FEDERAL TRUST CORP
Form 10-K
March 15, 2007

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**

for the fiscal ended December 31, 2006.

o **Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**

for the transition period from ______________ to ______________.

Commission file number: 33-27139.

FEDERAL TRUST CORPORATION

(Exact name of registrant as specified in its charter)

Florida	**59-2935028**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
312 West 1st Street Sanford, Florida	**32771**
(Address of principal executive office)	*(Zip Code)*

Registrant s telephone number, including area code: (407) 323-1833

Securities registered pursuant to Section 12(b) of the Act: None

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

Common Stock, par value $.01 per share

(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
o	x

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
o	x

Note - Checking the box above will not relieve any registrant required to file reports pursuant to section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

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
x	o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will no be contained, to the best of registrant s knowledge, indefinitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to the Form 10-K. o

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

Large accelerated filer o Accelerated filer x Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes	No
o	x

Revenues for the fiscal year ended December 31, 2006: $46,068,000

The aggregate market value of the common stock of the Registrant held by non-affiliates of the Registrant (8,365,460 shares) on June 30, 2006, was approximately $91,184,000. The closing price of Registrant s common stock on June 30, 2006 was $10.90 per share. For the purposes of this response, directors, officers and holders of 5% or more of the Registrant s common stock are considered the affiliates of the Registrant at that date.

The number of shares outstanding of the Registrant s common stock, as of March 9, 2007 was 9,388,825 shares.

DOCUMENTS INCORPORATED BY REFERENCE:

1. Portions of the Proxy Statement for the 2007 Annual Meeting of Shareholders filed electronically with the Securities and Exchange Commission on or about April 15, 2007. (Part III)

TABLE OF CONTENTS

Federal Trust Corporation and Subsidiaries (Registrant).

(1) The material required by Items 9 through 11 and item 14 is hereby incorporated by reference from Registrant s definitive Proxy Statement, pursuant to Instruction E 3 of Form 10-K.

PART I

ITEM 1. BUSINESS

General

Federal Trust Corporation (Federal Trust) was organized in February 1989 for the purpose of becoming the unitary savings and loan holding company of Federal Trust Bank (the Bank), a federally-chartered stock savings bank. Federal Trust essentially has two wholly-owned operating subsidiaries, the Bank and Federal Trust Mortgage Company (the Mortgage Company) collectively referred to as the Subsidiaries. Federal Trust and its Subsidiaries are collectively referred to herein as the Company. As a savings and loan holding company, Federal Trust has greater flexibility than the Bank to diversify and expand its business activities, either through newly formed subsidiaries or through acquisitions.

Federal Trust is a legal entity separate from its Subsidiaries. Federal Trust s corporate headquarters are located at 312 West 1st Street, Sanford, Florida 32771, and its telephone number is (407) 323-1833. To date, the principal source of Federal Trust s revenues, on an unconsolidated basis, is earnings of the Bank and the Mortgage Company. Various regulatory restrictions and tax considerations limit, directly or indirectly, the amount of dividends the Bank can pay to Federal Trust. In addition, federal law restricts the Bank in the making of investments in or loans to Federal Trust or its affiliates. See Regulation and Supervision.

Subsidiaries

Federal Trust Bank is chartered as a Federal-stock savings bank and is primarily engaged in the business of obtaining funds in the form of customer deposits and Federal Home Loan Bank (FHLB) advances and investing such funds in permanent loans on residential and commercial real estate and, as well as in various types of construction, commercial and consumer loans and in investment securities. The Federal Deposit Insurance Corporation (FDIC), an agency of the United States Government, insures through the Deposit Insurance Fund (DIF), all depositors of the Bank up to $100,000 in accordance with the rules and regulations of the FDIC. The Bank is subject to comprehensive regulation, examination and supervision by the Office of Thrift Supervision (OTS) and the FDIC, which is intended primarily for the benefit of depositors. See Regulation and Supervision.

Federal Trust Mortgage Company was formed in May 2005 as a wholly-owned subsidiary of Federal Trust. The Mortgage Company commenced operations on January 2, 2006 to provide residential loan products for customers of the Bank, to produce mortgage loans to be sold to third party purchasers, to buy and sell mortgages in the secondary market and to service the residential loans, including the Bank s portfolio. When the Mortgage Company commenced operations, the mortgage origination and servicing staff of the Bank were transferred to the Mortgage Company.

Federal Trust Statutory Trust I (the Statutory Trust I) - was formed in September 2003, for the sole purpose of issuing $5,000,000 of trust preferred securities. In accordance with Financial Accounting Standards Interpretation No. 46 *Consolidation of Variable Interest Entities,* Federal Trust accounts for the Statutory Trust under the equity method of accounting.

Critical Accounting Policies

Our financial condition and results of operations are sensitive to accounting measurements and estimates of matters that are inherently uncertain. When applying accounting policies in areas that are subjective in nature, we use our best judgment to arrive at the carrying value of certain assets. The most sensitive accounting measurement we applied is related to the valuation of the loan portfolio and the adequacy of the allowance for loan losses.

A number of factors impact the carrying value of the loan portfolio including the calculation of the allowance for loan losses, the valuation of underlying collateral, the timing of loan charge-offs and the amount and amortization of loan fees and deferred origination costs. We believe that the determination of the allowance for loan losses represents a critical accounting policy. The allowance for loan losses is maintained at a level management considers to be adequate to absorb probable loan losses inherent in the portfolio, based on evaluations of the collectibility and historical loss experience of loans. Credit losses are charged and recoveries are credited to the allowance. Provisions for loan losses are based on our review of the historical loan loss experience and such factors which, in management s judgment, deserve consideration under existing economic conditions in estimating probable credit losses. The allowance is based on ongoing assessments of the probable estimated losses inherent in the loan portfolio.

Our methodology for assessing the appropriate allowance level consists of several key elements described in the section Lending Activities Allowance for Loan Losses . The allowance for loan losses is also discussed as part of Results of Operations and in Notes 1 and 3 to the consolidated financial statements. The significant accounting policies are discussed in Note 1 to the consolidated financial statements.

Forward Looking Statements

Readers should note, in particular, that this document contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), that involve substantial risks and uncertainties, including the risks described in Item 1A of this Form 10-K. When used in this document, or in the documents incorporated by reference herein, the words anticipate, believe, estimate, may, intend and expect and similar expressions identify certain of such forward-looking statements. Actual results, performance or achievements could differ materially from those contemplated, expressed or implied by the forward-looking statements contained herein. Actual results may differ materially, depending upon a variety of important factors, including competition, inflation, general economic conditions, changes in interest rates and changes in the value of collateral securing loans we have made, among other things.

Strategy

Our operating strategy has been and continues to be focused on building a strong community bank branch network serving Central Florida with competitive deposit products, which fund the origination and acquisition of residential mortgage loans, and the expansion of our commercial loan portfolio. Residential loans are typically secured by a first mortgage on a dwelling and commercial loans are secured by real estate located and operated primarily in our market area and where appropriate, the working assets of the borrower (such as accounts receivable, inventory, and equipment). We also provide loans to consumers secured by the equity in their homes.

Our lending activities are funded by core deposit generation through our expanding branch network, borrowings from the Federal Home Loan Bank, and in the brokered deposit market when rates are favorable. To the extent possible, we attempt to control interest rates paid on deposits; however, outside factors such as economic, environmental, competitive and liquidity needs will have an effect on the cost of funds. Our principal sources of earnings is interest on loans, securities, and overnight deposits, fees on checking and loan accounts and sales of loans and investments held for sale. Our principal expenses are interest paid on deposits and other borrowings, personnel and other operating expenses.

Market Area and Competition

We have nine full-service branch offices located in: Sanford, Winter Park, New Smyrna Beach, Casselberry, Deltona, Orange City, Lake Mary, Port Orange and Eustis, Florida. Sanford, which is located approximately 20 miles northeast of downtown Orlando, is the second largest city in Seminole County and is the county seat. Winter Park is located 13 miles southeast of Sanford and approximately seven miles northeast of downtown Orlando. Our market area encompasses Orange, Seminole, Lake, and Volusia Counties in Central Florida. The total population of the four County areas is estimated at 1.9 million, with the majority in Orange and Seminole Counties. The Casselberry and Lake Mary branches are located in Seminole County between our Sanford and Winter Park Offices. New Smyrna Beach and Port Orange are located in Volusia County near the Atlantic Ocean, south of Daytona Beach, Florida. Eustis is located in Lake County, 26 miles west of our Sanford branch. Deltona and Orange City are both located in the Western part of Volusia County along the Interstate 4 corridor between Orlando and Daytona Beach. During 2006, we opened our Lake Mary branch in January, Port Orange branch in July and Eustis branch in October. We plan to open two additional branches in the second half of 2007, our Palm Coast branch in Flagler County and the Edgewater branch in Eastern Volusia County. Our administrative and operation offices are housed in Sanford.

Our primary market area is Orange, Seminole, Volusia and Lake Counties, and to a lesser extent Flagler and Osceola Counties. Although best known as a tourist destination, with over 20 million visitors a year, the Central Florida area has become a center for industries such as aerospace and defense, electro-optics and lasers, computer simulated training, computer networking and data management. In addition, motion picture production, professional and amateur sports, and distribution makes the local economy more diverse each year. Many companies, including some in the Fortune 500, have chosen the greater Orlando area as a base for corporate, regional, and divisional headquarters.

The area is also home to the University of Central Florida with an enrollment of 47,000, one of the fastest growing schools in the state university system, as well as Valencia Community College and Seminole Community College whose combined enrollment exceeds 80,000. Winter Park is home to Rollins College, Florida s oldest college. In addition, Stetson University, Florida s first private university is located in Volusia County.

We experience substantial competition in attracting and retaining deposits and in lending funds. The primary factors in competing for deposits are customer service, branch locations and interest rates. Direct competition for deposits comes from other savings institutions, commercial banks and nontraditional financial service providers, including insurance companies, consumer finance companies, brokerage houses and credit unions. Additional significant competition for deposits comes from corporate and government securities and money market funds. The primary factors in competing for loans are loan structure, interest rates and loan origination fees. Competition for origination of real estate loans normally comes from other savings institutions, commercial banks, mortgage bankers, insurance companies and real estate investment trusts.

Consolidation within the banking industry, and in particular within Florida, has remained constant over the past several years. As of June 30, 2006, the five largest out-of-state bank holding companies in Florida controlled approximately 57% of the bank deposits. Federal Trust is one of the largest independent financial institutions with headquarters and all of our branch locations in the Central Florida market place. At the same time that we have seen continued consolidation of local community banks, seasoned banking executives continue to spearhead the formation of new community banks with aggressive capital and growth plans.

Geographic deregulation also has had a material impact on the banking industry. Legislation in Florida and on the national level, has removed most of the final barriers to interstate banking. Under Florida Law, bank holding companies are permitted to acquire existing non *de novo* banks across state lines. A bank holding company may consolidate its interstate subsidiary banks into branches and merge with a bank in another state, depending on state laws.

Lending Activities

General. Our residential lending has traditionally included the origination, purchase and sale of mortgage loans for the purchase, refinance or constructing of residential real property, primarily secured by first liens on such property. In January 2006, the residential origination and underwriting functions were transferred to the Mortgage Company. These loans are typically conventional home loans or lot loans which are not insured by the Federal Housing Agency (FHA) or partially secured by the Veterans Administration (VA). Loans with fixed rates beyond five years are generally sold into the secondary market. Loans with fixed rates of five years or less are generally considered for portfolio. Interest rates for construction loans are generally tied to the prime rate and float daily during the construction period and are converted to either fixed or adjustable permanent mortgages upon completion. To a lesser extent, we also make home equity loans with second liens, which generally float daily with the prime rate. Other consumer related loans are savings loans secured by certificates of deposit at an interest rate above the rate paid on the certificate.

Since 2000, we have increased our commercial real estate lending and cross marketing of business accounts. Commercial loans are comprised of loans to small businesses secured by real estate used in the enterprise and, where appropriate, the working assets of the business. We also make real estate loans for the acquisition and development of land for residential, and income producing projects. Commercial loans are generally priced on a floating prime rate basis or fixed at repricing intervals not to exceed five years. As a matter of policy, commercial loans are generally guaranteed by the borrowers principals.

Credit Risk. Since our primary business is the origination and acquisition of real estate secured loans, that activity entails potential credit losses which are beyond our control, the magnitude of which depends on a variety of economic factors affecting borrowers. While guidelines have been instituted and credit review procedures have been put into place to protect us from credit losses, some losses may inevitably occur. During 2006, we recognized $39,000 in charge-offs, and $21,000 in recoveries from prior charge-offs.

Loan Portfolio Composition. Our net loan amount, which is total loans plus premiums paid for loans purchased less loans in process, deferred loan origination fees and costs and allowance for loan losses, totaled $603.9 million at December 31, 2006, representing 84% of total assets at such date. At December 31, 2005, our net loan portfolio was $630.8 million or 86% of total assets.

Residential mortgage loans, not including construction and lot loans, still comprise the largest group of loans in our loan portfolio, amounting to $356.1 million or 56% of the total loan portfolio at December 31, 2006, down from $400.0 million or 57% of the total loan portfolio at December 31, 2005. The decrease in the residential loan portfolio in 2006 was primarily due to the decrease in the volume of residential origination and purchase loan activity, due to the flat yield curve. As a result, the volume of loan prepayments exceeded the volume of new loans added to our portfolio. We offer and purchase adjustable rate mortgage (ARM) loans with maturities up to 30 years. As of December 31, 2006, approximately 97% of the residential loan portfolio loans were ARM loans and 3% were fixed-rate. Fixed-rate loans are generally underwritten to secondary market standards to insure liquidity and interest-rate risk protection. Residential lot loans amounted to $42.7 million or 7% of total loans at December 31, 2006. These loans are secured by developed lots ready for construction of single-family homes. As a result of the softening in the housing market during 2006, we also reduced our residential construction loans to $36.6 million or 6% of total loans at December 31, 2006, from $81.6 million or 12% of total loans at the end of 2005. These loans are generally on property in Southwest Florida and throughout the state and are underwritten directly to the individual or family for their primary residence or second home.

Commercial real estate secured loans amounted to $93.1 million or 15% of the total loan portfolio at December 31, 2006. This portfolio includes loans to businesses to finance their office, manufacturing or retail facilities. Commercial land, development and construction loans amounted to $88.6 million or 14% of total loans. The land loans are generally larger parcels of property held for future development. The development and construction loans include loans for the acquisition and development of both residential and commercial projects. The construction loans are made directly to the builders of single and multi-family homes for pre-sold or speculative units. We also finance the construction of commercial facilities, generally for the owner/operator.

Commercial loans at December 31, 2006, were $15.3 million or 2% of total loans. These loans are generally secured by the assets of the borrower including accounts receivable, inventory and fixed assets, including company owned real estate and are usually also guaranteed by the owners.

Consumer loans, consisting of installment loans and savings account loans at December 31, 2006, were $125,000 or less than 1% of the total loan portfolio.

The following table sets forth information on our loan portfolio by type (in thousands):

	At December 31,									
	2006		2005		2004		2003		2002	
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
Residential lending:										
Mortgages	$ 356,133	56.4%	$ 399,973	56.6%	$ 374,581	70.8%	$ 302,083	75.4%	$ 246,235	79.2%
Lot loans	42,676	6.7	40,203	5.7	41,369	7.8	20,816	5.2	8,742	2.8
Construction	36,570	5.8	81,572	11.5	5,405	1.0	780	0.2	1,822	0.6
Total Residential lending	435,379	68.9	521,748	73.8	421,355	79.6	323,679	80.8	256,799	82.6
Commercial lending:										
Real estate secured	93,095	14.7	71,253	10.1	56,267	10.6	47,918	12.0	32,061	10.3
Land, development and construction	88,586	14.0	90,794	12.8	38,091	7.2	16,524	4.1	14,598	4.7
Commercial loans	15,308	2.4	22,529	3.2	13,257	2.5	11,639	2.9	6,568	2.1
Total Commercial lending	196,989	31.1	184,576	26.1	107,615	20.3	76,081	19.0	53,227	17.1
Consumer loans	125		447	0.1	657	0.1	864	0.2	969	0.3
Total loans	632,493	100.0%	706,771	100.0%	529,627	100.0%	400,624	100.0%	310,995	100.0%
Add (deduct):										
Allowance for loan losses	(5,098)		(4,477)		(3,835)		(2,779)		(2,110)	
Net premiums, discounts, deferred fees and costs	3,567		4,584		3,524		3,346		2,902	
Loans in process	(27,045)		(76,051)		(7,985)		(2,790)		(3,189)	
Net loans	$ 603,917		$ 630,827		$ 521,331		$ 398,401		$ 308,598	