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HARLEYSVILLE SAVINGS FINANCIAL CORP
Form 10-K
December 21, 2006

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
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: September 30, 2006

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 Number: 0-29709

HARLEYSVILLE SAVINGS FINANCIAL CORPORATION

(Exact name of Registrant as specified in its charter)

Pennsylvania

23-3028464

(State or Other Jurisdiction of
Incorporation or Organization)

(I.R.S. Employer
Identification Number)

271 Main Street, Harleysville, Pennsylvania

19438

(Address of Principal Executive Offices)

(Zip Code)

Registrant's telephone number, including area code: (215) 256-8828

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

Title of each class	Name of each exchange on which registered
Common Stock, \$.01 par value per share	Nasdaq Global Market

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 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 the 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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES NO

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

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The aggregate market value of the 3,404,325 shares of the Registrant's Common Stock held by non-affiliates (3,864,665 shares outstanding less 460,340 shares held by affiliates), based upon the closing price of \$17.45 for the Common Stock on March 31, 2006, as reported by the Nasdaq Stock Market, was approximately \$59.4 million. Shares of Common Stock held by each executive officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded since such persons may be deemed affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

Number of shares of Common Stock outstanding as of December 19, 2006: 3,859,958

DOCUMENTS INCORPORATED BY REFERENCE

Set forth below are the documents incorporated by reference and the part of the Form 10-K into which the document is incorporated:

- (1) Portions of the Annual Report to Stockholders for the year ended September 30, 2006 are incorporated by reference into Part II, Items 5-8 and Part IV, Item 15 of this Form 10-K.
- (2) Portions of the definitive Proxy Statement for the 2007 Annual Meeting of Stockholders are incorporated by reference into Part III, Items 10-14 of this Form 10-K.

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HARLEYSVILLE SAVINGS FINANCIAL CORPORATION 2006 ANNUAL REPORT ON FORM 10-K

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Forward-Looking Statements

This Annual Report on Form 10-K contains certain forward looking statements (as defined in the Securities Exchange Act of 1934 and the regulations hereunder). Forward looking statements are not historical facts but instead represent only the beliefs, expectations or opinions of Harleysville Savings Financial Corporation and its management regarding future events, many of which, by their nature, are inherently uncertain. Forward looking statements may be identified by the use of such words as: "believe", "expect", "anticipate", "intend", "plan", "estimate", or words of similar meaning, or future or conditional terms such as "will", "would", "should", "could", "may", "likely", "probably", or "possibly." Forward looking statements include, but are not limited to, financial projections and estimates and their underlying assumptions; statements regarding plans, objectives and expectations with respect to future operations, products and services; and statements regarding future performance. Such statements are subject to certain risks, uncertainties and assumption, many of which are difficult to predict and generally are beyond the control of Harleysville Savings Financial Corporation and its management, that could cause actual results to differ materially from those expressed in, or implied or projected by, forward looking statements. The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward looking statements: (1) economic and competitive conditions which could affect the volume of loan originations, deposit flows and real estate values; (2) the levels of non-interest income and expense and the amount of loan losses; (3) competitive pressure among depository institutions increasing significantly; (4)

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changes in the interest rate environment causing reduced interest margins; (5) general economic conditions, either nationally or in the markets in which Harleysville Savings Financial Corporation is or will be doing business, being less favorable than expected; (6) political and social unrest, including acts of war or terrorism; or (7) legislation or changes in regulatory requirements adversely affecting the business in which Harleysville Savings Financial Corporation will be engaged. Harleysville Savings Financial Corporation undertakes no obligation to update these forward looking statements to reflect events or circumstances that occur after the date on which such statements were made.

As used in this report, unless the context otherwise requires, the terms "we," "us," or the "Company" refer to Harleysville Savings Financial Corporation, a Pennsylvania corporation, and the term the "Bank" refers to Harleysville Savings Bank, a Pennsylvania chartered savings bank and wholly owned subsidiary of the Company. In addition, unless the context otherwise requires, references to the operations of the Company include the operations of the Bank.

PART I

Item 1. Business.

General

Harleysville Savings Financial Corporation is a Pennsylvania corporation headquartered in Harleysville, Pennsylvania. The Company became the bank holding company for Harleysville Savings Bank in connection with the holding company reorganization of the Bank in February 2000 (the "Reorganization"). In August 1987, the Bank's predecessor, Harleysville Savings Association, converted to the stock form of organization. The Bank, whose predecessor was originally incorporated in 1915, converted from a Pennsylvania chartered, permanent reserve fund savings association to a Pennsylvania chartered stock savings bank in June 1991. The Bank operates from six full-service offices located in Montgomery County, Pennsylvania. The Bank's primary market area includes Montgomery County, which has the third largest population and the second highest per capita income in the Commonwealth of Pennsylvania, and, to a lesser extent, Bucks County. As of September 30, 2006, the Company had \$775.6 million of total assets, \$429.3

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million of deposits and \$48.5 million of stockholders' equity. The Company's stockholders' equity constituted 6.25% of total assets as of September 30, 2006.

The Bank's primary business consists of attracting deposits from the general public through a variety of deposit programs and investing such deposits principally in first mortgage loans secured by residential properties in the Bank's primary market area. The Bank also originates a variety of consumer loans, predominately home equity loans and lines of credit also secured by residential properties in the Bank's primary lending area. The Bank serves its customers through its full-service branch network as well as through remote ATM locations, the internet and telephone banking.

Deposits with the Bank are insured to the maximum extent provided by law through the Savings Association Insurance Fund ("SAIF") administered by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is subject to examination and comprehensive regulation by the FDIC and the Pennsylvania Department of Banking ("Department"). It is also a member of the Federal Home Loan Bank of Pittsburgh ("FHLB of Pittsburgh" or "FHLB"), which is one of the 12

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regional banks comprising the Federal Home Loan Bank System ("FHLB System"). The Bank is also subject to regulations of the Board of Governors of the Federal Reserve System ("Federal Reserve Board") governing reserves required to be maintained against deposits and certain other matters.

The Company's principal executive offices are located at 271 Main Street, Harleysville, Pennsylvania 19438 and its telephone number is (800) 243-8700.

Competition

The Company faces significant competition in attracting deposits. Its most direct competition for deposits has historically come from commercial banks and other savings institutions located in its market area. The Company faces additional significant competition for investors' funds from other financial intermediaries. The Company competes for deposits principally by offering depositors a variety of deposit programs, convenient branch locations, hours and other services. The Company does not rely upon any individual group or entity for a material portion of its deposits.

The Company's competition for real estate loans comes principally from mortgage banking companies, other savings institutions, commercial banks and credit unions. The Bank competes for loan originations primarily through the interest rates and loan fees it charges, the efficiency and quality of services it provides borrowers, referrals from real estate brokers and builders, and the variety of its products. Factors which affect competition include the general and local economic conditions, current interest rate levels and volatility in the mortgage markets.

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") eliminated many of the distinctions between commercial banks and savings institutions and holding companies and allowed bank holding companies to acquire savings institutions. FIRREA has generally resulted in an increase in the competition encountered by savings institutions and has resulted in a decrease in both the number of savings institutions and the aggregate size of the savings industry.

Lending Activities

Loan Portfolio Composition. The Company's loan portfolio is predominantly comprised of loans secured by first mortgages on single-family residential properties. As of September 30, 2006, first mortgage loans on residential properties, including loans on single-family and multi-family residential properties and construction loans on such properties, amounted to \$97.8 million or 16.0% of the Company's total loan and

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mortgage-backed securities portfolio. Loans on the Company's residential properties are primarily long-term and are conventional (i.e., not insured or guaranteed by a federal agency). At September 30, 2006, mortgage-backed securities totaled \$220.3 million and comprised 35.9% of the portfolio.

As of September 30, 2006, loans secured by commercial real estate comprised \$5.9 million or 1.0% of the total loan and mortgage-backed securities portfolio. Consumer loans, including installment home equity loans, home equity lines of credit, automobile loans, loans on savings accounts and education loans, constituted \$97.8 million or 16.0% of the total loan and mortgage-backed securities portfolio as of September 30, 2006.

As of September 30, 2006, the Company had \$220.3 million, or 35.9%, of

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the total portfolio invested in Federal Home Loan Mortgage Corporation ("FHLMC"), Government National Mortgage Association ("GNMA") or Federal National Mortgage Association ("FNMA") backed securities. FHLMC securities are guaranteed by the FHLMC, GNMA securities by the Federal Housing Administration and FNMA securities by the FNMA, which are an instrumentality of the United States government, and, pursuant to federal regulations, are deemed to be part of the Company's loan portfolio.

The following table sets forth information concerning the Company's loan and mortgage-backed securities portfolio by type of loan at the dates indicated.

	As of September 30,						
	2006		2005		2004		Amount
	Amount	Percent	Amount	Percent	Amount	Percent	Amount
	(Dollars in Thousands)						
Residential:							
Single-family	\$278,621	45.4%	\$267,246	41.8%	\$255,023	41.7%	\$234,7
Multi-family	2,933	0.5	2,893	0.5	914	0.2	1,5
Construction	6,987	1.1	7,640	1.2	7,971	1.3	10,0
Lot loans	626	0.1	801	0.1	576	0.1	9
Mortgage-backed securities	220,314	35.9	265,009	41.5	265,087	43.2	230,2
Commercial	5,894	1.0	2,002	0.3	2,141	0.4	1,0
Total real estate loans and mortgage-backed securities	515,375	84.0	545,591	85.4%	531,712	86.9%	478,4
Consumer loans:							
Education loans	--	--	--	--	--	--	
Installment equity loans	70,515	11.5	59,724	9.4%	46,257	7.6%	29,7
Line of credit loans	25,500	4.3	31,580	5.0	32,329	5.3	29,4
Savings account loans	1,003	0.2	921	0.1	811	0.1	7
Automobile and other loans	812	0.1	772	0.1	732	0.1	5
Total consumer loans	97,830	16.0%	92,997	14.6%	80,129	13.1%	60,4
Total loans receivable and mortgage-backed securities	613,205	100.0%	638,588	100.0%	611,841	100.0%	538,9
Less:							
Loans in process	(4,941)		(4,934)		(5,238)		(7,8
Deferred loan fees	(544)		(671)		(955)		(1,5
Allowance for loan losses	(1,956)		(1,968)		(1,977)		(1,9
Total loans receivable and mortgage-backed securities, net	\$605,764		\$631,015		\$603,671		\$527,5

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Contractual Maturities. The following table sets forth scheduled contractual maturities of the loan and mortgage-backed securities portfolio of the Company as of September 30, 2006 by categories of loans and securities. The principal balance of the loan is set forth in the period in which it is scheduled to mature. This table does not reflect loans in process or unamortized premiums, discounts and fees.

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Principal Balance at September 30, 2006	Principal Repayments Contractually Due in Y			
	2007	2008	2009- 2011	201
(In Thousands)				
Real estate loans:				
Residential				
Single-family	\$ 278,621	\$ 4,179	\$ 4,458	\$ 15,046
Multi-family	2,933	44	47	158
Construction	6,987	105	112	377
Lot loans	626	34	37	126
Mortgage-backed Securities	220,314	3,305	3,745	12,338
Commercial	5,894	212	230	807
Consumer and other loans	97,830	12,033	12,914	44,782
Total(1)	\$ 613,205	\$ 19,912	\$ 21,542	\$ 73,634
	=====	=====	=====	=====

(1) With respect to the \$593.3 million of loans with principal maturities contractually due after September 30, 2006, \$573.0 million have fixed rates of interest and \$20.3 million have adjustable or floating rates of interest.

Contractual principal maturities of loans do not necessarily reflect the actual term of the Company's loan portfolio. The average life of mortgage loans is substantially less than their contractual terms because of loan prepayments and because of enforcement of due-on-sale clauses, which give the Company the right to declare a loan immediately due and payable in the event, among other things, that the borrower sells the real property subject to the mortgage and the loan is not repaid. The average life of mortgage loans tends to increase when current mortgage loan rates substantially exceed rates on existing mortgage loans and, conversely, decrease when rates on existing mortgage loans substantially exceed current mortgage loan rates.

Interest rates charged by the Company on loans are affected principally by the demand for such loans and the supply of funds available for lending purposes. These factors are, in turn, affected by general economic conditions, monetary policies of the federal government, including the Federal Reserve Board, legislative tax policies and government budgetary matters. The interest rates charged by the Company are competitive with those of other local financial institutions.

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Origination, Purchase and Sale of Loans. Although the Company has general authority to originate, purchase and sell loans secured by real estate located throughout the United States, the Company's lending activities are focused in its assessment area of Montgomery County, Pennsylvania and surrounding suburban counties.

The Company accepts loan applications through its branch network, and also accepts mortgage applications from mortgage brokers who are approved by the Board of Directors to do business with the Company. The Company generally does not engage in the purchase of whole loans or loan participations.

The Company sold \$921,000 and \$2.6 million of loans during fiscal 2005 and 2004, resulting in a gain of approximately \$17,000 and \$61,000, respectively. During the year ended September 30, 2006, the Company did not sell any loans.

The Company's total loan originations decreased by \$6.1 million or 5.4% in fiscal 2006 and decreased by \$24.2 million or 17.6% in fiscal 2005. Of the \$107.3 million and \$113.4 million of single-family loans originated in fiscal 2006 and 2005, respectively, \$7.4 million and \$8.7 million, respectively, were loans originated to fund multi-family and construction properties, \$54.2 million and \$60.6 million, respectively, were loans to acquire residential property. During this period, the Company's originations of consumer loans amounted to \$45.7 million and \$44.1 million or 42.6% and 38.9% of total loan originations during fiscal 2006

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and 2005, respectively. Management intends to continue to emphasize origination of consumer loans which may have adjustable rates, and generally have shorter terms than residential real estate loans.

The following table shows total loans originated, sold and repaid during the periods indicated.

	Year Ended September 30,		
	2006	2005	2004
	(In Thousands)		
Real estate loan originations:			
Residential:			
Single-family	\$ 54,249	\$ 60,608	\$ 69,124
Multi-family	493	1,300	300
Construction	6,886	7,433	9,526
Lot loans	--	--	--
	61,628	69,341	78,950
Total real estate loan originations			
Consumer loan originations(1)	45,688	44,057	58,655
	107,316	113,398	137,605
Total loan originations			
Purchases of mortgage-backed securities	2,001	62,027	121,201
	109,317	175,425	258,806
Total loan originations, and purchases			
Principal loan and mortgage-backed securities repayments	134,700	147,757	183,321
Sales of loans and mortgage-backed securities	--	921	2,578

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Total principal repayments and sales	134,700	148,678	185,899
Net (decrease) increase in loans	\$ (25,383)	\$ 26,747	\$ 72,907

(1) Includes installment home equity loans, home equity lines of credit, vehicle loans, Pennsylvania Higher Education Assistance loans, secured and unsecured personal loans and lines of credit.

Loan Underwriting Policies. Each loan application received by the Company is underwritten to the standards of the Company's written underwriting policies as adopted by the Company's Board of Directors. The Company's Board of Directors has granted loan approval authority to several officers and employees of the Company, provided that the loan meets the guidelines set out in its written underwriting policies. Individual approval authority of \$500,000 has been granted to the Company's Chief Executive Officer, the Company's President, and the Company's Chief Lending Officer. Joint approval authority of \$1.0 million has been granted to a combination of at least two of the above named individuals. Individual lending authority of \$250,000 has been granted to the Bank's Assistant Vice President/Loan Administration Manager, the Assistant Vice President/Loan Customer Service Manager and to the Bank's Consumer Loan and Residential Mortgage Underwriter, employed by the Company. Additional consumer loan lending authority of \$50,000 has been granted to several delegated underwriters, employed by the Bank. Loans with policy exceptions require approval by the next highest approval authority. Loans over \$1.0 million must be approved by the Company's Board of Directors.

In the exercise of any loan approval authority, the officers of the Company will take into account the risk associated with the extension of credit to a single borrower, borrowing entity, or affiliation. The Company has an aggregate loans to one borrower limit of 15% of the Company's unimpaired capital and unimpaired surplus in accordance with federal regulations. At September 30, 2006, the largest aggregate amount of loans outstanding to any borrower, including related entities, was \$2.0 million, which did not exceed the Company's loan to one borrower limitation.

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Real Estate Lending. The Company is permitted to lend up to 100% of the appraised value of the real property securing a loan. The Company will generally lend up to 95% of the lesser of the appraised value or the sale price for the purchase of single-family, owner-occupied dwellings which conform to the secondary market underwriting standards. Refinancings are limited to 90% or less. Loans over \$417,000 and other non-conforming loans, secured by 1-4 residential, owner-occupied dwellings, are limited to 90% of the lesser of the purchase price or appraised value. The purchase of non-owner occupied, 1-4 unit dwellings may be financed to 80% of the lower of the appraisal or sale price; a refinance is limited to 70% of the appraised value if the borrower's FICO score is less than 720 and the transaction's purpose is cash-out.

All appraisals and other property valuations are performed by independent fee appraisers approved by the Company's Senior Loan Committee. On all amortizing real estate loans, the Company requires borrowers to obtain title insurance, insuring the Company has a valid first lien on the mortgaged real estate. Borrowers must also obtain and maintain a hazard insurance policy prior to closing and, when the real estate is located in a flood hazard area designated by the Federal Emergency Management Agency, a flood insurance policy

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is required. Generally, borrowers advance funds on a monthly basis together with payment of principal and interest into a mortgage escrow account from which the Company makes disbursements for items such as real estate taxes and insurance premiums when appropriate as they fall due.

The Company presently originates fixed-rate loans on single-family residential properties pursuant to underwriting standards consistent with secondary market guidelines, and which may or may not be sold into the secondary mortgage market as conditions warrant. Adjustable rate mortgages ("ARMs"), as well as non-conforming and jumbo fixed-rate loans in amounts up to \$1.0 million, are held in the portfolio. It is the Company's policy to originate both fixed-rate loans and ARMs for terms up to 30 years. As of September 30, 2006, \$285.6 million or 46.6% and \$2.9 million or 0.5% of the Company's total loan and mortgage-backed securities portfolio consisted of single-family (including construction loans) and multi-family residential loans, respectively. As of September 30, 2006, approximately \$478.5 million or 92.8% of the Company's total mortgage loans and mortgage-backed securities portfolio consisted of fixed-rate, single-family residential mortgage loans. As of such date, \$36.9 million or 7.2% of the total mortgage loan portfolio consisted of adjustable-rate single-family residential mortgage loans and mortgage-backed securities. Most of the Company's residential mortgage loans include "due on sale" clauses.

During the years ended September 30, 2006 and 2005, the Company originated \$9.1 million and \$5.9 million of ARM mortgages, respectively. ARMs represented 20.0% and 9.7% of the Company's total mortgage loan portfolio originations in fiscal 2006 and 2005, respectively. The ARM mortgages offered by the Company are originated with initial adjustment periods varying from one to 10 years, and provide for initial rates of interest below the rates which would prevail were the index used for repricing applied initially. The Company expects to emphasize the origination of ARMs as market conditions permit, in order to reduce the impact of rising interest rates in the market place. Such loans, however, may not adjust as rapidly as changes in the Company's cost of funds.

The Company also originates, to a lesser extent, loans secured by multi-family rental units or properties with some commercial usage. The primary method used by the Company to evaluate a multi-family residential or commercial mortgage loan is based on both the fair market value of the property and an income approach pursuant to which the Company determines if the income from the project will be sufficient to support the related debt and other associated costs. The Company also considers a review of the costs to develop the project and the overall financial strength of the borrower. Multi-family residential loans are made on an adjustable rate basis for a maximum term of 25 years or a fixed rate of 10 years or less.

Construction Loans. The Company offers fixed-rate and adjustable-rate construction loans on residential properties. Residential construction loans are originated for individuals who are building their

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primary residence as well as to selected local builders for construction of single-family dwellings. As of September 30, 2006, \$6.9 million or 1.1% of the total loan and mortgage-backed securities portfolio consisted of construction loans.

Construction loans to homeowners are usually made in connection with the permanent financing on the property. The permanent loans have amortizing terms up to 30 years, following the initial construction phase during which time the borrower pays interest on the funds advanced. These loans are reclassified as permanent mortgage loans when the residences securing the loans are completed. The Company will make construction/permanent loans up to a maximum of

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90% of the fair market value of the completed project. The rate on the loan during construction is the same rate as the Company will charge on the permanent loan on the completed project. Advances are made on a percentage of completion basis with the Company's receipt of a satisfactory inspection report of the project.

Historically, the Company has been active in on-your-lot home construction lending and intends to continue to emphasize such lending. Although construction lending is generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate, the Company historically has not experienced any significant problems.

The Company also offers mortgage loans on undeveloped single lots held for residential construction. These loans are generally fixed-rate loans with terms not exceeding 15 years; they are not a significant part of the Company's lending activities.

Consumer and Other Loans. The Company actively originates consumer loans to provide a wider range of financial services to its customers and to improve the interest rate sensitivity of its interest-earning assets. Originations of consumer loans as a percent of total loan originations amounted to 42.6% and 38.9% during fiscal 2006 and 2005, respectively. The shorter-term and normally higher interest rates on such loans help the Company to maintain a profitable spread between its average loan yield and its cost of funds. The Company's consumer loan department offers a variety of loans, including home equity installment loans and lines of credit, vehicle loans, personal loans and lines of credit. Loans secured by deposit accounts at the Company are also made to depositors in an amount up to 90% of their account balances with terms of up to 15 years.

Home equity loans continue to be a popular product and represented \$96 million or 15.7% of the loan and mortgage-backed securities portfolio at September 30, 2006. After taking into account first mortgage balances, the Company will lend up to 80% of the value of owner-occupied property on fixed rate terms up to 15 years. This amount may be raised to 100% when considering other factors, such as excellent credit history and income stability. At September 30, 2006, the Company had outstanding 3,041 home equity loans of which 1,773 were installment equity loans and 1,268 were line of credit loans. As of such date, the Company had an outstanding balance on line of credit loans of approximately \$25.5 million and there was approximately \$40.8 million of unused credit available on such loans.

Consumer loans generally involve more risk of collectibility than mortgage loans because of the type and nature of the collateral and, in certain cases, the absence of collateral. As continued payments are dependent on the borrower's continuing financial stability, these loans may be more likely to be adversely affected by job loss, divorce, personal bankruptcy or by adverse economic conditions.

Loan Fee and Servicing Income. The Company receives fees both for the origination of loans and for making commitments to originate and purchase residential and commercial mortgage loans. The Company also receives servicing fees with respect to residential mortgage loans it has sold. It also receives loan fees related to existing loans, including late charges, and credit life insurance commissions. Loan origination and

commitment fees and discounts are a volatile source of income, varying with the volume and type of loans and commitments made and purchased and with competitive and economic conditions.

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Loans fees generated on origination of real estate mortgage loans under accounting principles generally accepted in the United States of America are deferred to the extent that they exceed the costs of originating such loans. Deferred loan fees and discounts on mortgage loans purchased are amortized to income as a yield adjustment over the estimated remaining terms of such loans using the interest method. The Company recorded servicing income of \$52,000, \$138,000 and \$459,000 in deferred loan fees in fiscal 2006, 2005 and 2004, respectively.

In its real estate lending, the Company charges loan fees which are calculated as a percentage of the amount borrowed. The fees received in connection with the origination of residential real estate loans and commercial real estate loans generally do not exceed 3% of the principal amount. All origination fees in excess of loan origination costs are deferred and amortized into income over the estimated life of the related loans.

As of September 30, 2006, the Company was servicing \$3.9 million of loans for others, which related to loans sold by the Company to the FHLMC and Federal Home Loan Bank of Pittsburgh in the amounts of \$270,000 and \$3.6 million, respectively. The Company receives a servicing fee of 0.25% on such loans.

Non-performing Loans and Real Estate Owned. When a borrower fails to make a required loan payment, the Company attempts to cure the default by contacting the borrower; generally, after a payment is more than 15 days past due, at which time a late charge is assessed. Defaults are cured promptly in most cases. If the delinquency on a mortgage loan exceeds 60 days and is not cured through the Company's normal collection procedures, or an acceptable arrangement is not worked out with the borrower, the Company will institute measures to remedy the default. This may include commencing a foreclosure action or, in special circumstances, accepting from the borrower a voluntary deed of the secured property in lieu of foreclosure with respect to mortgage loans and equity loans, or title and possession of collateral in the case of other consumer loans. Substantial delays may occur in instituting and completing residential foreclosure proceedings due to the extensive procedures and time periods required to be complied with under Pennsylvania law.

All interest accrued but not collected for loans that are placed nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Interest income is recognized using the interest method when the collection is reasonably assured. The Company had no loans outstanding which were recorded as loans accounted for on a non-accrual basis as of the end of fiscal 2006 and 2005.

If foreclosure is effected, the property is sold at a public auction in which the Company may participate as a bidder. If the Company is the successful bidder, the acquired real estate property is then included in the Company's real estate owned ("REO") account until it is sold. When property is acquired, it is recorded at the lower of cost or market value at the date of acquisition less estimated cost to sell and any write-down resulting is charged to the allowance for loan losses. Interest accrual, if any, ceases on the date of acquisition and all costs incurred in maintaining the property from that date forward are expensed. Costs incurred for the improvement or development of such property are capitalized. The Company is permitted under Department regulations to finance sales of real estate owned by "loans to facilitate," which may involve more favorable interest rates and terms than generally would be granted under the Company's underwriting guidelines. The Company had no REO at the end of fiscal 2006 and 2005.

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The following table sets forth information regarding non-accrual loans, loans which are 90 days or more delinquent but on which the Company is accruing interest, troubled debt restructuring, and other real estate owned held by the Company at the dates indicated. The Company continues to accrue interest on loans which are 90 days or more overdue where management believes that such interest is collectible.

	As of September 30,		
	2006	2005	2004
	(Dollars in Thousands)		
Residential real estate loans:			
Non-accrual loans	\$ --	\$ --	\$ --
Accruing loans 90 days overdue	18	260	291
Troubled debt restructurings	--	--	--
Total	18	260	291
Consumer loans:			
Non-accrual loans	--	--	--
Accruing loans 90 days overdue	--	--	--
Troubled debt restructurings	--	--	--
Total	--	--	--
Total non-performing loans:			
Non-accrual loans	--	--	--
Accruing loans 90 days overdue	18	260	291
Troubled debt restructurings	--	--	--
Total	\$ 18	\$ 260	\$ 291
Total non-performing loans to total loans	.004%	.07%	.09%
Total real estate owned, net of related reserves	--	--	--
Total non-performing loans and other real estate owned to total assets	.002%	.03%	.04%

Management establishes reserves for losses on delinquent loans when it determines that losses are probable. The Company did not record a provision for general loan losses in fiscal 2006, 2005 or 2004 due to the overall performance of the loan portfolio and management's assessment of the overall adequacy of the allowance for loan losses. Although management believes that it uses the best information available to make determinations with respect to loan loss reserves, future adjustments to reserves may be necessary if economic conditions differ substantially from the assumptions used in making the initial determinations.

Residential mortgage lending generally entails a lower risk of default than other types of lending. Consumer loans and commercial real estate loans generally involve more risk of collectibility because of the type and nature of the collateral and, in certain cases, the absence of collateral. It is the Company's policy to establish specific reserves for losses on delinquent consumer loans and commercial loans when it determines that losses are probable. In addition, consumer loans are charged against reserves if they are more than 120 days delinquent unless a satisfactory repayment schedule is arranged. Although management has currently established no specific reserves for losses,

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no assurance can be given as to whether future provisions may be required. The establishment of any such reserves could affect net income.

The following table summarizes activity in the Company's allowance for loan losses during the periods indicated.

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	Year Ended September 30,			
	2006	2005	2004	2003
Allowances at beginning of year	\$ 1,967,607	\$ 1,976,849	\$ 1,990,672	\$ 2,000,000
Provision for loan losses charged to operating expenses	--	--	--	--
Recoveries	8,524	83,707	1,571	--
Loans charged off	(20,326)	(92,949)	(15,394)	(1,000,000)
Allowances at end of year	\$ 1,955,805	\$ 1,967,607	\$ 1,976,849	\$ 1,990,672
Ratio of net charge-offs to average loans outstanding	--	--	--	--
Ratio of allowances to period-end loans	.50%	.54%	.58%	.62%

Investment Activities

The Company is required to maintain certain liquidity ratios and does so by investing in securities that qualify as liquid assets under FDIC regulations. Such securities include obligations issued or fully guaranteed by the United States government, certain federal agency obligations, certain time deposits and certificates of deposit as well as other specified investments. See "Regulation - Federal Home Loan Bank System."

The Company's investment portfolio consists primarily of United States Treasury securities and obligations of United States government agencies. The other investments include interest-bearing deposits in other banks, tax-exempt obligations, money market mutual funds, and stock of the FHLB of Pittsburgh. The Company has primarily invested in instruments that reprice within five years; the amount of such investments as of September 30, 2006 was \$57.3 million.

The following table sets forth the Company's investment portfolio at carrying value as of the dates indicated.

	2006	2005	2004
Interest-bearing deposits at other depository institutions	\$ 8,453	\$ 6,742	\$ 3,040
Tax-exempt obligations	24,596	24,799	24,966
Money market mutual funds	7,110	1,976	6,685
Equities	997	859	1,029
U.S. Government and agency obligations held to maturity	86,503	62,566	43,196
FHLB of Pittsburgh stock	15,499	16,036	15,184
Total	\$143,158	\$112,978	\$ 94,100

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The Company's investment strategy is set and reviewed periodically by the entire Board of Directors.

Sources of Funds

General. Deposits are the primary source of the Company's funds for use in lending and for other general business purposes. In addition to deposits, the Company obtains funds from loan payments and prepayments, FHLB advances and other borrowings, and, to a lesser extent, sales of loans. Loan repayments are a relatively stable source of funds, while deposit inflows and outflows are significantly influenced by general market interest rates and economic conditions.

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Deposits. The Company has a number of different programs designed to attract both short-term and long-term deposits from the general public by providing an assortment of accounts and rates consistent with FDIC regulations. These programs include passbook and club savings accounts, NOW and regular checking accounts, money market deposit accounts, retirement accounts, certificates of deposit ranging in terms from 90 days to 60 months and jumbo certificates of deposit in denominations of \$98,000 or more. The interest rates on the Company's various accounts are determined weekly by the Interest Rate Risk Management Officer based on reports prepared by members of senior management. The Company attempts to control the flow of deposits by pricing its accounts to remain competitive with other financial institutions in its market area.

The Company's deposits are obtained primarily from residents of Montgomery and Bucks Counties; the Company does not utilize brokered deposits. The principal methods used by the Company to attract deposit accounts include local advertising, offering a wide variety of services and accounts, competitive interest rates and convenient office locations. The Company also is a member of the "STAR" ATM network.

The following table shows the distribution of, and certain other information relating to, the Company's deposits by type as of the dates indicated.

	As of September 30,					
	2006		2005		2004	
	Amount	Percent of Deposits	Amount	Percent of Deposits	Amount	Percent Deposits
	(Dollars in Thousands)					
Passbook and club accounts	\$ 3,325	0.8%	\$ 3,807	0.9%	\$ 4,047	1
NOW accounts	15,720	3.7	18,283	4.4	19,839	4
Checking accounts	30,749	7.2	18,721	4.5	11,767	2
Money market demand accounts	58,174	13.6	75,874	18.1	99,225	24
Certificates of deposit:						
6 month	5,019	1.2	8,126	1.9	8,650	2
9 month	25,508	5.9	10,630	2.5	3,031	0
12 month	22,747	5.3	10,110	2.4	16,471	4
15 month	45,565	10.6	17,063	4.1	4,554	1

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17 month	1,215	0.3	1,485	0.3	2,474	0
18 month	6,443	1.5	11,125	2.7	18,967	4
20 month	7,810	1.8	9,685	2.3	--	
24 month	4,796	1.1	7,740	1.8	12,297	3
27 month	4,112	1.0	4,966	1.2	12,326	3
36 month	24,892	5.8	29,302	7.0	35,024	8
48 month	71,565	16.7	82,402	19.7	60,392	14
60 month	32,321	7.5	38,431	9.2	38,901	9
Other	13,104	3.1	16,924	4.0	7,057	1
Retirement accounts:						
Money market deposit accounts	815	0.2	707	0.2	1,224	0
Certificates of deposit	55,374	12.9	53,599	12.8	48,985	12
	-----		-----	-----	-----	-----
Total deposits	\$429,254	100.00%	\$418,980	100.0%	\$405,231	100
	=====	=====	=====	=====	=====	=====

The large variety of deposit accounts offered by the Company has increased the Company's ability to retain deposits and has allowed it to be competitive in obtaining new funds, although the threat of disintermediation (the flow of funds away from savings institutions into direct investment vehicles such as government and corporate securities and non-deposit products) still exists. The new types of accounts; however, have been more costly than traditional accounts during periods of high interest rates. In addition, the Company has become more vulnerable to short-term fluctuations in deposit flows as customers have become more rate-conscious and willing to move funds into higher yielding accounts. The ability of the Company to

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attract and retain deposits and the Company's cost of funds have been, and will continue to be, significantly affected by money market conditions.

The following table presents certain information concerning the Company's deposit accounts as of September 30, 2006 and the scheduled quarterly maturities of its certificates of deposit.

	Amount	Percentage of Total Deposits	Weighted Average Nominal Rate
	-----	-----	-----
(Dollars in Thousands)			
Passbook and club accounts	\$ 3,325	0.8%	1.17%
NOW accounts	15,720	3.7	0.25
Checking accounts	30,749	7.2	1.63
Money market deposits accounts(1)	58,989	13.7	1.58
	-----	-----	-----
Total	\$ 108,783	25.3%	1.39%
	=====	=====	=====
Certificate accounts maturing by quarter:			
December 31, 2006	\$ 68,436	15.9%	3.62%
March 31, 2007	62,135	14.5	3.80
June 30, 2007	45,441	10.6	4.46
September 30, 2007	33,095	7.7	4.67
December 31, 2007	13,087	3.0	4.40

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March 31, 2008	15,442	3.6	3.85
June 30, 2008	14,616	3.4	3.73
September 30, 2008	28,199	6.6	3.99
December 31, 2008	16,760	3.9	3.95
March 31, 2009	7,969	1.9	3.92
June 30, 2009	5,496	1.3	3.88
September 30, 2009	2,265	0.5	3.77
Thereafter	7,530	1.8	4.05
	-----	-----	-----
Total certificate accounts(1)	320,471	74.7	4.00
	-----	-----	-----
Total deposits	\$ 429,254	100.0%	3.34%
	=====	=====	=====

(1) Includes retirement accounts.

Management of the Company expects, based on historical experience and its pricing policies, to retain a significant portion of the \$209.1 million of certificates of deposit which mature during the 12 months ending September 30, 2007.

The following table sets forth the net deposit flows of the Company during the periods indicated.

	Year Ended September 30,		
	2006	2005	2004
	-----	-----	-----
	(In Thousands)		
Increase (decrease) before interest credited	\$ (978)	\$ 5,112	\$ 1,770
Interest credited	11,252	8,637	7,474
	-----	-----	-----
Net deposit increase	\$ 10,274	\$ 13,749	\$ 24,544
	=====	=====	=====

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The following table presents by various interest rate categories the amounts of certificate accounts as of the dates indicated and the amounts of certificate accounts as of September 30, 2006 which mature during the periods indicated.

	Amounts at September 30, 2006 Maturing				
	As of September 30, 2006	One Year or Less	Two Years	Three Years	Thereafter
	-----	-----	-----	-----	-----
	(In Thousands)				
Certificate accounts:					
0.01% to 2.00%	\$ 385	\$ 199	\$ 86	\$ --	\$ 10
2.01% to 4.00%	155,992	81,492	46,564	25,259	2,67
4.01% to 6.00%	162,668	125,990	24,695	7,230	4,75

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6.01% to 8.00%		1,426	1,426	--	--	--
		-----	-----	-----	-----	-----
Total certificate accounts (1)	\$	320,471	\$ 209,107	\$ 71,345	\$ 32,489	\$ 7,53
		=====	=====	=====	=====	=====

(1) Includes retirement accounts.

The following table sets forth the maturity of certificate deposits in excess of \$100,000 as of September 30, 2006.

	Amount
	(In Thousands)
1 to 3 months	\$ 6,875
4 to 6 months	9,033
7 to 12 months	8,689
Thereafter	18,576

Total	\$43,173
	=====

Borrowings. The Bank obtains advances from the FHLB of Pittsburgh upon the security of its capital stock in the FHLB of Pittsburgh and a portion of its first mortgages. See "Regulation - Regulation of the Bank - Federal Home Loan Bank System." At September 30, 2006, the Bank had FHLB advances with maturities of one year or less totaling \$79.5 million at an interest rate of 4.92% and FHLB advances with maturities of 13 months to 10 years totaling \$215.1 million at interest-rates ranging from 3.80% to 5.38%. Such advances are made pursuant to several different credit programs, each of which has its own interest rate and range of maturities.

Depending on the program, limitations on the amount of advances are based on either a fixed percentage of assets or the FHLB of Pittsburgh's assessment of the Bank's creditworthiness. FHLB advances are generally available to meet seasonal and other withdrawals of deposit accounts, to purchase mortgage-backed securities, investment securities and to expand lending.

The following table sets forth certain information regarding the borrowings of the Company as of the dates indicated.

	September 30,			
	2006		2005	
	Balance	Weighted Average Rate	Balance	Weighted Average Rate
	-----	-----	-----	-----
	(Dollars in Thousands)			
Advances from FHLB of Pittsburgh	\$ 294,611	4.67%	\$ 297,268	4.38%
				\$ 265,9

The following table sets forth certain information concerning the

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short-term borrowings of the Company for the periods indicated.

	Year Ended September 30,		
	2006	2005	2004
	(Dollars in Thousands)		
Advances from FHLB of Pittsburgh:			
Average balance outstanding	\$29,278	\$29,355	\$20,267
Maximum amount outstanding at any month-end during the period	59,400	36,100	25,600
Weighted average interest rate during the period	4.89%	2.98%	1.38%

Employees

The Company had 67 full-time employees and 37 part-time employees as of September 30, 2006. None of these employees is represented by a collective bargaining agent, and the Company believes that it enjoys good relations with its personnel.

Regulation

The references to laws and regulations which are applicable to the Company and the Bank set forth below and elsewhere herein are brief summaries thereof which do not purport to be complete and are qualified in their entirety by reference to such laws and regulations.

Regulation of the Company

General. The Company is a registered bank holding company pursuant to the Bank Holding Company Act ("BHCA") and, as such, is subject to regulation and supervision by the Federal Reserve Board and the Department. The Company is required to file annually a report of its operations with, and will be subject to examination by, the Federal Reserve Board and the Department.

BHCA Activities and Other Limitations. The BHCA prohibits a bank holding company from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any bank, or increasing such ownership or control of any bank, without prior approval of the Federal Reserve Board. The BHCA also generally prohibits a bank holding company from acquiring any bank located outside of the state in which the existing bank subsidiaries of the bank holding company are located unless specifically authorized by applicable state law. No approval under the BHCA is required; however, for a bank holding company already lawfully owning or controlling 50% of the voting shares of a bank to acquire additional shares of such bank.

The BHCA also prohibits a bank holding company, with certain exceptions, from acquiring more than 5% of the voting shares of any company that is not a bank and from engaging in any business other than banking or managing or controlling banks. Under the BHCA, the Federal Reserve Board is authorized to approve the ownership of shares by a bank holding company in any company, the activities of which the Federal Reserve Board has determined to be so closely related to banking or to managing or controlling banks as to be a proper incident thereto. In making such determinations, the Federal Reserve Board is required to weigh the expected benefit to the public, such as greater convenience, increased competition or gains in efficiency, against the possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. The 1999 Act permits a bank holding company

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to elect to be considered a financial holding company ("FHC"). A bank holding company that makes an FHC election is permitted to engage in activities that are financial in nature or incidental to such financial activities. The 1999 Act lists certain activities that are considered financial in nature and permits the Federal Reserve Board to expand that list to include other activities that are complementary to the activities on the preapproved list. The preapproved activities include (1) securities underwriting, dealing and market making; (2) insurance underwriting; (3) merchant banking; and (4) insurance company portfolio investments. The Company has not made the FHC election.

The Federal Reserve Board has by regulation determined that certain activities are closely related to banking within the meaning of the BHCA. These activities include operating a mortgage company, finance company, credit card company, factoring company, trust company or savings association; performing certain data processing operations; providing limited securities brokerage services; acting as an investment or financial advisor; acting as an insurance agent for certain types of credit-related insurance; leasing personal property on a full-payout, non-operating basis; providing tax planning and preparation services; operating a collection agency; and providing certain courier services. The Federal Reserve Board also has determined that certain other activities, including real estate brokerage and syndication, land development, property management and underwriting of life insurance not related to credit transactions, are not closely related to banking and a proper incident thereto. However, under the 1999 Act certain of these activities are permissible for a bank holding company that becomes an FHC.

Limitations on Transactions with Affiliates. Transactions between savings banks and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a savings bank is any company or entity which controls, is controlled by or is under common control with the savings bank. In a holding company context, the parent holding company of a savings bank (such as the Company) and any companies which are controlled by such parent holding company are affiliates of the savings bank. Generally, Section 23A (i) limits the extent to which the savings bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of such bank's capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. Section 23B applies to "covered transactions" as well as certain other transactions and requires that all transactions be on terms substantially the same, or at least favorable, to the bank or subsidiary as those provided to a non-affiliate. The term "covered transaction" includes the making of loans to, purchase of assets from, issuance of a guarantee to an affiliate and similar transactions. Section 23B transactions also apply to the provision of services and the sale of assets by a savings bank to an affiliate.

In addition, Sections 22(h) and (g) of the Federal Reserve Act places restrictions on loans to executive officers, directors and principal stockholders. Under Section 22(h), loans to a director, an executive officer and to a greater than 10% stockholder of a savings bank, and certain affiliated interests of either, may not exceed, together with all other outstanding loans to such person and affiliated interests, the savings bank's loans to one borrower limit (generally equal to 15% of the bank's unimpaired capital and surplus). Section 22(h) also requires that loans to directors, executive officers and principal stockholders be made on terms substantially the same as offered in comparable transactions to other persons and also requires prior board approval for certain loans. In addition, the aggregate amount of extensions of credit by a savings bank to all insiders cannot exceed the bank's unimpaired capital and surplus. Furthermore, Section 22(g) places additional restrictions on loans to executive officers.

Capital Requirements. The Federal Reserve Board has adopted capital

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adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the BHCA. The Federal Reserve Board capital adequacy guidelines generally require bank holding companies to maintain total capital equal to 8% of total risk-adjusted assets,

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with at least one-half of that amount consisting of Tier I or core capital and up to one-half of that amount consisting of Tier II or supplementary capital. Tier I capital for bank holding companies generally consists of the sum of common stockholders' equity and perpetual preferred stock (subject in the case of the latter to limitations on the kind and amount of such stocks which may be included as Tier I capital), less goodwill and, with certain exceptions, intangibles. Tier II capital generally consists of hybrid capital instruments; perpetual preferred stock which is not eligible to be included as Tier I capital; term subordinated debt and intermediate-term preferred stock; and, subject to limitations, general allowances for loan losses. Assets are adjusted under the risk-based guidelines to take into account different risk characteristics, with the categories ranging from 0% (requiring no additional capital) for assets such as cash to 100% for the bulk of assets which are typically held by a bank holding company, including multi-family residential and commercial real estate loans, commercial business loans and consumer loans. Single-family residential first mortgage loans which are not past-due (90 days or more) or non-performing and which have been made in accordance with prudent underwriting standards are assigned a 50% level in the risk-weighting system, as are certain privately-issued mortgage-backed securities representing indirect ownership of such loans. Off-balance sheet items also are adjusted to take into account certain risk characteristics.

In addition to the risk-based capital requirements, the Federal Reserve Board requires bank holding companies to maintain a minimum leverage capital ratio of Tier I capital to total assets of 3.0%. Total assets for this purpose does not include goodwill and any other intangible assets and investments that the Federal Reserve Board determines should be deducted from Tier I capital. The Federal Reserve Board has announced that the 3.0% Tier I leverage capital ratio requirement is the minimum for the top-rated bank holding companies without any supervisory, financial or operational weaknesses or deficiencies or those which are not experiencing or anticipating significant growth. Other bank holding companies will be expected to maintain Tier I leverage capital ratios of at least 4.0% to 5.0% or more, depending on their overall condition.

Financial Support of Affiliated Institutions. Under Federal Reserve Board policy, the Company is expected to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances when it might not do so absent such policy. The Congress attempted to clarify the application of this "source-of-strength" doctrine by an amendment to Section 18 of the Federal Deposit Insurance Act ("FDIA") that was included in the Gramm-Leach-Bliley Act of 1999. The amendment describes the circumstances under which a Federal banking agency would be protected from a claim by an affiliate or a controlling shareholder of an insured depository institution seeking the return of assets of such an affiliate or controlling shareholder. Under the amended provision, a claim would not be permitted if (1) the insured depository institution was under a written Federal directive to raise capital, (2) the institution was undercapitalized, and (3) the subject Federal banking agency followed the procedures set forth in Section 5(g) of the BHCA.

Sarbanes-Oxley Act of 2002. On July 30, 2002, President George W. Bush signed into law the Sarbanes-Oxley Act of 2002, which generally establishes a comprehensive framework to modernize and reform the oversight of public company auditing, improve the quality and transparency of financial reporting by those

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companies and strengthen the independence of auditors. Among other things, the new legislation (i) created a public company accounting oversight board which is empowered to set auditing, quality control and ethics standards, to inspect registered public accounting firms, to conduct investigations and to take disciplinary actions, subject to SEC oversight and review; (ii) strengthened auditor independence from corporate management by, among other things, limiting the scope of consulting services that auditors can offer their public company audit clients; (iii) heightened the responsibility of public company directors and senior managers for the quality of the financial reporting and disclosure made by their companies; (iv) adopted a number of provisions to deter wrongdoing by corporate management; (v) imposed a number of new corporate disclosure requirements; (vi) adopted provisions which generally seek to limit and expose to public view possible conflicts of interest affecting securities analysts; and (vii) imposed a range of new criminal penalties

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for fraud and other wrongful acts, as well as extended the period during which certain types of lawsuits can be brought against a company or its insiders.

Regulation of the Bank

General. The Bank is subject to extensive regulation and examination by the Department and by the FDIC, which insures its deposits to the maximum extent permitted by law. The federal and state laws and regulations which are applicable to banks regulate, among other things, the scope of their business, their investments, their reserves against deposits, the timing of the availability of deposited funds and the nature and amount of collateral for certain loans. There are periodic examinations by the Department and the FDIC to test the Bank's compliance with various regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulation, whether by the Department, the FDIC or the Congress could have a material adverse impact on the Bank and their operations.

Pennsylvania Savings Bank Law. The Pennsylvania Banking Code of 1965, as amended (the "Banking Code") contains detailed provisions governing the organization, location of offices, rights and responsibilities of directors, officers, employees and members, as well as corporate powers, savings and investment operations and other aspects of the Bank and its affairs. The Banking Code delegates extensive rulemaking power and administrative discretion to the Department so that the supervision and regulation of state-chartered savings banks may be flexible and readily responsive to changes in economic conditions and in savings and lending practices.

One of the purposes of the Banking Code is to provide savings banks with the opportunity to be competitive with each other and with other financial institutions existing under other Pennsylvania laws and other state, federal and foreign laws. A Pennsylvania savings bank may locate or change the location of its principal place of business and establish an office anywhere in Pennsylvania, with the prior approval of the Department.

The Department generally examines each savings bank not less frequently than once every two years. Although the Department may accept the examinations and reports of the FDIC in lieu of the Department's examination, the present practice is for the Department to conduct individual examinations. The

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Department may order any savings bank to discontinue any violation of law or unsafe or unsound business practice and may direct any trustee, officer, attorney or employee of a savings bank engaged in an objectionable activity, after the Department has ordered the activity to be terminated, to show cause at a hearing before the Department why such person should not be removed.

Interstate Acquisitions. The Interstate Banking Act allows federal regulators to approve mergers between adequately capitalized banks from different states regardless of whether the transaction is prohibited under any state law, unless one of the banks' home states has enacted a law expressly prohibiting out-of-state mergers before June 1997. This act also allows a state to permit out-of-state banks to establish and operate new branches in this state. The Commonwealth of Pennsylvania has "opted in" to this interstate merger provision. Therefore, the prior requirement that interstate acquisitions would only be permitted when another state had "reciprocal" legislation that allowed acquisitions by Pennsylvania-based bank holding companies has been eliminated. The new Pennsylvania legislation, however, retained the requirement that an acquisition of a Pennsylvania institution by a Pennsylvania or a non-Pennsylvania-based holding company must be approved by the Banking Department.

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FDIC Insurance Premiums. The deposits of the Bank are insured by the Deposit Insurance Fund, which is administered by the FDIC. Under current FDIC regulations, insured institutions are assigned to one of three capital groups which are based solely on the level of an institution's capital. Deposit Insurance Fund assessment rates are then tied to the level of an institution's supervisory concern based on risk classifications derived from the capital groups. Rates during the last six months of 2006 ranged from zero for well capitalized, healthy institutions, such as the Bank, to 27 basis points for undercapitalized institutions with substantial supervisory concerns.

In addition, all institutions with deposits insured by the FDIC are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation, a mixed-ownership government corporation established to recapitalize a predecessor to the Deposit Insurance Fund. The assessment rate for the third quarter of 2006 was .00315% of insured deposits and is adjusted quarterly. These assessments will continue until the Financing Corporation bonds mature in 2019.

Under the FDIA, insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged or is engaging in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or written agreement entered into with the FDIC. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance. At September 30, 2006, the Bank's regulatory capital exceeded all of its capital requirements.

Deposit Insurance Reform. On February 8, 2006, President George W. Bush signed into law legislation that merged the Bank Insurance Fund and the Savings Association Insurance Fund to form the Deposit Insurance Fund, eliminated any disparities in bank and thrift risk-based premium assessments, reduced the administrative burden of maintaining and operating two separate funds and established certain new insurance coverage limits and a mechanism for possible periodic increases. The legislation also gave the Federal Deposit Insurance Corporation greater discretion to identify the relative risks all institutions present to the Deposit Insurance Fund and set risk-based premiums.

Major provisions in the legislation include:

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- o merging the Savings Association Insurance Fund and Bank Insurance Fund, which became effective March 31, 2006;
- o maintaining basic deposit and municipal account insurance coverage at \$100,000 but providing for a new basic insurance coverage for retirement accounts of \$250,000. Insurance coverage for basic deposit and retirement accounts could be increased for inflation every five years in \$10,000 increments beginning in 2011;
- o providing the Federal Deposit Insurance Corporation with the ability to set the designated reserve ratio within a range of between 1.15% and 1.50%, rather than maintaining 1.25% at all times regardless of prevailing economic conditions;
- o providing a one-time assessment credit of \$4.7 billion to banks and savings associations in existence on December 31, 1996, which may be used to offset future premiums with certain limitations; and
- o requiring the payment of dividends of 100% of the amount that the insurance fund exceeds 1.5% of the estimated insured deposits and the payment of 50% of the amount that the insurance fund exceeds 1.35% of the estimated insured deposits (when the reserve is greater than 1.35% but no more than 1.5%).

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Capital Requirements. The FDIC has promulgated regulations and adopted a statement of policy regarding the capital adequacy of state-chartered banks which, like the Bank, are not members of the Federal Reserve System. The FDIC's capital regulations establish a minimum 3.0% Tier I leverage capital requirement for the most highly-rated state-chartered, non-member banks, with an additional cushion of at least 100 to 200 basis points for all other state-chartered, non-member banks, which effectively will increase the minimum Tier I leverage ratio for such other banks to 4.0% to 5.0% or more. Under the FDIC's regulation, highest-rated banks are those that the FDIC determines are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, which are considered a strong banking organization, rated composite 1 under the Uniform Financial Institutions Rating System. Leverage or core capital is defined as the sum of common stockholders' equity (including retained earnings), noncumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries, minus all intangible assets other than certain qualifying supervisory goodwill, and certain purchased mortgage servicing rights and purchased credit and relationships.

The FDIC also requires that savings banks meet a risk-based capital standard. The risk-based capital standard for savings banks requires the maintenance of total capital which is defined as Tier I capital and supplementary (Tier 2 capital) to risk weighted assets of 8%. In determining the amount of risk-weighted assets, all assets, plus certain off balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on the risks the FDIC believes are inherent in the type of asset or item.

The components of Tier I capital are equivalent to those discussed above under the 3% leverage standard. The components of supplementary (Tier 2) capital include certain perpetual preferred stock, certain mandatory convertible

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securities, certain subordinated debt and intermediate preferred stock and general allowances for loan losses. Allowance for loan losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of capital counted toward supplementary capital cannot exceed 100% of core capital. At September 30, 2006, the Bank met each of its capital requirements.

A bank which has less than the minimum leverage capital requirement shall, within 60 days of the date as of which it fails to comply with such requirement, submit to its FDIC regional director for review and approval a reasonable plan describing the means and timing by which the bank shall achieve its minimum leverage capital requirement. A bank which fails to file such plan with the FDIC is deemed to be operating in an unsafe and unsound manner, and could subject the bank to a cease-and-desist order from the FDIC. The FDIC's regulation also provides that any insured depository institution with a ratio of Tier I capital to total assets that is less than 2.0% is deemed to be operating in an unsafe or unsound condition pursuant to Section 8(a) of the FDIA and is subject to potential termination of deposit insurance. However, such an institution will not be subject to an enforcement proceeding thereunder solely on account of its capital ratios if it has entered into and is in compliance with a written agreement with the FDIC to increase its Tier I leverage capital ratio to such level as the FDIC deems appropriate and to take such other action as may be necessary for the institution to be operated in a safe and sound manner. The FDIC capital regulation also provides, among other things, for the issuance by the FDIC or its designee(s) of a capital directive, which is a final order issued to a bank that fails to maintain minimum capital to restore its capital to the minimum leverage capital requirement within a specified time period. Such directive is enforceable in the same manner as a final cease-and-desist order.

The Bank is also subject to more stringent Department capital guidelines. Although not adopted in regulation form, the Department utilizes capital standards requiring a minimum of 6% leverage capital and 10% risk-based capital. The components of leverage and risk-based capital are substantially the same as those defined by the FDIC.

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Loans-to-One Borrower Limitation. Under federal regulations, with certain limited exceptions, a Pennsylvania chartered savings bank may lend to a single or related group of borrowers on an "unsecured" basis an amount equal to 15% of its unimpaired capital and surplus. An additional amount may be lent, equal to 10% of unimpaired capital and surplus, if such loan is secured by readily-marketable collateral, which is defined to include certain securities and bullion, but generally does not include real estate.

Activities and Investments of Insured State-Chartered Banks. Section 24 of the FDIA, as amended by the Federal Deposit Insurance Corporation Improvement Act of 1991, generally limits the activities and equity investments of FDIC-insured, state-chartered banks to those that are permissible for national banks. Under regulations dealing with equity investments, an insured state bank generally may not directly or indirectly acquire or retain any equity investment of a type, or in an amount, that is not permissible for a national bank. An insured state bank is not prohibited from, among other things, (i) acquiring or retaining a majority interest in a subsidiary, (ii) investing as a limited partner in a partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank's total assets, (iii) acquiring up to 10% of the voting stock of a company that solely provides or reinsures directors', trustees' and officers' liability insurance coverage or bankers' blanket bond group insurance

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coverage for insured depository institutions, and (iv) acquiring or retaining the voting shares of a depository institution if certain requirements are met.

The FDIC has adopted final regulations pertaining to the other activity restrictions imposed upon insured savings banks and their subsidiaries by Section 24. Pursuant to such regulations, insured savings banks engaging in impermissible activities may seek approval from the FDIC to continue such activities. Savings banks not engaging in such activities but that desire to engage in otherwise impermissible activities may apply for approval from the FDIC to do so; however, if such bank fails to meet the minimum capital requirements or the activities present a significant risk to the FDIC insurance funds, such application will not be approved by the FDIC. The FDIC has authorized the bank's subsidiary HARL, LLC, to invest up to 15% of its capital in the equity securities of bank holding companies, banks or thrifts. \$997,000 was invested by HARL, LLC as of September 30, 2006 in such equity securities.

Regulatory Enforcement Authority. FIRREA included substantial enhancement to the enforcement powers available to federal banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties, as defined. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities. FIRREA significantly increased the amount of and grounds for civil money penalties and requires, except under certain circumstances, public disclosure of final enforcement actions by the federal banking agencies.

Federal and State Taxation

General. The Bank is subject to federal income taxation in the same general manner as other corporations with some exceptions, including particularly the reserve for bad debts discussed below. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to the Bank.

Method of Accounting. For federal income tax purposes, the Bank currently reports its income and expenses on the accrual method of accounting and uses a tax year ending September 30 for filing its federal income tax returns.

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Bad Debt Reserves. The Company computes its reserve for bad debts under the specific charge-off method. The bad debt deduction allowable under this method is available to large banks with assets greater than \$500 million. Generally, this method allows the Company to deduct an annual addition to the reserve for bad debts equal to its net charge-offs. Retained earnings at September 30, 2006 and 2005 includes approximately \$1.3 million representing bad debt deductions for which no deferred income taxes have been provided.

Distributions. If the Bank distributes cash or property to its stockholders, and the distribution is treated as being from its accumulated pre-1988 tax bad debt reserves, the distribution will cause the Bank to have additional taxable income. A distribution to stockholders is deemed to have been made from accumulated bad debt reserves to the extent that (a) the reserves exceed the amount that would have been accumulated on the basis of actual loss experience, and (b) the distribution is a "non-dividend distribution." A distribution in respect of stock is a non-dividend distribution to the extent

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that, for federal income tax purposes, (i) it is in redemption of shares, (ii) it is pursuant to a liquidation of the institution, or (iii) in the case of a current distribution, together with all other such distributions during the taxable year, it exceeds the Bank's current and post-1951 accumulated earnings and profits. The amount of additional taxable income created by a non-dividend distribution is an amount that when reduced by the tax attributable to it is equal to the amount of the distribution.

Minimum Tax. The Code imposes an alternative minimum tax at a rate of 20% on a base of regular taxable income plus certain tax preferences ("alternative minimum taxable income" or "AMTI"). The alternative minimum tax is payable to the extent such AMTI is in excess of an exemption amount. The Code provides that an item of tax preference is the excess of the bad debt deduction allowable for a taxable year pursuant to the percentage of taxable income method over the amount allowable under the experience method. The other items of tax preference that constitute AMTI include (a) tax exempt interest on newly-issued (generally, issued on or after August 8, 1986) private activity bonds other than certain qualified bonds and (b) for taxable years beginning after 1989, 75% of the excess (if any) of (i) adjusted current earnings as defined in the Code, over (ii) AMTI (determined without regard to this preference and prior to reduction by net operating losses). Net operating losses can offset no more than 90% of AMTI. Certain payments of alternative minimum tax may be used as credits against regular tax liabilities in future years.

Net Operating Loss Carryovers. A financial institution may carry back net operating losses to the preceding three taxable years and forward to the succeeding 15 taxable years. Effective for net operating losses arising in tax years beginning after October 1, 1997, the carryback period is reduced from three years to two years and the carryforward period is extended from 15 years to 20 years. At September 30, 2006, the Bank had no net operating loss carryforwards for federal income tax purposes.

Corporate Dividends-Received Deduction. The corporate dividends-received deduction is 80% in the case of dividends received from corporations with which a corporate recipient does not file a consolidated tax return, and corporations which own less than 20% of the stock of a corporation distributing a dividend may deduct only 70% of dividends received or accrued on their behalf. However, a corporation may deduct 100% of dividends from a member of the same affiliated group of corporations.

Other Matters. The Company's federal income tax returns for its tax years 1993 and beyond are open under the statute of limitations and are subject to review by the Internal Revenue Service ("IRS").

Pennsylvania Taxation. The Bank is subject to tax under the Pennsylvania Mutual Thrift Institutions Tax Act, which imposes a tax at the rate of 11.5% on the Bank's net earnings, determined in accordance with accounting principles generally accepted in the United States of America, as shown on its books. For fiscal years beginning in 1983, and thereafter, net operating losses may be carried forward and allowed as a

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deduction for three succeeding years. This Act exempts the Bank from all other corporate taxes imposed by Pennsylvania for state tax purposes, and from all local taxes imposed by political subdivisions thereof, except taxes on real estate and real estate transfers.

Subsidiary

The Bank is the only direct wholly owned subsidiary of the Company. The

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Bank formed HSB, Inc., a Delaware company, as a wholly owned subsidiary of the Bank during fiscal 1997. HSB, Inc. was formed in order to accommodate the transfer of certain assets that are legal investments for the Bank and to provide for a greater degree of protection to claims of creditors. The laws of the State of Delaware and the court system create a more favorable environment for the proposed business affairs of the subsidiary. HSB, Inc. currently manages the investment securities for the Bank, which as of September 30, 2006 amounted to approximately \$146.3 million. The Bank formed two limited liability companies in 2002, Freedom Financial Solutions LLC ("FFS") and HARL LLC ("HARL"). FFS was established to engage in the sale of insurance products through a third party. HARL was established for the purpose of investing in FDIC insured financial institutions/holding company equity securities.

Item 1A. Risk Factors.

In analyzing whether to make or to continue an investment in our securities, investors should consider, among other factors, the following risk factors.

Our results of operations are significantly dependent on economic conditions and related uncertainties.

Commercial banking is affected, directly and indirectly, by domestic and international economic and political conditions and by governmental monetary and fiscal policies. Conditions such as inflation, recession, unemployment, volatile interest rates, real estate values, government monetary policy, international conflicts, the actions of terrorists and other factors beyond our control may adversely affect our results of operations. Changes in interest rates, in particular, could adversely affect our net interest income and have a number of other adverse effects on our operations, as discussed in the immediately succeeding risk factor. Adverse economic conditions also could result in an increase in loan delinquencies, foreclosures and nonperforming assets and a decrease in the value of the property or other collateral which secures our loans, all of which could adversely affect our results of operations. We are particularly sensitive to changes in economic conditions and related uncertainties in Eastern Pennsylvania because we derive substantially all of our loans, deposits and other business from this area. Accordingly, we remain subject to the risks associated with prolonged declines in national or local economies.

Changes in interest rates could have a material adverse effect on our operations.

The operations of financial institutions such as ours are dependent to a large extent on net interest income, which is the difference between the interest income earned on interest-earning assets such as loans and investment securities and the interest expense paid on interest-bearing liabilities such as deposits and borrowings. Changes in the general level of interest rates can affect our net interest income by affecting the difference between the weighted average yield earned on our interest-earning assets and the weighted average rate paid on our interest-bearing liabilities, or interest rate spread, and the average life of our interest-earning assets and interest-bearing liabilities. Changes in interest rates also can affect our ability to originate loans; the value of our interest-earning assets and our ability to realize gains from the sale of such assets; our ability to obtain and retain deposits in competition with other available investment alternatives; the ability of our borrowers to repay adjustable or variable rate loans; and the fair value of the derivatives carried on our balance sheet, derivative hedge effectiveness testing and the amount of ineffectiveness recognized in our earnings.

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Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions and other factors beyond our control. Although we believe that the estimated maturities of our interest-earning assets currently are well balanced in relation to the estimated maturities of our interest-bearing liabilities (which involves various estimates as to how changes in the general level of interest rates will impact these assets and liabilities), there can be no assurance that our profitability would not be adversely affected during any period of changes in interest rates.

There are increased risks involved with multi-family residential, commercial real estate, commercial business and consumer lending activities.

Our lending activities include loans secured by existing multi-family residential and commercial real estate. In addition, from time to time we originate loans for the construction of multi-family residential real estate and land acquisition and development loans. Multi-family residential, commercial real estate and construction lending generally is considered to involve a higher degree of risk than single-family residential lending due to a variety of factors, including generally larger loan balances, the dependency on successful completion or operation of the project for repayment, the difficulties in estimating construction costs and loan terms which often do not require full amortization of the loan over its term and, instead, provide for a balloon payment at stated maturity. Our lending activities also include commercial business loans and leases to small to medium businesses, which generally are secured by various equipment, machinery and other corporate assets, and a wide variety of consumer loans, including home improvement loans, home equity loans, education loans and loans secured by automobiles, boats, mobile homes, recreational vehicles and other personal property. Although commercial business loans and leases and consumer loans generally have shorter terms and higher interests rates than mortgage loans, they generally involve more risk than mortgage loans because of the nature of, or in certain cases the absence of, the collateral which secures such loans.

We are subject to extensive regulation which could adversely affect our business and operations.

We and our subsidiaries are subject to extensive federal and state governmental supervision and regulation, which are intended primarily for the protection of depositors. In addition, we and our subsidiaries are subject to changes in federal and state laws, as well as changes in regulations, governmental policies and accounting principles. The effects of any such potential changes cannot be predicted but could adversely affect the business and operations of us and our subsidiaries in the future.

We face strong competition which may adversely affect our profitability.

We are subject to vigorous competition in all aspects and areas of our business from banks and other financial institutions, including savings and loan associations, savings banks, finance companies, credit unions and other providers of financial services, such as money market mutual funds, brokerage firms, consumer finance companies and insurance companies. We also compete with non-financial institutions, including retail stores that maintain their own credit programs and governmental agencies that make available low cost or guaranteed loans to certain borrowers. Certain of our competitors are larger financial institutions with substantially greater resources, lending limits, larger branch systems and a wider array of commercial banking services. Competition from both bank and non-bank organizations will continue.

Our ability to successfully compete may be reduced if we are unable to make

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technological advances.

The banking industry is experiencing rapid changes in technology. In addition to improving customer services, effective use of technology increases efficiency and enables financial institutions to reduce costs. As a result, our future success will depend in part on our ability to address our customers' needs by using technology. We cannot assure you that we will be able to effectively develop new technology-driven products

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and services or be successful in marketing these products to our customers. Many of our competitors have far greater resources than we have to invest in technology.

We and our banking subsidiary are subject to capital and other requirements which restrict our ability to pay dividends.

Our ability to pay dividends to our shareholders depends to a large extent upon the dividends we receive from Harleysville Savings Bank. Dividends paid by the Bank are subject to restrictions under Pennsylvania and federal laws and regulations. In addition, Harleysville Savings Bank must maintain certain capital levels, which may restrict the ability of the Bank to pay dividends to us and our ability to pay dividends to our shareholders.

Holders of our common stock have no preemptive rights and are subject to potential dilution.

Our articles of incorporation do not provide any shareholder with a preemptive right to subscribe for additional shares of common stock upon any increase thereof. Thus, upon the issuance of any additional shares of common stock or other voting securities of the Company or securities convertible into common stock or other voting securities, shareholders may be unable to maintain their pro rata voting or ownership interest in us.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

As of September 30, 2006, the Company conducted its business from its main office in Harleysville, Pennsylvania and five other full service branch offices. The Company is also part of the STAR ATM System, which provides customers with access to their deposits at locations worldwide.

County	Address	Owned or Leased	Lease Expiration Date	Net Book Value of Property and Leasehold Improvements as of September 30,
-----	-----	-----	-----	-----
Montgomery	1889 Ridge Park Royersford, Pennsylvania	Owned	--	\$3,266
Montgomery	271 Main Street Harleysville, Pennsylvania	Owned	--	1,092

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Montgomery	640 East Main Street Lansdale, Pennsylvania	Leased	May 2043(1)	906
Montgomery	1550 Hatfield Valley Road Hatfield, Pennsylvania	Leased	January 2064(1)	825
Montgomery	2301 West Main Street Norristown, Pennsylvania	Owned	--	550
Montgomery	3090 Main Street Sumneytown, Pennsylvania	Owned	--	318
Total				\$6,957

(1) The land at this office is leased; however, the Bank owns the building.

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Item 3. Legal Proceedings.

The Company is not involved in any legal proceedings except nonmaterial litigation incidental to the ordinary course of business.

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

Not Applicable.

PART II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

(a) The information required herein is incorporated by reference from page 31 of the Company's 2006 Annual Report to Stockholders ("Annual Report") and from Part III, Item 12 hereof.

(b) Not applicable.

(c) The following table sets forth information with respect to purchases made by or on behalf of the Company of shares of Common Stock of the Company during the indicated periods.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May be Purchased Under Plans or Programs
July 1-31, 2006	--	\$ --	--	39,787
August 1-31, 2006	--	--	--	39,787
September 1-30, 2006	--	--	--	39,787

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Total	--	\$ --	--	
	=====	=====	=====	

39,787
=====

 (1) On June 18, 2003, the Company announced its current program to repurchase up to 5.0% of the outstanding shares of Common Stock of the Company, or 191,667 shares. The program does not have an expiration date and all shares are purchased in the open market.

Item 6. Selected Financial Data.

The information required herein is incorporated by reference from page 1 of the Annual Report.

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

The information required herein is incorporated by reference from pages 4 to 10 of the Annual Report.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The information required herein is incorporated by reference from pages 8 to 10 of the Annual Report.

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Item 8. Financial Statements and Supplementary Data.

The information required herein is incorporated by reference from pages 12 to 30 of the Annual Report.

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

Not Applicable.

Item 9A. Controls and Procedures.

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of September 30, 2006. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and are operating in an effective manner.

No change in our internal control over financial reporting (as defined

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in Rules 13a-15(f) and 15(d)-15(f) under the Securities Exchange Act of 1934) occurred during the fourth fiscal quarter of fiscal 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information.

Not applicable.

PART III

Item 10. Directors and Executive Officers of the Registrant.

The information required herein is incorporated by reference from the information contained in the section captioned "Information with Respect to Nominees for Director, Directors Whose Terms Continue and Executive Officers" in the Company's definitive Proxy Statement for the Annual Meeting of Stockholders to be held January 24, 2007 (the "Proxy Statement"), a copy of which will be filed with the Securities and Exchange Commission before the meeting date.

The Company has adopted a Code of Conduct and Ethics that applies to its principal executive officer and principal financial officer, as well as other officers and employees of the Company and the Bank. A copy of the Code of Ethics, was included as an exhibit to the Company's Form 10-K for the year ended September 30, 2003 and filed with the Securities and Exchange Commission, may also be found on the Company's website at www.harleystillesavingsbank.com.

Item 11. Executive Compensation.

The information required herein is incorporated by reference from the information contained in the section captioned "Management Compensation" in the Proxy Statement.

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Item 12. Security Ownership of Certain Beneficial Owners and Management and

Related Stockholder Matters.

The information required herein is incorporated by reference from the information contained in the section captioned "Beneficial Ownership of Common Stock by Certain Beneficial Owners and Management" in the Proxy Statement.

Equity Compensation Plan Information

The following table sets forth certain information for all equity compensation plans and individual compensation arrangements (whether with employees or non-employees, such as directors), in effect as of September 30, 2006.

Number of Shares to be
issued upon the Exercise
of Outstanding Options,

Weighted-Average
Exercise Price of

Number of Sh
Future Is

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Plan Category	Warrants and Rights(1)	Outstanding Options	Reflected
Equity compensation plans			
approved by security holders	243,100	\$ 15.01	
Equity compensation plans not			
approved by security holders	--	--	
	-----	-----	
Total	243,100	\$ 15.01	
	=====		

-
- (1) Does not take into account purchase rights accruing under the Company's 1995 Employee Stock Purchase Plan, which was approved by stockholders and provides for up to 87,281 shares to be issued. Under the Employee Stock Purchase Plan, each eligible employee may purchase shares of common stock at semi-annual intervals each year at a purchase price determined by the committee of the board of directors which administers the plan, which shall not be less than the lesser of (i) 85% of the fair market value of a share of common stock on the first business day of the applicable semi-annual offering period or (ii) 85% of the fair market value of a share of common stock on the last business day of such offering period. In no event may the amount of common stock purchased by a participant in the Employee Stock Purchase Plan in a calendar year exceed \$25,000, measured as of the time an option under the plan is granted.
- (2) Includes shares available for future issuance under the Employee Stock Purchase Plan. As of September 30, 2006, an aggregate of 53,583 shares of common stock were available for issuance under this plan.

Item 13. Certain Relationships and Related Transactions.

The information required herein is incorporated by reference from the information contained in the section captioned "Management Compensation - Indebtedness of Management" in the Proxy Statement.

Item 14. Principal Accounting Fees and Services.

The information required herein is incorporated by reference from the information contained in the section captioned "Relationship with Independent Registered Public Accounting Firm" in the Proxy Statement.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

- (a) (1) The following financial statements are incorporated by reference from Item 8 hereof (see Exhibit 13.0):

Report of Independent Registered Public Accounting Firm
 Consolidated Statements of Financial Condition as of September 30, 2006
 and 2005
 Consolidated Statements of Income for the Years Ended September 30,
 2006, 2005 and 2004

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Consolidated Statements of Stockholders' Equity for the Years Ended
September 30, 2006, 2005 and 2004

Consolidated Statements of Cash Flows for the Years Ended September 30,
2006, 2005 and 2004

Notes to Consolidated Financial Statements

(2) All schedules are omitted because they are not required or applicable, or the required information is shown in the consolidated financial statements or the notes thereto.

(3) Exhibits

The following exhibits are filed as part of this Form 10-K and this list includes the Exhibit Index.

No.	Exhibits
3.1	Articles of Incorporation
3.2	Bylaws
4.0	Common Stock Certificate
10.1	1995 Employee Stock Purchase Plan*
10.2	1995 Stock Option Plan*
10.3	2000 Stock Option Plan*
10.4	2005 Stock Option Plan*
10.5	Profit Sharing Incentive Plan*
10.6	Employment Agreement with Edward J. Molnar and Marian Bickerstaff*
10.7	Amended and Restated Employment Agreement between the Company, the Bank and Ronald B. Geib*
13.0	Annual Report to Stockholders
22.0	Subsidiaries of the Registrant - Reference is made to "Item 1. Business - Subsidiaries" of this Form 10-K for the required information
23.0	Consent of Deloitte & Touche LLP
31.1	Certification of Chief Executive Officer
31.2	Certification of Chief Financial Officer
32.0	Section 1350 Certification of the Chief Executive Officer and Chief Financial Officer
99.0	Code of Conduct and Ethics

* Denotes management compensation plan or arrangement.

- (1) Incorporated herein by reference to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission ("SEC") on February 25, 2000.
- (2) Incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended September 30, 2003, filed with the SEC on December 23, 2003.
- (3) Incorporated by reference to the Company's definitive proxy statement dated December 19, 2000 filed with the SEC.
- (4) Incorporated by reference from the Company's definitive proxy statement for the 2005 Annual Meeting of Stockholders filed with the SEC on December 16, 2005.
- (5) Incorporated herein by reference to Harleysville Savings Bank's Registration Statement on Form 10 filed with the Federal Home Loan Bank Board, the predecessor to the Office of Thrift Supervision, on July 1, 1987.
- (6) Incorporated by reference to the Company's Current Report on Form 8-K

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filed with the SEC on November 1, 2006.

(b) Exhibits

The exhibits listed under (a) (3) of this Item 15 are filed herewith.

(c) Reference is made to (a) (2) of this Item 15.

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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.

HARLEYSVILLE SAVINGS
FINANCIAL CORPORATION

December 20, 2006

By: /s/ Edward J. Molnar

Edward J. Molnar
Chairman and Chief Executive Officer

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 the date indicated.

Name	Title	Date
----- /s/ Edward J. Molnar ----- Edward J. Molnar	Chairman and Chief Executive Officer (principal executive officer)	December 20,
----- /s/ Ronald B. Geib ----- Ronald B. Geib	President and Chief Operating Officer	December 20,
----- /s/ Brendan J. McGill ----- Brendan J. McGill	Senior Vice President, Treasurer and Chief Financial Officer (principal financial and principal accounting officer)	December 20,
----- /s/ Sanford L. Alderfer ----- Sanford L. Alderfer	Director	December 20,
----- /s/ Philip A. Clemens ----- Philip A. Clemens	Director	December 20,

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/s/ Mark R. Cummins ----- Mark R. Cummins	Director	December 20,
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Name -----	Title -----	Date -----
/s/ David J. Friesen ----- David J. Friesen	Director	December 20,
/s/ Charlotte A. Hunsberger ----- Charlotte A. Hunsberger	Director	December 20,
/s/ George W. Meschter ----- George W. Meschter	Director	December 20,
/s/ James L. Rittenhouse ----- James L. Rittenhouse	Director	December 20,

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