

MSB FINANCIAL CORP.
Form 10-K
September 29, 2008
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

ANNUAL REPORT

PURSUANT TO SECTIONS 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

(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, 2008 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. **001-33246**

MSB FINANCIAL CORP.

(Exact name of Registrant as specified in its Charter)

United States

(State or other Jurisdiction of

Incorporation or Organization)

34-1981437

(I.R.S. Employer Identification No.)

1902 Long Hill Road, Millington, New Jersey

(Address of Principal Executive Offices)

07946-0417

(Zip Code)

Registrant's telephone number, including area code: **908-647-4000**

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$0.10 par value	The Nasdaq Stock Market LLC

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

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 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.

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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer <input type="radio"/>	Accelerated filer <input type="radio"/>
Non-accelerated filer <input type="radio"/>	Smaller reporting company <input checked="" type="radio"/>

(Do not check if a smaller reporting company)

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based on the closing price of the Registrant's common stock as quoted on the Nasdaq Stock Market LLC on December 31, 2007, was approximately \$24.2 million.

As of September 22, 2008 there were 5,475,161 shares outstanding of the Registrant's common stock.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Proxy Statement for the 2008 Annual Meeting of Shareholders. (Parts II and III)

MSB FINANCIAL CORP.

FORM 10-K

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

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PART I

Forward-Looking Statements

MSB Financial Corp. (the "Company") may from time to time make written or oral "forward-looking statements," including statements contained in the Company's filings with the Securities and Exchange Commission (including this Annual Report on Form 10-K and the exhibits thereto), in its reports to stockholders and in other communications by the Company, which are made in good faith by the Company pursuant to the "safe harbor" provisions of the private securities litigation reform act of 1995.

These forward-looking statements involve risks and uncertainties, such as statements of the Company's plans, objectives, expectations, estimates and intentions, that are subject to change based on various important factors (some of which are beyond the Company's control). The following factors, among others, could cause the Company's financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: The strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the board of governors of the federal reserve system, inflation, interest rate, market and monetary fluctuations; the timely development of and acceptance of new products and services of the Company and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors' products and services; the willingness of users to substitute competitors' products and services for the Company's products and services; the success of the Company in gaining regulatory approval of its products and services, when required; the impact of changes in financial services' laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes, acquisitions; changes in consumer spending and saving habits; and the success of the Company at managing the risks involved in the foregoing.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

Item 1. Business

General

The Company is a federally chartered corporation organized in 2004 for the purpose of acquiring all of the capital stock that Millington Savings Bank (the "Bank") issued in its mutual holding company reorganization. During the fiscal year ended June 30, 2007, the Company conducted its initial public offering and sold 2,529,281 shares for net proceeds of approximately \$24.5 million. The Company's principal executive offices are located at 1902 Long Hill Road, Millington, New Jersey 07946-0417 and its telephone number at that address is (908) 647-4000.

MSB Financial, MHC (the "MHC") is a federally chartered mutual holding company that was formed in 2004 in connection with the mutual holding company reorganization. The MHC has not engaged in any significant business since its formation. So long as the MHC is in existence, it will at all times own a majority of the outstanding stock of the Company.

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The Bank is a New Jersey-chartered stock savings bank and its deposits are insured by the Federal Deposit Insurance Corporation. As of June 30, 2008, the Bank had 49 full time equivalent employees.

The Bank is regulated by the New Jersey Department of Banking and Insurance and the Federal Deposit Insurance Corporation. The OTS regulates the MHC and the Company as federally-chartered savings and loan holding companies.

Throughout this document, references to “we,” “us,” or “our” refer to the Bank or Company, or both, as the context indicates.

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. A number of our competitors are significantly larger institutions with greater financial and managerial resources and lending limits. Our ability to compete successfully is a significant factor affecting our growth potential and profitability.

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 with commercial banks and savings institutions for consumer loans, and we face competition for funds from investment products such as mutual funds, short-term money funds and corporate and government securities. There are large competitors operating throughout our total market area, and we also face strong competition from other community-based financial institutions.

Lending Activities

We have traditionally focused on the origination of one-to-four family loans and home equity loans and lines of credit, which together comprise a substantial majority of the total loan portfolio. We also provide financing for commercial real estate, including multi-family dwellings/apartment buildings, service/retail and mixed-use properties, churches and non-profit properties, medical and dental facilities and other commercial real estate. In recent years, construction loans have grown as a component of our portfolio. We also originate commercial loans. Our consumer loans are comprised of auto loans, personal loans and account loans.

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Loan Portfolio Composition. The following tables analyze the composition of the Bank's portfolio by loan category at the dates indicated. Except as set forth below, there were no concentrations of loans exceeding 10% of total loans.

	At June 30, 2008		2007		2006		2005		2004		
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	
	(Dollars in thousands)										
<u>Type of Loans:</u>											
One-to-four family real estate	\$ 145,868	56.31 %	\$ 123,601	50.94 %	\$ 120,921	53.89 %	\$ 113,488	58.50 %	\$ 109,781	62.73 %	
Commercial real estate	30,068	11.61	28,989	11.95	23,587	10.51	17,971	9.26	17,162	9.81	
Construction	17,771	6.86	23,822	9.82	23,276	10.37	18,398	9.48	13,668	7.81	
Consumer	1,259	0.49	1,995	0.82	1,861	0.83	1,819	0.94	1,703	0.97	
Home equity	54,778	21.15	55,896	23.04	49,257	21.95	38,291	19.74	29,710	16.98	
Commercial	9,285	3.58	8,338	3.43	5,497	2.45	4,029	2.08	2,970	1.70	
Total loans receivable	259,029	100.00 %	242,641	100.00 %	224,399	100.00 %	193,996	100.00 %	174,994	100.00 %	
Less:											
Construction loans in process	(3,568)		(7,999)		(4,968)		(5,719)		(5,371)		
Allowance for loan losses	(1,025)		(926)		(921)		(874)		(742)		
Deferred loan fees	(146)		(218)		(189)		(211)		(267)		
Total loans receivable, net	\$ 254,290		\$ 233,498		\$ 218,321		\$ 187,192		\$ 168,614		

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Loan Maturity Schedule. The following table sets forth the maturity of the Bank's loan portfolio at June 30, 2008. Demand loans, loans having no stated maturity, and overdrafts are shown as due in one year or less. Undisbursed amounts on construction loans totaling \$3.6 million at June 30, 2008 are not shown in the table. The table shows contractual maturities and does not reflect repricing or the effect of prepayments. Actual maturities may differ.

At June 30, 2008

	One-to-Four Family Real Estate	Commercial Real Estate	Construction	Consumer	Home Equity	Commercial	Total
(In thousands)							
<u>Amounts Due:</u>							
Within 1 Year	\$ 10,780	\$ 2,854	\$ 14,156	\$ 650	\$ 65	\$ 166	\$ 28,671
After 1 year:							
1 to 5 years	37,419	8,662	47	588	2,193	7,366	56,275
5 to 10 years	16,620	8,521	-	21	15,845	461	41,468
After 10 years	81,049	10,031	-	-	36,675	1,292	129,047
Total due after one year	135,088	27,214	47	609	54,713	9,119	226,790
Total amount due	\$ 145,868	\$ 30,068	\$ 14,203	\$ 1,259	\$ 54,778	\$ 9,285	\$ 255,461

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The following table sets forth the dollar amount of all loans at June 30, 2008 due after June 30, 2009, which have fixed interest rates and which have floating or adjustable interest rates.

	Fixed Rates (In thousands)	Floating or Adjustable Rates	Total
One-to-four family real estate	\$ 132,106	\$ 2,982	\$ 135,088
Commercial real estate	27,214	-	27,214
Construction	47	-	47
Consumer	433	176	609
Home equity	35,548	19,165	54,713
Commercial	3,642	5,477	9,119
Total	\$ 198,990	\$ 27,800	\$ 226,790

One-to-Four Family Real Estate Mortgages. Our primary lending activity consists of the origination of one-to-four family first mortgage loans. Fixed rate, conventional mortgage loans are offered by the Bank with terms from 5 to 30 years. A bi-weekly payment option is available wherein a payment is made every fourteen days via automatic deduction from the borrower's Millington Savings Bank account.

We also originate fixed rate balloon mortgages with terms of 3 to 10 years and flexible amortizations. At the end of each term the mortgage may be paid off in full with no penalty or, provided that the loan is in good standing and there has been no negative change in value of the collateral, we may extend the existing mortgage on new terms, at a new interest rate. If the mortgage is extended, there may be additional charges at the time of each extension.

We originate adjustable rate mortgages, or ARM's, with up to 30 year terms at rates based upon the U.S. Treasury One Year Constant Maturity as an index. Our ARM's currently reset on an annual basis, beginning with the first year, and have a two percent annual increase cap and a six percent lifetime adjustment cap. We do not originate "teaser" rate or negative amortization loans.

Substantially all residential mortgages include "due on sale" clauses, which are provisions giving the lender the right to declare a loan immediately payable if the borrower sells or otherwise transfers an interest in the property to a third party. Property appraisals on real estate securing one-to-four family residential loans are made by state certified or licensed independent appraisers and are performed in accordance with applicable regulations and policies. We require title insurance policies on all first lien one-to-four family residential loans. Homeowners, liability, fire and, if applicable, flood insurance policies are also required.

We provide financing on residential investment properties with either 3 to 10 year balloon mortgages or 5 to 30 year fixed duration mortgages. At the end of each term a balloon mortgage on an investment property may be paid off in full with no penalty or, provided that the loan is in good standing and there has been no negative change in value of the collateral, we may extend the existing mortgage on new terms, at a new interest rate. If the mortgage is extended, there may be additional charges at the time of each extension. Our investment property lending is available to individuals or proprietorships, partnerships, limited liability corporations, and corporations with personal guarantees. All investment property is underwritten on its ability substantially to carry itself, unless the property is a two-family residence with the mortgagor living in one of the units. Preference is given to those loans where rental

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income covers all operating expenses, including but not limited to principal and interest, real estate tax, hazard insurance, utilities, maintenance, and reserve. Operating expenses generally may not exceed rental income by more than 10%. Any negative cash flow will be included in the limit on the borrower's total debt ratio.

We generally originate one-to-four family first mortgage loans, for primary residence or investment, for up to 80% loan-to-value. Although not our normal practice, our lending policy permits us to exceed this limit. Our president and executive vice president are both authorized to approve a loan-to-value ratio of up to 90%. Loans in excess of 90% loan-to-value must have private mortgage insurance and must be approved by the Board of Directors.

Commercial Real Estate Mortgages. Our commercial real estate lending includes multi-family dwellings/apartment buildings, service/retail and mixed-use properties, churches and non-profit properties, medical and dental facilities and other commercial real estate. Our commercial real estate mortgage loans are either 3 to 10 year balloon mortgages (with a maximum amortization period of 25 years) or 15 year fixed duration mortgages. This type of lending is made available to proprietorships, partnerships, and corporations with personal guarantees. All commercial property is underwritten on its ability substantially to carry itself. A cash flow and lease analysis is performed for each property. Preference is given to those loans where rental income covers all operating expenses, including but not limited to principal and interest, real estate tax, hazard insurance, utilities, maintenance, and reserve. Operating expenses may exceed rental income by not more than 10%. Any negative cash flow will be included in the limit on the borrower's total debt ratio. Cash from other assets of the borrower, who may own multiple properties and generate a surplus, can be made available to cover debt-service shortages of the financed property.

The maximum loan-to-value ratio on most commercial real estate loans we originate is 80%. Although not our normal practice, our lending policy permits us to originate these loans in excess of an 80% loan-to-value. Our President and Executive Vice President are authorized to approve a loan-to-value ratio of up to 90% on commercial real estate loans.

The management skills of the borrower are judged on the basis of his/her professional experience and must be documented to meet the Bank's satisfaction in relation to the desired project. The assets of the borrower must indicate his/her ability to support the proposed investment, both in terms of liquidity and net worth, and tangible history of the borrower's capability and experience must be evident.

Unlike single-family 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 commercial 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. As a result, the availability of funds for the repayment of commercial real estate and multi-family loans may be substantially dependent on the success of the business itself and the general economic environment. Commercial real estate and multi-family loans, therefore, have greater credit risk than one-to-four family residential mortgages or consumer loans. In addition, commercial real estate and multi-family loans generally result in larger balances to single borrowers, or related groups of borrowers and also generally require substantially greater evaluation and oversight efforts.

Construction Loans. We originate construction and land acquisition loans for an owner-occupied residence or to a builder with a valid contract of sale. With prior Board of Director approval, we also provide financing for speculative residential or commercial construction and development. Individual consideration is given to builders based on their past performance, workmanship, and financial worth.

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Our construction lending includes loans for construction or major renovations or improvements of owner-occupied residences; however, the majority of this portfolio consists of real estate developers.

Construction loans are mortgages with a one-year duration. Funds are disbursed periodically upon inspections made by our inspectors on the completion of each phase, as per the approved draw schedule. Funds disbursed may not exceed 90% loan-to-value of land and improvements at any time during construction. Interest rates on disbursed funds are based on the rate and terms set at the time of closing. The majority of our construction lending is variable rate loans with rates tied to the prime rate published in *The Wall Street Journal*, plus a premium. Payments on disbursed funds must be made on a monthly basis. The loan-to-value limitation on land acquisition loans is 75%.

Construction lending is generally considered to involve a higher degree of credit risk than residential mortgage lending. If the 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 the entire unpaid portion of the loan. In addition, 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.

Consumer Loans. Our consumer lending products consist of new and used auto loans, secured and unsecured personal loans, account loans and overdraft lines of credit. The maximum term for a loan on a new or used automobile is six years or four years, respectively. We will lend up to 80% of retail value or dealer invoice on a car loan. We offer a deduction on the interest rate for car loans with payments automatically deducted from the borrower's checking or statement savings account with us.

Our personal loans have terms of up to four years with a minimum and maximum balance of \$1,000 and \$5,000, respectively. A deduction to the interest rate is offered for loans with automatic debit repayment from a checking or statement savings account with us. Our account loans permit a depositor to borrow up to 90% of his or her funds on deposit with us in certificate of deposit accounts. The interest rate is the current rate paid to the depositor, plus a premium. A minimum payment of interest only is required. We offer an overdraft line of credit with a minimum of \$500 and up to a maximum of \$5,000 and an interest rate tied to the prime rate published in *The Wall Street Journal*, plus a premium.

Consumer lending is generally considered to involve a higher degree of credit risk than residential mortgage lending. 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. Account loans are fully secured.

Home Equity Loans and Lines of Credit. We offer fixed rate home equity loans and variable rate home equity lines of credit with a minimum credit limit of \$5,000. Collateral valuation is established through a variety of methods, including an on-line appraisal valuation estimator, drive by appraisals, recent assessed tax value, purchase price or consideration value as evidenced by a deed or property search report or a report of real estate comparables from a licensed realtor. Loan requests over \$250,000, however, require full appraisals, and requests over \$450,000 require Board approval. The loan-to-value limit on home equity lending is 80% on owner occupied property and 75% on investment property. The variable rate on home equity lines of credit is adjusted monthly and is currently set at prime for owner occupied properties and prime plus a premium for investment properties. The fixed rate loans on investment property are also higher than fixed rate owner occupied home equity loans. We generally provide home equity financing only for a first or second lien position.

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Our fixed rate home equity loans have terms of 5 to 30 years. Our variable rate home equity lines of credit have terms of 15 years, and we also offer an interest only home equity line of credit based on a 10 year term. The loan-to-value limit on interest only home equity financing is 70% on owner occupied property and 60% on investment property. We also offer bridge loans with a variable rate and a 70% loan-to-value limit on owner occupied property and 60% on investment property.

Commercial Loans. We offer revolving lines of credit to businesses to finance short-term working capital needs like accounts receivable and inventory. These lines of credit may be unsecured or secured by accounts receivable and inventory or real estate. We generally provide such financing for no more than a 3 year term and with a variable rate.

We also originate commercial term loans to fund longer-term borrowing needs such as purchasing equipment, property improvements or other fixed asset needs. These loans are secured by new and used machinery, equipment, fixtures, furniture or other long-term fixed assets and have terms of 1 to 7 years. We originate commercial term loans for other general long-term business purposes, and these loans are secured by real estate. Interest on commercial term loans is payable monthly and principal may be payable monthly or quarterly.

The normal minimum amount for our commercial term loans and lines of credit is \$5,000. We generally will not lend more than \$100,000 on a commercial line of credit or \$500,000 on a commercial term loan. We typically do not provide working capital loans to businesses outside our normal market area or to new businesses where repayment is dependent solely on future profitable operation of the business. We avoid originating loans for which the primary source of repayment could be liquidation of the collateral securing the loan in light of poor repayment prospects. We typically require personal guarantees on all commercial loans, regardless of other collateral securing the loan.

The loan-to-value limits related to commercial lending vary according to the collateral. Loans secured by real estate may be originated for up to 80% loan-to-value. Other limits are as follows. Savings accounts: 90% of the deposit amount; accounts receivable: 80% of eligible amounts receivable 60 days or less past due or 90 days from invoice, whichever is less; inventory: 50% of raw materials and 60% of finished goods; stocks: 50% to 75% depending on exchange or market listing; bonds: 'A' rated or better, 90% of market value, less than 'A' rated, 60% of market value; new equipment: 75% of purchase price; and used equipment: lesser of 75% of purchase price or 75% of current market value.

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, as of June 30, 2008, our loans to one borrower legal limit was approximately \$5.0million.

Loans that approach the loans to one borrower limit are reviewed by the Board of Directors before being approved. The Bank's lending policies require Board approval before any borrower's existing and/or committed borrowings from the Bank may exceed \$1.0 million in aggregate. Any single loan in excess of \$1.0 million also requires prior Board approval.

Loan Originations, Purchases, Sales, Solicitation and Processing. Our customary sources of loan applications include repeat customers, referrals from realtors and other professionals and "walk-in" customers. Our residential loan originations are driven by the Bank's reputation, as opposed to being advertising driven.

We normally do not sell loans into the secondary mortgage market and did not sell any loans in the five year period ended June 30, 2008. Because it has been our policy to retain the loans we originate

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in our portfolio, we have not uniformly originated our real estate mortgage loans to meet the documentation standards to sell loans in the secondary mortgage market. We may do so, however, in the future if we find it desirable in connection with interest rate risk management to sell longer term fixed rate mortgages into the secondary mortgage market.

We did not purchase any whole loans in the five-year period ended June 30, 2008. We did, however, purchase a few participation interests in loans originated by other banks during this period.

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 President and Chief Executive Officer Gary Jolliffe, Executive Vice President and Chief Operating Officer Michael Shriner and Vice President and Chief Lending Officer Nancy Schmitz. Each of these officers may approve loans within the following limits: first mortgage real estate and construction loans up to \$500,000; home equity loans up to \$150,000; consumer loans up to \$150,000; and commercial loans up to \$150,000. These officers may combine their authorities to make home equity, consumer and commercial loans up to \$450,000 and first mortgage real estate and construction loans up to \$1.0 million. Prior Board approval is required for home equity, consumer and commercial loans in excess of \$450,000 and for first mortgage real estate and construction loans in excess of \$1.0 million. The Board also must give prior approval for any aggregation of existing and/or committed loans to one borrower that exceed \$1.0 million. Certain other Bank employees also have limited lending authority.

Asset Quality

Loan Delinquencies and Collection Procedures. The Bank's procedures for delinquent loans are as follows:

15 days delinquent:	late charge added, first delinquent notice mailed
30 days delinquent:	second delinquent notice mailed
45 days delinquent:	additional late charge, third delinquent notice mailed, telephone contact made
60 days delinquent:	telephone contact made, separate letter mailed
90 days delinquent:	decision made to foreclose or workout

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

As 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 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. At June 30, 2008, we held no real estate owned.

As to commercial loans, the Bank requires updated financial statements when the loan becomes 90 days delinquent. As to account loans, the outstanding balance is collected from the related account along with accrued interest when the loan is 180 days delinquent.

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Loans are reviewed on a regular basis, and all delinquencies of 60 days or more are reported to the Board of Directors. Loans are placed on non-accrual status when they are more than 90 days delinquent, with the exception of loans that may be placed on a non-accrual status at any time if, in the opinion of management, the collection of additional interest is doubtful. Loans with a loan-to-value ratio of 60% or less, however, are not automatically placed on non-accrual status if more than 90 days delinquent. 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. At June 30, 2008, we had approximately \$2.9 million of loans that were held on a non-accrual basis. \$2.7 million of the non-accrual loans were classified as impaired as of June 30, 2008, and were subject to specific loss allowances totaling \$114,000.

Non-Performing Assets. The following table provides information regarding our non-performing loans and other non-performing assets as of the dates indicated.

	At June 30,				
	2008	2007	2006	2005	2004
<u>Loans accounted for on a non-accrual basis:</u>					
One-to-four family real estate	\$ 1,234	\$ 116	\$ -	\$ 1,662	\$ 951
Commercial real estate	410	-	-	-	216
Construction	-	666	-	-	55
Consumer	-	-	1	13	-
Home equity	634	634	325	554	549
Commercial	658	166	98	99	124
Total	2,936	1,582	424	2,328	1,895
<u>Accruing loans contractually past due</u>					
<u>90 days or more:</u>					
One-to-four family real estate	1,615	740	252	39	74
Commercial real estate	378	-	-	-	-
Construction	-	-	47	-	-
Consumer	16	-	-	2	13
Home equity	234	27	-	38	-
Commercial	-	-	-	-	-
Total	2,243	767	299	79	87
Total non-performing loans	\$ 5,179	\$ 2,349	\$ 723	\$ 2,407	\$ 1,982
Total non-performing assets	\$ 5,179	\$ 2,349	\$ 723	\$ 2,407	\$ 1,982
Total non-performing loans to total loans	2.00 %	0.97 %	0.32 %	1.24 %	1.13 %
Total non-performing loans to total assets	1.68 %	0.83 %	0.27 %	1.01 %	0.92 %
Total non-performing assets to total assets	1.68 %	0.83 %	0.27 %	1.01 %	0.92 %

During the year ended June 30, 2008, gross interest income of \$186,000 would have been recorded on loans accounted for on a non-accrual basis if those loans had been current, and \$169,000 of interest on a cash basis as collected was included in income. At June 30, 2008, there were \$516,000 in loans that were not classified as nonaccrual, 90 days past due or restructured but where known information about possible credit problems of borrowers caused management to have serious concerns as to the ability of the borrowers to comply with present loan repayment terms and may result in future disclosure as nonaccrual, 90 days past due or restructured.

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Classified Assets. Management, in compliance with the Uniform Credit Classification and Account Management Policy adopted by the Federal Deposit Insurance Corporation, has instituted an internal loan review program, whereby non-performing loans 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.

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.

Management's classification of assets is reviewed by the Board on a regular basis and by the regulatory agencies as part of their examination process. An independent loan review firm performs periodic reviews of our loan portfolio.

The following table discloses the Bank's classification of assets as of June 30, 2008.

	At June 30, 2008
	(In thousands)
Special Mention	\$ 2,483
Substandard	3,761
Doubtful	-
Loss	22
Total	\$ 6,266

At June 30, 2008, fourteen out of twenty loans classified as "special mention," totaling \$1.9 million; ten out of twelve loans classified as "substandard" totaling \$3.3 million; and the single loan classified as "loss" for \$22,000 are included as non-performing assets in the non-performing assets table.

Allowance for Loan Losses. The allowance for loan losses is a valuation account that reflects our estimation of the losses in our loan portfolio to the extent they are both probable and reasonable to estimate. The allowance is established through provisions for loan losses that are charged to income in the period they are established. We charge losses on loans against the allowance for loan losses when we believe the collection of loan principal is unlikely. Recoveries on loans previously charged-off are added back to the allowance.

Management, in determining the allowance for loan losses, considers the losses inherent in the loan portfolio and changes in the nature and volume of our loan activities, along with general economic and real estate market conditions. We establish a specific allowance for loans classified as "loss" or that are determined to be impaired. We make provisions for loan losses to a general allowance according to (i) the type of loan, one-to-four family real estate mortgages, commercial real estate mortgages, construction loans, commercial term loans and lines of credit, consumer loans and home equity loans and lines of credit, with commercial, construction and consumer loans receiving a higher allowance than other loan types, and (ii) whether the loan is current and performing or delinquent, with higher allowances made according to the number of days a loan is delinquent. However, for purposes of establishing the general valuation allowance loans that are delinquent 90 days or more are treated as current if they have a loan-to-value ratio of less than 60%.

We maintain a loan review system which provides for a systematic review of the loan portfolios and the early identification of potential impaired loans. We generally review a loan for impairment as soon as the loan is 60 or more days delinquent. A loan evaluated for impairment is deemed to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Payments received on impaired loans are applied first to unpaid interest, escrow and late charges and then to principal.

Specific loan loss allowances are established for impaired loans based on a review of such information and/or appraisals of the underlying collateral. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions and management's judgment. The estimation of the allowance for loan losses is inherently subjective as it requires estimates and assumptions that are susceptible to significant revisions as more information becomes available or as future events change. Future additions to the allowance for loan losses may be necessary if economic and other conditions in the future differ substantially from the current operating environment. In addition, the New Jersey Department of Banking and Insurance and the Federal Deposit Insurance Corporation, as an integral part of their examination process, periodically review our loan and foreclosed real estate portfolios and the related allowance for loan losses and valuation allowance for foreclosed real estate. They 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 the Bank's allowance for loan losses for the periods indicated:

	Year Ended June 30,									
	2008	2007	2006	2005	2004					
	(Dollars in thousands)									
Allowance balance at beginning of period	\$ 926	\$ 921	\$ 874	\$ 742	\$ 651					
Provision for loan losses	135	5	60	135	134					
<u>Charge-offs:</u>										
Consumer	42	3	17	3	45					
Total charge-offs	42	3	17	3	45					
<u>Recoveries:</u>										
Consumer	6	3	4	-	2					
Total recoveries	6	3	4	-	2					
Net charge-offs	\$ 36	\$ -	\$ 13	\$ 3	\$ 43					
Allowance balance at end of period	\$ 1,025	\$ 926	\$ 921	\$ 874	\$ 742					
Total loans outstanding at end of period	\$ 259,029	\$ 242,641	\$ 224,399	\$ 193,996	\$ 174,994					
Average loans outstanding during period	\$ 243,879	\$ 228,069	\$ 205,905	\$ 179,837	\$ 151,736					
Allowance for loan losses as a percentage of non-performing loans	19.79	%	39.42	%	127.39	%	36.31	%	37.44	%
Allowance for loan losses as a percentage of total loans	0.40	%	0.38	%	0.41	%	0.45	%	0.42	%
Net loans charge-offs as a percentage of average loans	0.01	%	-	%	0.01	%	-	%	0.03	%

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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 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 that 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,		2007		2006		2005		2004	
	2008									
	Percent		Percent		Percent		Percent		Percent	
	of Loans		of Loans		of Loans		of Loans		of Loans	
	to Total		to Total		to Total		to Total		to Total	
	Amount	Loans	Amount	Loans	Amount	Loans	Amount	Loans	Amount	Loans
	(Dollars in thousands)									
<u>At end of period</u>										
<u>allocated to:</u>										
One-to-four family real estate	\$ 471	56.31 %	\$ 389	50.94 %	\$ 436	53.89 %	\$ 467	58.50 %	\$ 418	62.73 %
Commercial real estate	116	11.61	105	11.95	108	10.51	72	9.26	85	9.81
Construction	74	6.86	83	9.82	125	10.37	72	9.48	47	7.81
Consumer	7	0.49	9	0.82	9	0.83	19	0.94	8	0.97
Home equity	238	21.45	236	23.04	178	21.95	202	19.24	157	16.98
Commercial	119	3.58	104	3.43	65	2.45	42	2.08	27	1.70
Total allowance	\$ 1,025	100.00 %	\$ 926	100.00 %	\$ 921	100.00 %	\$ 874	100.00 %	\$ 742	100.00 %

Securities Portfolio

Our investment policy is designed to manage cash flows and foster earnings within prudent interest rate risk and credit risk guidelines. The portfolio mix is governed by our short term and long term liquidity needs. Rate-of-return, cash flow, rating and guarantor-backing are also considered when making investment decisions. The purchase of principal only and stripped coupon interest only security instruments is specifically not authorized by our investment policy. Furthermore, other than government related securities which may not be rated, we only purchase securities with a rating of AAA or AA. We invest primarily in mortgage-backed securities, U.S. government obligations and U.S. government agency issued securities.

Mortgage-backed securities represent a participation interest in a pool of mortgages issued by U.S. government agencies or government-sponsored entities, such as Federal Home Loan Mortgage Corporation (“Freddie Mac”), the Government National Mortgage Association (“Ginnie Mae”), and the Federal National Mortgage Association (“Fannie Mae”), as well as non-government, private corporate issuers. Mortgage-backed securities are pass-through securities and 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 issued or sponsored by U.S. government agencies and government-sponsored entities are guaranteed as to the payment of principal and interest to investors. Private corporate issuers’ mortgage-backed securities typically offer rates above those paid on government agency issued or sponsored securities, but lack the guaranty of those agencies.

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 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.”

At the present time, nearly our entire securities portfolio is purchased with the intent to hold the security until maturity. At June 30, 2008, we maintained a small trading account totaling \$82,000 and the rest of our securities portfolio was classified as held to maturity. Securities not classified as “held to maturity” or as “trading securities” are classified as “available for sale” and are reported at fair value with unrealized gains and losses on the securities impacting equity.

Individual securities are considered impaired when fair value is less than amortized cost. Management evaluates on a quarterly basis whether any securities are other-than-temporarily impaired. In making this determination, we consider the extent and duration of the impairment, the nature and financial health of the issuer, other factors relevant to specific securities, and our ability and intent to hold securities for a period of time sufficient to allow for any anticipated recovery in market value. If a security is determined to be other-than-temporarily impaired, an impairment loss is charged to operations.

At June 30, 2008, our securities portfolio did not contain securities of any issuer, other than the U.S. government or its agencies, having an aggregate book value in excess of 10% of our 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.

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The following table sets forth certain information regarding the carrying values, weighted average yields and maturities of our held to maturity securities portfolio at June 30, 2008. This table shows contractual maturities and does not reflect repricing or the effect of prepayments. 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.

	At June 30, 2008											
	One Year or Less		One to Five Years		Five to Ten Years		More than Ten Years		Total Investment Securities			
	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Market Value	
	(Dollars in thousands)											
U.S. Government Agency Obligations	\$ -	- %	\$ -	- %	\$ 2,000	5.00 %	\$ 22,023	5.37 %	\$ 24,023	5.34 %	\$ 23,440	
<u>Mortgage-Backed Securities:</u>												
Government National Mortgage Association	-	-	-	-	-	-	41	5.77	41	5.77	43	
Federal Home Loan Mortgage Corporation	-	-	-	-	128	6.52	524	6.08	652	6.16	660	
Federal National Mortgage Association	-	-	861	6.13	987	4.82	2,179	6.02	4,027	5.75	4,052	
Total	\$ -	- %	\$ 861	6.13 %	\$ 3,115	5.01 %	\$ 24,767	5.44 %	\$ 28,743	5.42 %	\$ 28,195	

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The following table sets forth the carrying value of our held to maturity securities portfolio at the dates indicated. Securities classified as held to maturity are shown at our amortized cost.

	At June 30		
	2008	2007	2006
	(In thousands)		
U.S. Government Agency Obligations	\$ 24,023	\$ 24,120	\$ 24,127
Government National Mortgage Association	41	55	69
Federal Home Loan Mortgage Corporation	652	758	923
Federal National Mortgage Association	4,027	4,403	2,588
Total securities held to maturity	\$ 28,743	\$ 29,336	\$ 27,707

Sources of Funds

General. Deposits are our major source of funds for lending and other investment purposes. To the extent that our loan originations have exceeded the funding available from deposits, we have borrowed funds from the Federal Home Loan Bank to supplement the amount of funds for lending and funding daily operations.

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 (IRA's). 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. Our savings account menu includes regular passbook, statement, money market and club accounts. We also offer a six-level tiered savings account. Our certificates of deposit currently range in terms from 6 months to 10 years. Our IRA's are available with the same maturities as certificates of deposit accounts, with the exception of the 30 month term. We offer a two year certificate of deposit that permits the depositor to increase the interest rate to the current two year rate once during the term.

Deposits are obtained primarily from within New Jersey. The Bank utilizes brokered deposits as a funding source. Brokered deposits at June 30, 2008 totaled \$720,000. Premiums or incentives for opening accounts are sometimes offered. We periodically select particular certificate of deposit maturities for promotion in connection with asset/liability management and interest rate risk concerns.

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.

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A large percentage of our deposits are in certificates of deposit. 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 tables set forth the distribution of average deposits for the periods indicated and the weighted average nominal interest rates for each period on each category of deposits presented.

	For the Year Ended June 30, 2008				2007				2006			
	Average Balance	Percent of Total Deposits	Weighted Average Nominal Rate		Average Balance	Percent of Total Deposits	Weighted Average Nominal Rate		Average Balance	Percent of Total Deposits	Weighted Average Nominal Rate	
	(Dollars in thousands)											
Non-interest-bearing demand	\$8,540	3.95 %	0.00 %		\$9,804	4.75 %	0.00 %		\$8,294	4.21 %	0.00 %	
Interest-bearing demand	26,906	12.46	0.90		29,056	14.07	0.96		34,117	17.32	0.96	
Savings and club	51,048	23.63	2.48		48,248	23.37	1.86		44,839	22.76	1.27	
Certificates of deposit	129,506	59.96	4.76		119,364	57.81	4.65		109,755	55.71	3.73	
Total deposits	\$216,000	100.00 %	3.55 %		\$206,472	100.00 %	3.26 %		\$197,005	100.00 %	2.53 %	

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The following table sets forth certificates of deposit classified by interest rate as of the dates indicated.

	At June 30, 2008		2007		2006	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
(Dollars in thousands)						
<u>Interest Rate:</u>						
1.00% - 1.99%	\$ 1	- %	\$ 7	0.01 %	\$ 8	0.01 %
2.00% - 2.99%	22,434	18.46	1	-	2,375	2.12
3.00% - 3.99%	13,639	11.22	4,997	3.89	28,049	25.04
4.00% - 4.99%	44,128	36.32	47,472	36.98	68,182	60.86
5.00% - 5.99%	41,307	34.00	75,857	59.08	13,400	11.96
6.00% - 6.99%	-	0.00	48	0.04	14	0.01
Total	\$ 121,509	100.00 %	\$ 128,382	100.00 %	\$ 112,028	100.00 %

The following table sets forth the amount and maturities of certificates of deposit at the Bank at June 30, 2008.

	Amount Due Year Ending June 30,					After June 30, 2013
	2009	2010	2011	2012	2013	
(In thousands)						
<u>Interest Rate:</u>						
1.00% - 1.99%	\$ 1	\$ -	\$ -	\$ -	\$ -	\$ -
2.00% - 2.99%	20,202	2,059	168	5	-	-
3.00% - 3.99%	9,035	3,852	413	11	230	98
4.00% - 4.99%	35,472	3,960	1,694	144	1,672	1,186
5.00% - 5.99%	31,996	-	-	1,835	1,386	6,090
6.00% - 6.99%	-	-	-	-	-	-
Total	\$ 96,706	\$ 9,871	\$ 2,275	\$ 1,995	\$ 3,288	\$ 7,374

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The following table shows the amount of the Bank's certificates of deposit of \$100,000 or more by time remaining until maturity as of June 30, 2008.

	Certificates of Deposit (In thousands)
<u>Remaining Time Until Maturity:</u>	
Within three months	\$ 15,963
Three through six months	10,768