
Loans on savings accounts	—	0.18	—	0.16	—	0.23	—	0.22	—	0.24
Unallocated	37		164	0.00	213	0.00	160	0.00	1	0.00
<b>Total allowance</b>	<b>\$ 2,180</b>	<b>100.00 %</b>	<b>\$ 1,910</b>	<b>100.00 %</b>	<b>\$ 1,840</b>	<b>100.00 %</b>	<b>\$ 1,675</b>	<b>100.00 %</b>	<b>\$ 1,500</b>	<b>100.00 %</b>

## Securities Portfolio

Our investment policy is designed to foster earnings and manage cash flows within prudent interest rate risk and credit risk guidelines. Generally, our investment policy is to invest funds in various categories of securities and maturities based upon our liquidity needs, asset/liability management policies, pledging requirements, investment quality, marketability and performance objectives.

All of our securities carry market risk insofar as increases in market rates of interest may cause a decrease in their market value. Prior to investing, consideration is given to the interest rate environment, tax considerations, market volatility, yield, settlement date and maturity of the security, our liquidity position, and anticipated cash needs and sources. The effect that the proposed security would have on our credit and interest rate risk and risk-based capital is also considered.

Federally chartered savings banks have the authority to invest in various types of liquid assets. The investments authorized under the Bank's investment policy include U.S. government and government agency securities, municipal securities (consisting of bond obligations of state and local governments), mortgage-backed securities, collateralized mortgage obligations and corporate bonds. On a short-term basis, our investment policy authorizes investment in federal funds, certificates of deposit and money market investments with insured institutions and with brokerage firms.

Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, requires that securities be categorized as "held to maturity," "trading securities" or "available-for-sale," based on management's intent as to the ultimate disposition of each security. Statement No. 115 allows debt securities to be classified as "held to maturity" and reported in financial statements at amortized cost only if the reporting entity has the positive intent and ability to hold these securities to maturity. Securities that might be sold in response to changes in market interest rates, changes in the security's prepayment risk, increases in loan demand, or other similar factors cannot be classified as "held to maturity."

We do not currently use or maintain a trading account. Securities not classified as "held to maturity" are classified as "available-for-sale." These securities are reported at fair value, and unrealized gains and losses on the securities are excluded from earnings and reported, net of deferred taxes, as a separate component of stockholders' equity.

We do not currently participate in hedging programs, interest rate caps, floors or swaps, or other activities involving the use of off-balance sheet derivative financial instruments, however, we may in the future utilize such instruments if we believe it would be beneficial for managing our interest rate risk. Further, we do not purchase securities which are not rated investment grade.

Actual maturities of the securities held by us may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without prepayment penalties. Callable securities pose reinvestment risk because we may not be able to reinvest the proceeds from called securities at an equivalent or higher interest rate.

***Mortgage-Backed Securities and Collateralized Mortgage Obligations.*** Mortgage-related securities represent a participation interest in a pool of one-to-four-family or multi-family mortgages. We primarily invest in mortgage-backed securities secured by one-to-four-family mortgages. Our mortgage-related securities portfolio includes mortgage-backed securities and collateralized mortgage obligations issued by U.S. government agencies or government-sponsored entities, such as Freddie Mac, Ginnie Mae, and Fannie Mae or issued by private,

non-government, corporate issuers.

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The mortgage originators use intermediaries (generally government agencies and government-sponsored enterprises, but also a variety of private corporate issuers) to pool and repackage the participation interests in the form of securities, with investors such as us receiving the principal and interest payments on the mortgages. Securities issued or sponsored by U.S. government agencies and government-sponsored entities are guaranteed as to the payment of principal and interest to investors. Privately issued non-government, corporate issuers' securities typically offer rates above those paid on government agency issued or sponsored securities, but present higher risk than government agency issued or sponsored securities because they lack the guaranty of those agencies and are generally less liquid investments.

Mortgage-backed securities are pass-through securities typically issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with interest rates that are within a specific range and have varying maturities. The life of a mortgage-backed security thus approximates the life of the underlying mortgages. Mortgage-backed securities generally yield less than the mortgage loans underlying the securities. The characteristics of the underlying pool of mortgages, i.e., fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the certificate holder. Mortgage-backed securities are generally referred to as mortgage participation certificates or pass-through certificates.

Collateralized mortgage obligations are mortgage-derivative products that aggregate pools of mortgages and mortgage-backed securities and create different classes of securities with varying maturities and amortization schedules as well as a residual interest with each class having different risk characteristics. The cash flows from the underlying collateral are usually divided into "tranches" or classes whereby tranches have descending priorities with respect to the distribution of principal and interest repayment of the underlying mortgages and mortgage-backed securities as opposed to pass through mortgage-backed securities where cash flows are distributed pro rata to all security holders. Unlike mortgage-backed securities from which cash flow is received and risk is shared pro rata by all securities holders, cash flows from the mortgages and mortgage-backed securities underlying collateralized mortgage obligations are paid in accordance with a predetermined priority to investors holding various tranches of the securities or obligations. William Penn Bank's investment in non-government agency collateralized mortgage obligations has increased in the last two years. The balance of its investments in these securities was \$13.4 million as of June 30, 2009, \$6.1 million as of June 30, 2008 and \$0 as of June 30, 2007.

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**Securities Portfolio Composition.** The following table sets forth the carrying value of our securities portfolio at the dates indicated. Securities that are held-to-maturity are shown at our amortized cost, and securities that are available-for-sale are shown at their fair value.

	<b>At June 30,</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
	<b>(In thousands)</b>		
<u>Securities Available for Sale:</u>			
Mutual funds	\$ 10	\$ 5	\$ 25
<u>Securities Held to Maturity:</u>			
U.S. Government corporations and agencies securities	\$ 32,371	\$ 48,005	\$ 53,718
Mortgage-backed securities	6,908	10,631	7,919
Collateralized Mortgage Obligations	19,236	4,377	—
Corporate debt securities	201	—	—
Municipal bonds	299	—	—
Total Held to Maturity	\$ 59,015	\$ 63,013	\$ 61,637

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The following tables set forth certain information regarding the carrying values, weighted average yields and maturities of our investment and mortgage-backed securities portfolio at June 30, 2009. These tables show contractual maturities and do not reflect repricing or the effect of prepayments. Actual maturities may differ.

	At June 30, 2009															
	One Year or Less			One to Five Years			Five to Ten Years			More Than Ten Years			Total Securities			
	Carrying Value	Average Yield	Weighted	Carrying Value	Average Yield	Weighted	Carrying Value	Average Yield	Weighted	Carrying Value	Average Yield	Weighted	Carrying Value	Average Yield	Weighted	Fair Value
	(Dollars in thousands)															
Mutual funds	\$ 10	1.50 %		\$—	— %		\$—	— %		\$—	— %		\$ 10	1.50 %		\$ 10
U.S. Government corporations and agencies securities	4,000	4.33		11,899	5.26		5,571	5.80		10,901	5.63		32,371	5.36		32,958
Mortgage-backed securities	30	5.13		—	—		160	5.55		6,718	5.15		6,908	5.16		7,128
Collateralized Mortgage Obligations	—	—		2,202	4.00		3,619	5.00		13,415	3.89		19,236	4.11		19,016
Corporate Bonds	100	4.30		101	6.75		—	—		—	—		201	5.53		202
Municipal Bonds	—	—		—	—		199	3.25		100	4.00		299	3.50		299
<b>Total</b>	<b>\$ 4,140</b>	<b>4.22 %</b>		<b>\$ 14,202</b>	<b>5.03 %</b>		<b>\$ 9,549</b>	<b>5.37 %</b>		<b>\$ 31,134</b>	<b>4.76 %</b>		<b>\$ 59,025</b>	<b>4.88 %</b>		<b>\$ 59,613</b>

**Sources of Funds**

**General.** Deposits are our major source of funds for lending and other investment purposes. We also have the ability to borrow funds from the Federal Home Loan Bank to supplement deposits as a source of funds.

In addition, we derive funds from loan and mortgage-backed securities principal repayments, and proceeds from the maturity and call of investment securities. Loan and securities payments are a relatively stable source of funds, while deposit inflows and outflows are significantly influenced by pricing strategies and money market conditions.

**Deposits.** Our current deposit products include checking and savings accounts, certificates of deposit and fixed or variable rate individual retirement accounts (IRAs). Deposit account terms vary, primarily as to the required minimum balance amount, the amount of time, if any, that the funds must remain on deposit and the applicable interest rate. The determination of deposit and certificate interest rates is based upon a number of factors, including: (1) need for funds based on loan demand, current maturities of deposits and other cash flow needs; (2) a current survey of a selected group of competitors' rates for similar products; (3) economic conditions; and (4) business plan projections.

We traditionally have preferred to obtain deposits from within our market area and have discouraged non-local deposits. We do not at this time utilize the services of deposit brokers.

The following table sets forth the average balance and the weighted average interest rates for each category of deposits for the last three fiscal years.

	Year Ended June 30, 2009			2008			2007		
	Average Balance	Weighted Average Rate		Average Balance	Weighted Average Rate		Average Balance	Weighted Average Rate	
	<b>(Dollars in thousands)</b>								
Noninterest-bearing									
demand accounts	\$ 1,496	—	%	\$ 1,522	—	%	\$ 1,487	—	%
NOW accounts	13,240	0.83		12,597	1.36		12,930	1.45	
Money market accounts	38,456	1.94		37,989	3.49		34,579	4.08	
Savings and club									
accounts	13,214	1.30		14,026	2.40		13,728	2.78	
Certificates of deposit	94,687	3.49		93,766	4.52		93,261	4.52	
Total deposits	\$ 161,093			\$ 159,900			\$ 155,985		

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The inflow of certificates of deposit and the retention of such deposits upon maturity are significantly influenced by general interest rates and money market conditions, making certificates of deposit traditionally a more volatile source of funding than core deposits. Our liquidity could be reduced if a significant amount of certificates of deposit maturing within a short period of time were not renewed. To the extent that such deposits do not remain with us, they may need to be replaced with borrowings, which could increase our cost of funds and negatively impact our net interest rate spread and our financial condition.

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The following table shows the amount of our certificates of deposit of \$100,000 or more by time remaining until maturity as of June 30, 2009.

<u>Maturity Period</u>	<b>At June 30, 2009</b> <b>(In thousands)</b>
Within three months	\$ 11,375
Three through six months	8,878
Six through twelve months	5,904
Over twelve months	9,740
	<b>\$ 35,897</b>

**Borrowings.** We periodically borrow funds from the Federal Home Loan Bank of Pittsburgh to supplement deposits as a source of funds. As of June 30, 2009, our borrowings totaled \$89 million and had a weighted average cost of 4.37%. As a strategy to lock in rates on funding beginning in the late 1990s we took long term advances to protect against rising rates. Rates, however, fell to historic lows instead of rising. These borrowings had been a drain on our profitability and we determined in early December 2007 to undertake a refinancing of these advances, as we expected the improvement in our net interest margin resulting from the refinancing would make it worth incurring a significant penalty for the pre-payment of the advances. The penalty was a \$1.5 million charge to earnings during the quarter ended December 31, 2007. We pre-paid \$25.0 million of advances with a weighted average rate of 5.87% and took replacement advances totaling \$30.0 million with a weighted average rate of 3.84%.

The following table sets forth certain information regarding our borrowed funds.

	<b>At or For the Year Ended June 30,</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
	<b>(Dollars in thousands)</b>		
<b>Federal Home Loan Bank Advances:</b>			
Average balance outstanding	\$ 85,385	\$ 70,000	\$ 68,692
Maximum amount outstanding at any			
month-end during the period	89,000	72,000	71,000
Balance outstanding at end of period	89,000	72,000	71,000
Weighted average interest rate during the period	4.46 %	5.19 %	5.69 %
Weighted average interest rate at end of period	4.37 %	4.53 %	5.61 %

Additional information regarding our borrowings is included in Note 10 to the Consolidated Financial Statements incorporated by reference herein.

### **Subsidiaries**

The Company's only subsidiary is the Bank. The Bank has one subsidiary: WPSLA Investment Corporation, incorporated under Delaware law in 2000 to hold securities. At June 30, 2009, this subsidiary held securities with a carrying value of approximately \$29.2 million, representing about

half of our total securities portfolio of \$59.0 million at that date.

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## Personnel

As of June 30, 2009, we had 32 full-time employees and 5 part-time employees. Our employees are not represented by a collective bargaining unit. We believe our relationship with our employees is good.

## Competition

We operate in a market area with a high concentration of banking and financial institutions, and we face substantial competition in attracting deposits and in originating loans, from both regional and large institutions as well as other smaller institutions like ourselves. Our larger competitors have the advantage of significantly greater financial and managerial resources and lending limits, but we feel we compete well on the level of personal attention we provide to customers.

Our competition for deposits and loans historically has come from other insured financial institutions such as local and regional commercial banks, savings institutions, and credit unions located in our primary market area. We also compete with mortgage banking and finance companies for real estate loans, and we face competition for funds from investment products such as mutual funds, short-term money funds and corporate and government securities.

## REGULATION

We operate in a highly regulated industry. This regulation establishes a comprehensive framework of activities in which a savings and loan holding company and federal savings bank may engage and is intended primarily for the protection of the deposit insurance fund and consumers. Set forth below is a brief description of certain laws that relate to the regulation of William Penn Bank and William Penn Bancorp. The description does not purport to be complete and is qualified in its entirety by reference to applicable laws and regulations.

Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of an institution and its holding company, the classification of assets by the institution and the adequacy of an institution's allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, or legislation, including changes in the regulations governing mutual holding companies, could have a material adverse impact on William Penn Bancorp, William Penn Bank, and their operations. The adoption of regulations or the enactment of laws that restrict the operations of William Penn Bank and/or William Penn Bancorp or impose burdensome requirements upon one or both of them could reduce their profitability and could impair the value of William Penn Bank's franchise, resulting in negative effects on the trading price of William Penn Bancorp common stock.

## Regulation of William Penn Bank

**General.** As a federally chartered savings bank with deposits insured by the Federal Deposit Insurance Corporation, William Penn Bank is subject to extensive regulation by the Office of Thrift Supervision and the Federal Deposit Insurance Corporation. This regulatory structure gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies regarding the classification of assets and the level of the allowance for loan losses. The activities of federal savings banks are subject to extensive regulation, including restrictions or requirements with respect to loans to one borrower, the percentage of non-mortgage loans or investments to total assets, capital distributions, permissible investments and lending activities, liquidity, transactions with affiliates and community reinvestment. Federal savings banks are also subject to reserve requirements imposed by the Board of Governors of the Federal Reserve System. A federal savings bank's relationship with its depositors and borrowers is regulated by both state and federal law, especially in such matters as the ownership of savings accounts and the form and content of the bank's mortgage documents.

William Penn Bank must file reports with the Office of Thrift Supervision concerning its activities and financial condition, and must obtain regulatory approvals prior to entering into certain transactions, such as mergers with or acquisitions of other financial institutions. The Office of Thrift Supervision regularly examines William Penn Bank and prepares reports to the Bank's Board of Directors on deficiencies, if any, found in its operations. The Office of Thrift Supervision has substantial discretion to impose enforcement action on an institution that fails to comply with applicable regulatory requirements, particularly with respect to its capital requirements. In addition, the Federal Deposit Insurance Corporation has the authority to recommend to the Director of the Office of Thrift Supervision that enforcement action be taken with respect to a particular federal savings bank and, if action is not taken by the Director, the Federal Deposit Insurance Corporation has authority to take such action under certain circumstances.

**Deposit Insurance.** The Bank's deposits are insured to applicable limits by the Federal Deposit Insurance Corporation. The maximum deposit insurance amount has been increased from \$100,000 to \$250,000 until December 31, 2013. On October 13, 2008, the FDIC established a Temporary Liquidity Guarantee Program under which the FDIC will fully guarantee all non-interest-bearing transaction accounts until December 31, 2009 (the "Transaction Account Guarantee Program") and all senior unsecured debt of insured depository institutions or their qualified holding companies issued between October 14, 2008 and October 31, 2009 that matures prior to December 31, 2012 (the "Debt Guarantee Program"). Senior unsecured debt would include federal funds purchased and certificates of deposit standing to the credit of the bank. After November 12, 2008, institutions that did not opt out of the Programs by December 5, 2008 are assessed at the rate of ten basis points for transaction account balances in excess of \$250,000 and at a rate between 50 and 100 basis points of the amount of debt issued. Participating holding companies that have not issued FDIC-guaranteed debt prior to April 1, 2009 must apply to remain in the Debt Guarantee Program. Participating institutions will be subject to surcharges for debt issued after that date. The Transaction Account Guarantee Program has been extended until June 30, 2010 but after January 1, 2010, participating institutions will be assessed at a rate between 15 and 25 basis points on transaction account balances in excess of \$250,000. Institutions currently participating in the Transaction Account Guarantee Program will be able to opt of the extended program until November 2, 2009. The Company and the MHC have not opted out of the Debt Guarantee Program. The Bank did not opt out of either part of the Temporary Liquidity Guarantee Program.

Pursuant to the Federal Deposit Insurance Reform Act of 2005 (the "Reform Act"), the FDIC is authorized to set the reserve ratio for the Deposit Insurance Fund annually at between 1.15% and 1.5% of estimated insured deposits. If the Deposit Insurance Fund's reserves exceed the designated reserve ratio,

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the FDIC is required to pay out all or, if the reserve ratio is less than 1.5%, a portion of the excess as a dividend to insured depository institutions based on the percentage of insured deposits held on December 31, 1996 adjusted for subsequently paid premiums. Insured depository institutions that were in existence on December 31, 1996 and paid assessments prior to that date (or their successors) are entitled to a one-time credit against future assessments based on their past contributions to the predecessor to the Deposit Insurance Fund.

The FDIC has set the designated reserve ratio at 1.25% of estimated insured deposits. The FDIC has also adopted a risk-based premium system that provides for quarterly assessments based on an insured institution's ranking in one of four risk categories based on their examination ratings and capital ratios. Well-capitalized institutions with the CAMELS ratings of 1 or 2 are grouped in Risk Category I and have been assessed for deposit insurance at an annual rate of between five and seven basis points with the assessment rate for an individual institution determined according to a formula based on a weighted average of the institution's individual CAMELS component ratings plus either five financial ratios or the average ratings of its long-term debt. Institutions in Risk Categories II, III and IV have been assessed at annual rates of 10, 28 and 43 basis points, respectively. The Bank used its special assessment credit to offset the cost of its deposit insurance premium until the third calendar quarter of 2008 when the credit was exhausted.

Due to recent bank failures, the FDIC has determined that the reserve ratio was 1.01% as of June 30, 2008. In accordance with the Reform Act, the FDIC must establish and implement a plan within 90 days to restore the reserve ratio to 1.15% within five years (subject to extension due to extraordinary circumstances). For the quarter beginning January 1, 2009, the FDIC raised the base annual assessment rate for institutions in Risk Category I to between 12 and 14 basis points while the base annual assessment rates for institutions in Risk Categories II, III and IV were increased to 17, 35 and 50 basis points, respectively. For the quarter beginning April 1, 2009 the FDIC has set the base annual assessment rate for institutions in Risk Category I to between 12 and 16 basis points and the base annual assessment rates for institutions in Risk Categories II, III and IV at 22, 32 and 45 basis points, respectively. An institution's assessment rate could be lowered by as much as five basis points based on the ratio of its long-term unsecured debt to deposits or, for smaller institutions based on the ratio of certain amounts of Tier 1 capital to deposits. The assessment rate would be adjusted for Risk Category I institutions that have a high level of brokered deposits and have experienced higher levels of asset growth (other than through acquisitions) and could be increased by as much as ten basis points for institutions in Risk Categories II, III and IV whose ratio of brokered deposits to deposits exceeds 10% of assets. Reciprocal deposit arrangements like CDARS® would be treated as brokered deposits for Risk Category II, III and IV institutions but not for institutions in Risk Category I. An institution's base assessment rate would also be increased if an institution's ratio of secured liabilities (including FHLB advances and repurchase agreements) to deposits exceeds 25%. The maximum adjustment for secured liabilities for institutions in Risk Categories I, II, III and IV would be 8, 11, 16 and 22.5 basis points, respectively, provided that the adjustment may not increase an institution's base assessment rate by more than 50%. The FDIC has further imposed a special assessment equal to five basis points of assets less Tier 1 capital as of June 30, 2009 payable on September 30, 2009 and may impose additional special assessments.

In addition, all FDIC-insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation ("FICO"), an agency of the Federal government established to recapitalize the Federal Savings and Loan Insurance Corporation. The FICO assessment, which is determined quarterly, was \$17,871 in fiscal year ended June 30, 2009. These assessments will continue until the FICO bonds mature in 2017.

**Regulatory Capital Requirements.** Office of Thrift Supervision capital regulations require savings institutions to meet three minimum capital standards: (1) tangible capital equal to 1.5% of total

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adjusted assets, (2) "Tier 1" or "core" capital equal to at least 4% (3% if the institution has received the highest possible rating on its most recent examination) of total adjusted assets, and (3) risk-based capital equal to 8% of total risk-weighted assets. In assessing an institution's capital adequacy, the Office of Thrift Supervision takes into consideration not only these numeric factors but also qualitative factors, and has the authority to establish higher capital requirements for individual institutions where necessary.

At June 30, 2009, William Penn Bank was in compliance with the minimum capital standards and qualified as "well capitalized."

The Office of Thrift Supervision may require any savings institution that has a risk-based capital ratio of less than 8%, a ratio of Tier 1 capital to risk-weighted assets of less than 4% or a ratio of Tier 1 capital to total adjusted assets of less than 4% (3% if the institution has received the highest rating on its most recent examination) to take certain action to increase its capital ratios. If the savings institution's capital is significantly below the minimum required levels of capital or if it is unsuccessful in increasing its capital ratios, the institution's activities may be restricted.

For purposes of the capital regulations, tangible capital is defined as core capital less all intangible assets except for certain mortgage servicing rights. Tier 1 or core capital is defined as common stockholders' equity, non-cumulative perpetual preferred stock and related surplus, minority interests in the equity accounts of consolidated subsidiaries, and certain non-withdrawable accounts and pledged deposits of mutual savings banks. William Penn Bank does not have any non-withdrawable accounts or pledged deposits. Tier 1 and core capital are reduced by an institution's intangible assets, with limited exceptions for certain mortgage and non-mortgage servicing rights and purchased credit card relationships. Both core and tangible capital are further reduced by an amount equal to the savings institution's debt and equity investments in "non-includable" subsidiaries engaged in activities not permissible for national banks other than subsidiaries engaged in activities undertaken as agent for customers or in mortgage banking activities and subsidiary depository institutions or their holding companies.

The risk-based capital standard for savings institutions requires the maintenance of total capital of 8% of risk-weighted assets. Total capital equals the sum of core and supplementary capital. The components of supplementary capital include, among other items, cumulative perpetual preferred stock, perpetual subordinated debt, mandatory convertible subordinated debt, intermediate-term preferred stock, the portion of the allowance for loan losses not designated for specific loan losses and up to 45% of unrealized gains on equity securities. The portion of the allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, supplementary capital is limited to 100% of core capital. For purposes of determining total capital, a savings institution's assets are reduced by the amount of capital instruments held by other depository institutions pursuant to reciprocal arrangements and by the amount of the institution's equity investments (other than those deducted from core and tangible capital).

A savings institution's risk-based capital requirement is measured against risk-weighted assets, which equal the sum of each on-balance-sheet asset and the credit-equivalent amount of each off-balance-sheet item after being multiplied by an assigned risk weight. These risk weights range from 0% for cash to 100% for delinquent loans, property acquired through foreclosure, commercial loans, and certain other assets.

***Dividend and Other Capital Distribution Limitations.*** A savings institution, like William Penn Bank, that is a subsidiary of a savings and loan holding company must file an application or a notice with the Office of Thrift Supervision at least thirty days before making a capital distribution, such as paying a dividend to William Penn Bancorp. The Office of Thrift Supervision imposes various restrictions or



requirements on the ability of savings institutions to make capital distributions, including cash dividends. A savings institution must file an application for prior approval of a capital distribution if: (i) it is not eligible for expedited treatment under the applications processing rules of the Office of Thrift Supervision; (ii) the total amount of all capital distributions, including the proposed capital distribution, for the applicable calendar year would exceed an amount equal to the savings institution's net income for that year to date plus the institution's retained net income for the preceding two years; (iii) it would not adequately be capitalized after the capital distribution; or (iv) the distribution would violate an agreement with the Office of Thrift Supervision or applicable regulations. If an application is not required, then a notice must be filed. The Office of Thrift Supervision may disapprove a notice or deny an application for a capital distribution if: (i) the savings institution would be undercapitalized following the capital distribution; (ii) the proposed capital distribution raises safety and soundness concerns; or (iii) the capital distribution would violate a prohibition contained in any statute, regulation or agreement.

Capital distributions by William Penn Bancorp, as a savings and loan holding company, are not subject to the Office of Thrift Supervision capital distribution rules. Because William Penn Bancorp retained 50% of the net proceeds of the stock offering, the possibility that William Penn Bank would need to file an application rather than a notice for capital distributions in the immediate future is not expected to affect the payment of cash dividends by William Penn Bancorp to its stockholders or the amount of such dividends.

**Safety and Soundness Standards.** As required by statute, the federal banking agencies have adopted guidelines establishing general standards relating to internal controls, information and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings and compensation, fees and benefits. The guidelines require, among other things, the implementation of appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. If it is determined that a savings institution has failed to meet any standard prescribed by the guidelines, the institution may be required to submit an acceptable plan to achieve compliance with the standard.

**Qualified Thrift Lender Test.** Savings institutions must meet a qualified thrift lender test or they become subject to the business activity restrictions and branching rules applicable to national banks. To qualify as a qualified thrift lender, a savings institution must either (i) be deemed a "domestic building and loan association" under the Internal Revenue Code by maintaining at least 60% of its total assets in specified types of assets, including cash, certain government securities, loans secured by and other assets related to residential real property, educational loans and investments in premises of the institution or (ii) satisfy the statutory qualified thrift lender test set forth in the Home Owners' Loan Act by maintaining at least 65% of its portfolio assets in qualified thrift investments (generally defined to include residential mortgages and related equity investments, certain mortgage-related securities, small business loans, student loans and credit card loans). For purposes of the statutory qualified thrift lender test, portfolio assets are defined as total assets minus goodwill and other intangible assets, the value of property used by the institution in conducting its business, and specified liquid assets up to 20% of total assets. A savings institution must maintain its status as a qualified thrift lender on a monthly basis in at least nine out of every twelve months. William Penn Bank met the qualified thrift lender test as of June 30, 2009 and in each of the last twelve months and, therefore, qualifies as a qualified thrift lender.

A savings bank that fails the qualified thrift lender test and does not convert to a bank charter generally will be prohibited from: (1) engaging in any new activity not permissible for a national bank; (2) paying dividends not permissible under national bank regulations; and (3) establishing any new branch office in a location not permissible for a national bank in the institution's home state. In addition, if the institution does not requalify under the qualified thrift lender test within three years after failing the test, the institution would be prohibited from engaging in any activity not permissible for a national bank and

would have to repay any outstanding advances from the Federal Home Loan Bank as promptly as possible.

**Community Reinvestment Act.** Under the Community Reinvestment Act, every insured depository institution, including William Penn Bank, has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The Community Reinvestment Act does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community. The Community Reinvestment Act requires the depository institution's record of meeting the credit needs of its community to be assessed and taken into account in the evaluation of certain applications by such institution, such as a merger or the establishment of a branch office by William Penn Bank. An unsatisfactory Community Reinvestment Act examination rating may be used as the basis for the denial of an application. William Penn Bank received an "outstanding" rating in its most recent Community Reinvestment Act examination.

**Federal Home Loan Bank System.** William Penn Bank is a member of the Federal Home Loan Bank of Pittsburgh, which is one of twelve regional federal home loan banks. Each federal home loan bank serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by financial institutions and proceeds derived from the sale of consolidated obligations of the Federal Home Loan Bank System. It makes loans to members pursuant to policies and procedures established by its board of directors. As a member, William Penn Bank is required to purchase and maintain stock in the Federal Home Loan Bank of Pittsburgh.

The Federal Home Loan Banks are required to provide funds for the resolution of troubled savings institutions and to contribute to affordable housing programs through direct loans or interest subsidies on advances targeted for community investment and low- and moderate-income housing projects. These contributions have adversely affected the level of Federal Home Loan Bank dividends paid and could continue to do so in the future. Dividends of \$60,000 were received from FHLB in 12 months ended June 30, 2009. \$200,000 were received in 12 months ended June 30, 2008. In addition, these requirements could result in the Federal Home Loan Banks imposing a higher rate of interest on advances to their members.

**The USA Patriot Act.** William Penn Bank is subject to regulations implementing the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, or the USA Patriot Act. The USA Patriot Act gave the federal government powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. By way of amendments to the Bank Secrecy Act, Title III of the USA Patriot Act took measures intended to encourage information sharing among bank regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative obligations on a broad range of financial institutions, including banks, thrifts, brokers, dealers, credit unions, money transfer agents and parties registered under the Commodity Exchange Act.

Among other requirements, Title III of the USA Patriot Act and the related regulations imposed the following requirements with respect to financial institutions:

- Establishment of anti-money laundering programs that included, at minimum: (i) internal policies, procedures, and controls; (ii) specific designation of an anti-money laundering compliance officer; (iii) ongoing employee training programs; and (iv) an independent audit function to test the anti-money laundering program.



- Establishment of a program specifying procedures for obtaining identifying information from customers seeking to open new accounts, including verifying the identity of customers within a reasonable period of time.
- Establishment of appropriate, specific, and, where necessary, enhanced due diligence policies, procedures, and controls designed to detect and report money laundering.
- Prohibitions on establishing, maintaining, administering or managing correspondent accounts for foreign shell banks (foreign banks that do not have a physical presence in any country), and compliance with certain record keeping obligations with respect to correspondent accounts of foreign banks.

Bank regulators are directed to consider a holding company's effectiveness in combating money laundering when ruling on applications under the Federal Reserve Act and the Bank Merger Act.

**Prompt Corrective Regulatory Action.** The Office of Thrift Supervision is required to take certain supervisory actions against undercapitalized institutions, the severity of which depends upon the institution's degree of undercapitalization. Generally, a savings institution that has a ratio of total capital to risk weighted assets of less than 8%, a ratio of Tier 1 (core) capital to risk-weighted assets of less than 4% or a ratio of core capital to total assets of less than 4% (3% or less for institutions with the highest examination rating) is considered to be "undercapitalized." A savings institution that has a total risk-based capital ratio less than 6%, a Tier 1 capital ratio of less than 3% or a leverage ratio that is less than 3% is considered to be "significantly undercapitalized" and a savings institution that has a tangible capital to assets ratio equal to or less than 2% is deemed to be "critically undercapitalized." Subject to a narrow exception, the Office of Thrift Supervision is required to appoint a receiver or conservator within specified time frames for an institution that is "critically undercapitalized." The regulation also provides that a capital restoration plan must be filed with the Office of Thrift Supervision within 45 days of the date a savings institution is deemed to have received notice that it is "undercapitalized," "significantly undercapitalized" or "critically undercapitalized." Compliance with the plan must be guaranteed by any parent holding company in the amount of up to the lessor of 5% of the savings association's total assets when it was deemed to be undercapitalized or the amount necessary to achieve compliance with applicable capital requirements. In addition, numerous mandatory supervisory actions become immediately applicable to an undercapitalized institution, including, but not limited to, increased monitoring by regulators and restrictions on growth, capital distributions and expansion. The Office of Thrift Supervision could also take any one of a number of discretionary supervisory actions, including the issuance of a capital directive and the replacement of senior executive officers and directors. Significantly and critically undercapitalized institutions are subject to additional mandatory and discretionary measures.

**Transactions with Related Parties.** The Bank's authority to engage in transactions with "affiliates" (e.g., any entity that controls or is under common control with an institution, including the Company and its non-savings institution subsidiaries) is limited by federal law. The aggregate amount of covered transactions with any individual affiliate is limited to 10% of the capital and surplus of the savings institution. The aggregate amount of covered transactions with all affiliates is limited to 20% of the savings institution's capital and surplus. Certain transactions with affiliates are required to be secured by collateral in an amount and of a type specified by federal law. The purchase of low quality assets from affiliates is generally prohibited. Transactions with affiliates must generally be on terms and under circumstances that are at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated companies. In addition, savings institutions are prohibited from lending to any affiliate that is engaged in activities that are not permissible for bank holding companies and no

savings institution may purchase the securities of any affiliate other than a subsidiary.

The Sarbanes-Oxley Act of 2002 generally prohibits loans by the Company to its executive officers and directors. However, the law contains a specific exception for loans by a bank to its executive officers and directors in compliance with federal banking laws. Under such laws, the Bank's authority to extend credit to executive officers, directors and 10% shareholders ("insiders"), as well as entities such persons control, is limited. The law limits both the individual and aggregate amount of loans the Bank may make to insiders based, in part, on the Bank's capital position and requires certain Board approval procedures to be followed. Such loans are required to be made on terms substantially the same as those offered to unaffiliated individuals and not involve more than the normal risk of repayment. There is an exception for loans made pursuant to a benefit or compensation program that is widely available to all employees of the institution and does not give preference to insiders over other employees.

**Enforcement.** The Office of Thrift Supervision has primary enforcement responsibility over savings institutions and has authority to bring actions against the institution and all institution-affiliated parties, including stockholders, and any attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal enforcement action may range from the issuance of a capital directive or cease and desist order to removal of officers and/or directors to institution of receivership, conservatorship or termination of deposit insurance. Civil penalties cover a wide range of violations and can amount to \$25,000 per day, or even \$1 million per day in especially egregious cases. The Federal Deposit Insurance Corporation has the authority to recommend to the Director of the Office of Thrift Supervision that enforcement action to be taken with respect to a particular savings institution. If action is not taken by the Director, the Federal Deposit Insurance Corporation has authority to take such action under certain circumstances. Federal law also establishes criminal penalties for certain violations.

#### **Regulation of William Penn Bancorp**

**General.** William Penn Bancorp is a savings and loan holding company within the meaning of Section 10 of the Home Owners' Loan Act. It is required to file reports with the Office of Thrift Supervision and is subject to regulation and examination by the Office of Thrift Supervision. William Penn Bancorp will need to obtain regulatory approval from the Office of Thrift Supervision before engaging in certain transactions, such as mergers with or acquisitions of other financial institutions. In addition, the Office of Thrift Supervision will have enforcement authority over William Penn Bancorp and any non-savings institution subsidiaries. This permits the Office of Thrift Supervision to restrict or prohibit activities that it determines to be a serious risk to William Penn Bank. This regulation is intended primarily for the protection of the depositors in William Penn Bank and not for the benefit of stockholders of William Penn Bancorp.

**Activities Restrictions.** As a savings and loan holding company and a subsidiary holding company of a mutual holding company, William Penn Bancorp is subject to statutory and regulatory restrictions on its business activities. The non-banking activities of William Penn Bancorp and its non-savings institution subsidiaries is restricted to certain activities specified by Office of Thrift Supervision regulation, which include performing services for and holding properties used by a savings institution subsidiary, activities authorized for multiple savings and loan holding companies as of March 5, 1987, and non-banking activities permissible for bank holding companies pursuant to the Bank Holding Company Act of 1956 or authorized for financial holding companies pursuant to the Gramm-Leach-Bliley Act. Before engaging in any non-banking activity or acquiring a company engaged in any such activities, William Penn Bancorp must obtain prior Office of Thrift Supervision approval of such planned activity or acquisition.

**Mergers and Acquisitions.** William Penn Bancorp is required to obtain approval from the Office of Thrift Supervision before acquiring, directly or indirectly, more than 5% of the voting stock of another savings institution or savings and loan holding company or acquiring such an institution or holding company by merger, consolidation or purchase of its assets. Federal law also prohibits a savings and loan holding company from acquiring more than 5% of a company engaged in activities other than those authorized for savings and loan holding companies by federal law or acquiring or retaining control of a depository institution that is not insured by the Federal Deposit Insurance Corporation. In evaluating an application for William Penn Bancorp to acquire control of a savings institution, the Office of Thrift Supervision would consider the financial and managerial resources and future prospects of William Penn Bancorp and the target institution, the effect of the acquisition on the risk to the insurance funds, the convenience and the needs of the community and competitive factors.

**Waivers of Dividends by William Penn, MHC.** William Penn, MHC is required to provide prior notice to the Office of Thrift Supervision of any proposed waiver of its receipt of dividends from William Penn Bancorp. The Office of Thrift Supervision reviews dividend waiver notices on a case-by-case basis, and, in general, does not object to any such waiver if: (i) the waiver would not be detrimental to the safe and sound operations of the subsidiary savings association and (ii) the mutual holding company's board of directors determines that such waiver is consistent with such directors' fiduciary duties to the mutual holding company's members. Neither the payment of a dividend by William Penn Bancorp nor the intension to waive by William Penn, MHC has been determined at this point.

**Conversion of William Penn, MHC to Stock Form.** Office of Thrift Supervision regulations permit William Penn, MHC to convert from the mutual form of organization to the capital stock form of organization, commonly referred to as a second-step conversion. In a second step conversion, a new holding company would be formed as the successor to William Penn Bancorp, William Penn, MHC's corporate existence would end, and certain depositors of William Penn Bank would receive the right to subscribe for shares of the new holding company. In a second-step conversion, each share of common stock held by stockholders other than William Penn, MHC would be automatically converted into shares of common stock of the new holding company. The Board of Directors has no current plans for a second-step conversion and there are no assurances that such a transaction will occur.

**Acquisition of Control.** Under the federal Change in Bank Control Act, a notice must be submitted to the Office of Thrift Supervision if any person (including a company), or group acting in concert, seeks to acquire "control" of a savings and loan holding company or savings association. An acquisition of "control" can occur upon the acquisition of 10% or more of the voting stock of a savings and loan holding company or savings institution or as otherwise defined by the Office of Thrift Supervision. Under the Change in Bank Control Act, the Office of Thrift Supervision has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the anti-trust effects of the acquisition. Any company that so acquires control would then be subject to regulation as a savings and loan holding company.

**Proposed Financial Regulatory Reform Legislation.** The U.S. Treasury Department recently released a legislative proposal that would implement sweeping changes to the current federal bank regulatory structure. The proposal would merge our current primary federal regulator, the Office of Thrift Supervision, and the Office of the Comptroller of the Currency (the primary federal regulator for national banks) into a new federal banking regulator, the National Bank Supervisor. The proposal would also eliminate the federal thrift charter and require all federal savings associations, such as William Penn Bank, to elect, within six months of the effective date of the legislation, to convert to either a national bank, state bank or state savings association. A federal savings association that does not make the election would, by operation of law, be converted into a national bank within one year of the effective date of the legislation.

If William Penn Bank is required to convert to a bank charter, William Penn, MHC and William Penn Bancorp would be required to become bank holding companies subject to regulation and supervision by the Board of Governors of the Federal Reserve System (the "Federal Reserve"), which differs from that of the Office of Thrift Supervision in certain important respects, particularly with respect to mutual holding companies. While Office of Thrift Supervision regulations permit mutual holding companies to waive the receipt of dividends, subject to notice to and non-objection by the Office of Thrift Supervision, the Federal Reserve's current policy is to prohibit mutual holding companies from waiving the receipt of dividends so long as the subsidiary savings bank is well capitalized. Moreover, Office of Thrift Supervision regulations provide that waived dividends will not be taken into account in determining an appropriate exchange ratio for minority shares in the event of the conversion of a mutual holding company to stock form. If the Office of Thrift Supervision is eliminated, the Federal Reserve becomes the exclusive regulator of mutual holding companies, and the Federal Reserve retains its current policy regarding dividend waivers by mutual holding companies, William Penn, MHC would not be permitted to waive the receipt of dividends declared by William Penn Bancorp. This would have an adverse impact on our ability to pay dividends.

### **Emergency Economic Stabilization Act of 2008**

In response to recent unprecedented market turmoil, the Emergency Economic Stabilization Act ("EESA") was enacted on October 3, 2008. EESA authorizes the Secretary of the Treasury to purchase up to \$700 billion in troubled assets from financial institutions under the Troubled Asset Relief Program or TARP. Troubled assets include residential or commercial mortgages and related instruments originated prior to March 14, 2008 and any other financial instrument that the Secretary determines, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, the purchase of which is necessary to promote financial stability. If the Secretary exercises his authority under TARP, EESA directs the Secretary of Treasury to establish a program to guarantee troubled assets originated or issued prior to March 14, 2008. The Secretary is authorized to purchase up to \$250 billion in troubled assets immediately and up to \$350 billion upon certification by the President that such authority is needed. The Secretary's authority will be increased to \$700 billion if the President submits a written report to Congress detailing the Secretary's plans to use such authority unless Congress passes a joint resolution disapproving such amount within 15 days after receipt of the report. The Secretary's authority under TARP expires on December 31, 2009 unless the Secretary certifies to Congress that extension is necessary provided that his authority may not be extended beyond October 3, 2010.

Institutions selling assets under TARP will be required to issue warrants for common or preferred stock or senior debt to the Secretary. If the Secretary purchases troubled assets directly from an institution without a bidding process and acquires a meaningful equity or debt position in the institution as a result or acquires more than \$300 million in troubled assets from an institution regardless of method, the institution will be required to meet certain standards for executive compensation and corporate governance, including a prohibition against incentives to take unnecessary and excessive risks, recovery of bonuses paid to senior executives based on materially inaccurate earnings or other statements and a prohibition against agreements for the payment of golden parachutes. Institutions that sell more than \$300 million in assets under TARP auctions will not be entitled to a tax deduction for compensation in excess of \$500,000 paid to its chief executive or chief financial official or any of its other three most highly compensated officers. In addition, any severance paid to such officers for involuntary termination or termination in connection with a bankruptcy or receivership will be subject to the golden parachute rules under the Internal Revenue Code.

EESA increases the maximum deposit insurance amount up to \$250,000 until December 31, 2009 and removes the statutory limits on the FDIC's ability to borrow from the Treasury during this period.

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The FDIC may not take the temporary increase in deposit insurance coverage into account when setting assessments. EESA allows financial institutions to treat any loss on the preferred stock of the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation as an ordinary loss for tax purposes. This provision was effective October 3, 2008.

Pursuant to his authority under EESA, the Secretary of the Treasury has created the TARP Capital Purchase Plan under which the Treasury Department will invest up to \$250 billion in senior preferred stock of U.S. banks and savings associations or their holding companies. Qualifying financial institutions may issue senior preferred stock with a value equal to not less than 1% of risk-weighted assets and not more than the lesser of \$25 billion or 3% of risk-weighted assets. The senior preferred stock will pay dividends at the rate of 5% per annum until the fifth anniversary of the investment and thereafter at the rate of 9% per annum. No dividends may be paid on common stock unless dividends have been paid on the senior preferred stock. Until the third anniversary of the issuance of the senior preferred, the consent of the U.S. Treasury will be required for any increase in the dividends on the common stock or for any stock repurchases unless the senior preferred has been redeemed in its entirety or the Treasury has transferred the senior preferred to third parties. The senior preferred will not have voting rights other than the right to vote as a class on the issuance of any preferred stock ranking senior, any change in its terms or any merger, exchange or similar transaction that would adversely affect its rights. The senior preferred will also have the right to elect two directors if dividends have not been paid for six periods. The senior preferred will be freely transferable and participating institutions will be required to file a shelf registration statement covering the senior preferred. The issuing institution must grant the Treasury piggyback registration rights. Prior to issuance, the financial institution and its senior executive officers must modify or terminate all benefit plans and arrangements to comply with EESA. Senior executives must also waive any claims against the Department of Treasury.

In connection with the issuance of the senior preferred, participating publicly traded institutions must issue to the Secretary immediately exercisable 10-year warrants to purchase common stock with an aggregate market price equal to 15% of the amount of senior preferred. The exercise price of the warrants will equal the market price of the common stock on the date of the investment. The Secretary may only exercise or transfer one-half of the warrants prior to the earlier of December 31, 2009 or the date the issuing financial institution has received proceeds equal to the senior preferred investment from one or more offerings of common or preferred stock qualifying as Tier 1 capital. The Secretary will not exercise voting rights with respect to any shares of common stock acquired through exercise of the warrants. The financial institution must file a shelf registration statement covering the warrants and underlying common stock as soon as practicable after issuance and grant piggyback registration rights. The number of warrants will be reduced by one-half if the financial institution raises capital equal to the amount of the senior preferred through one or more offerings of common stock or preferred stock qualifying as Tier 1 capital. If the financial institution does not have sufficient authorized shares of common stock available to satisfy the warrants or their issuance otherwise requires shareholder approval, the financial institution must call a meeting of shareholders for that purpose as soon as practicable after the date of investment. The exercise price of the warrants will be reduced by 15% for each six months that lapse before shareholder approval subject to a maximum reduction of 45%.

The recently enacted American Recovery and Reinvestment Act of 2009 ("ARRA") has imposed additional compensation restrictions on companies participating in the TARP Capital Purchase Program. ARRA directs the Secretary of the Treasury to adopt standards for executive compensation that include limits on compensation that exclude incentives to take unnecessary and excessive risks that threaten the value of the participant while any assistance remains outstanding and provision for recovery by the participant of any bonus, retention award or incentive compensation paid to any senior executive officer and up to 20 next mostly highly compensated employees of the participant based on statements of earnings, revenues, gains or other criteria that are later found to be materially inaccurate. The board of

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directors of any TARP participant must adopt policies on excessive or luxury expenditures, as identified by the Secretary. TARP participants will be required to annually allow shareholders to have a separate non-binding vote on executive compensation while a TARP investment is outstanding.

Due to its strong capital position the Company did not participate in the Treasury's Capital Purchase Plan.

### **Item 1A. Risk Factors**

Not applicable.

### **Item 1B. Unresolved Staff Comments**

Not applicable.

### **Item 2. Properties**

As of June 30, 2009, our investment in premises and equipment, net of depreciation and amortization, totaled \$2.0 million. We currently have three full-service offices, as shown in the table below.

<b>Office Location</b>	<b>Year Facility Opened</b>	<b>Leased or Owned</b>	<b>Net Book Value at June 30, 2009 (In thousands)</b>
Levittown	1967	Owned	\$ 41
Morrisville	1973	Owned	\$ 100
Richboro	1984	Owned	\$ 215

We also own a five-acre tract of land in Levittown, Pennsylvania with a net book value as of June 30, 2009 of approximately \$479,000. There are presently two buildings on this property. Our loan servicing department occupies part of one building with the other part of that building leased to a physicians group surgical center. The second building is vacant at present but is being renovated to become a bank operations center. We are in the process of receiving the necessary approvals to construct a new building on the vacant land on this site to serve as a new full-service office location.

We also own two adjacent single-family residential properties in Furlong, Pennsylvania (within Bucks County) with a book value as of June 30, 2009 of approximately \$279,000. We are currently holding these properties as a potential future office site.

**Item 3. Legal Proceedings**

William Penn Bank, from time to time, is a party to routine litigation which arises in the normal course of business, such as claims to enforce liens, condemnation proceedings on properties in which it holds security interests, claims involving the making and servicing of real property loans, and other issues incident to its business. There were no lawsuits pending or known to be contemplated against William Penn Bancorp or William Penn Bank as of June 30, 2009 that were expected to have a material effect on operations or income.

**Item 4. Submission of Matters to a Vote of Security-Holders**

There were no matters submitted to a vote of the security holders during the fourth quarter of fiscal year 2009.

**PART II**

**Item 5. Market for Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

(a) **Market Information.** The information contained under the section captioned “Stock Market Information” in the Company’s Annual Report to Shareholders for the fiscal year ended June 30, 2009 (the “Annual Report”) filed as Exhibit 13 to this Annual Report on Form 10-K is incorporated herein by reference.

(b) **Use of Proceeds.** Not applicable.

(c) **Issuer Purchases of Equity Securities.** Not applicable.

**Item 6. Selected Financial Data**

Not applicable.

**Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

The information contained in the section captioned “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in the Annual Report is incorporated herein by reference.

**Item 7A. Quantative and Qualitative Disclosures About Market Risk**

Not applicable.



**Item 8. Financial Statements and Supplementary Data**

The Company's consolidated financial statements are incorporated herein by reference from the Annual Report.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

The information contained in the section captioned "Change in Auditors" in the Annual Report is incorporated herein by reference.

**Item 9A(T). Controls and Procedures.**

(a) **Disclosure Controls and Procedures.** The Company's management evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures, as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

(b) **Internal Control Over Financial Reporting.** Management's Report on Internal Control Over Financial Reporting is furnished herein by reference from the Annual Report. Such report is not deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section. This annual report does not include an attestation of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

There were no changes in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information.**

Not applicable.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The information contained under the sections captioned “Corporate Governance,” “Section 16(a) Beneficial Ownership Reporting Compliance” and “Proposal I -- Election of Directors” in the Company’s definitive Proxy Statement for the 2009 Annual Meeting of Shareholders is incorporated herein by reference.

The Company has adopted a Code of Ethics that applies to its principal executive officer, principal financial officer, principal accounting officer or controller or persons performing similar functions. A copy of the Company’s Code of Ethics will be provided to any person without charge upon

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written request to Charles Corcoran, Chief Financial Officer, William Penn Bancorp, Inc., 8150 Route 13, Levittown, Pennsylvania 19057.

### **Item 11. Executive Compensation**

The information contained under the section captioned “Proposal I -- Election of Directors - Executive Compensation” and “Director Compensation” in the Proxy Statement is incorporated herein by reference.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

#### **(a) Security Ownership of Certain Beneficial Owners**

Information required by this item is incorporated herein by reference to the Section captioned “Principal Holders of the Common Stock” of the Proxy Statement.

#### **(b) Security Ownership of Management**

Information required by this item is incorporated herein by reference to the section captioned “Proposal I -- Election of Directors” of the Proxy Statement.

#### **(c) Changes in Control**

Management knows of no arrangements, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change in control of the registrant.

#### **(d) Securities Authorized for Issuance Under Equity Compensation Plans**

Not applicable.

### **Item 13. Certain Relationships and Related Transactions and Director Independence**

The information required by this item is incorporated herein by reference to the section captioned “Related Party Transactions” and “Corporate Governance” in the Proxy Statement.

**Item 14. Principal Accounting Fees and Services**

The information set forth under the caption “Proposal II – Ratification of Independent Auditors” in the Proxy Statement is incorporated herein by reference.

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**PART IV**

**Item 15. Exhibits, Financial Statement Schedules**

(a) The following documents are filed as part of this report:

(1) The consolidated balance sheet of William Penn Bancorp, Inc. as of June 30, 2009 and 2008 (as restated) and the related consolidated statements of income, changes in stockholders' equity (as restated) and cash flows for each of the two years in the period ended June 30, 2009, together with the related notes and the independent auditors' report of S. R. Snodgrass, A.C., independent registered accounting firm, at and for the years ended June 30, 2009 and 2008.

(2) Schedules omitted as they are not applicable.

(3) The following exhibits are either filed as part of this Annual Report on Form 10-K or incorporated herein by reference:

<b>Number</b>	<b>Description</b>
3(i)	Charter of William Penn Bancorp, Inc. *
3(ii)	Bylaws of William Penn Bancorp, Inc. **
4.1	Specimen Stock Certificate of William Penn Bancorp, Inc. *
10.1 †	Directors Consultation and Retirement Plan ***
10.2 †	Deferred Compensation Plan for Directors ***
10.3 †	Restated Deferred Compensation Plan ***
13	Annual Report to Stockholders for fiscal year ended June 30, 2009
16	Letter of Concurrence from Beard Miller Company LLP to the SEC Regarding Change in Certifying Accountants ****
21	Subsidiaries of the Registrant
23.1	Consent of S. R. Snodgrass, A.C.
31	Rule 13a-14(a)/15d-14(a) Certification
32	Section 1350 Certification

† Management contract or compensatory plan or arrangement.

\* Incorporated by reference from the Registrant's Registration Statement on Form S-1 (File No. 333-148219)

\*\* Incorporated by reference from the identically numbered exhibit to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2009.

\*\*\* Incorporated by reference from the identically numbered exhibits to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2008.

\*\*\*\* Incorporated by reference from the exhibit to Registrant's Current Report on Form 8-K/A filed on June 30, 2008.



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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**WILLIAM PENN BANCORP, INC.**

Date: September 28, 2009

/s/ Charles Corcoran  
By: Charles Corcoran  
President  
(Duly Authorized Representative)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on September 28, 2009.

/s/ Charles Corcoran  
Charles Corcoran  
President and Director  
(Principal Executive and Financial Officer)

/s/ Aswini Hiremath  
Aswini Hiremath  
Chief Accounting Officer  
(Principal Accounting Officer)

/s/ William J. Feeney  
William J. Feeney  
Chairman of the Board of Directors

/s/ Craig Burton  
Craig Burton  
Director

/s/ Glenn Davis  
Glenn Davis  
Director

/s/ William B.K. Parry, Jr.  
William B.K. Parry, Jr.  
Director

