THIRD CENTURY BANCORP
Form 10KSB
March 28, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-KSB

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2005
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________________________ to ________________________

Commission File Number: 000-50828

THIRD CENTURY BANCORP
(Name of Small Business Issuer in its Charter)

Indiana	**20-0857725**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)
80 East Jefferson Street, Franklin, Indiana	**46131**
(Address of Principal Executive Office)	(Zip Code)

(317) 736-7151
(Issuer's Telephone Number including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT:
None

Securities Registered Pursuant to Section 12(g) of the Act:

Common Stock, no par value per share
(Title of Class)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past twelve months (or for such shorter period that the Registrant was required to file reports) and (2) has been subject to such requirements for the past 90 days. (1) YES þ . NO o.

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendments to this Form 10-KSB. **x [Confirm]**

The Registrant's revenues for the fiscal year ended December 31, 2005 were $6.3 million.

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

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. o

As of February 28, 2006, there were 1,653,125 shares issued and outstanding of the Registrant's Common Stock. The aggregate value of the voting stock held by non-affiliates of the Registrant, computed by reference to the closing price of the Common Stock as of February 28, 2006 was $16,048,361 million.

DOCUMENTS INCORPORATED BY REFERENCE

1. Proxy Statement for the 2006 Annual Meeting of Stockholders (Part III)
2. 2005 Annual Report (parts II and IV)

THIRD CENTURY BANCORP
FORM 10-KSB
INDEX

PART I

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-KSB ("**Form 10-KSB**") contains statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements appear in a number of places in this Form 10-KSB and include statements regarding the intent, belief, outlook, estimates or expectations of Third Century Bancorp, its directors, or its officers primarily with respect to future events and the future financial performance of Third Century Bancorp. Readers of this Form 10-KSB are cautioned that any such forward-looking statements are not guarantees of future events or performance and involve risks and uncertainties, and that actual results may differ materially from those in the forward-looking statements as a result of various factors. The accompanying information contained in this Form 10-KSB identifies important factors that could cause such differences. These factors include but are not limited to changes in interest rates; loss of deposits and loan demand to other savings and financial institutions; substantial changes in financial markets; changes in real estate values and the real estate market; regulatory changes; or unanticipated results in pending legal proceedings.

ITEM 1. DESCRIPTION OF BUSINESS.

Third Century Bancorp ("**Third Century**" and, together with Mutual Savings Bank, the "**Company**" or "**we**") was formed on March 15, 2004, as an Indiana corporation to be the holding company for Mutual Savings Bank ("**Mutual**" or the "**Bank**"). On June 29, 2004, Third Century acquired the common stock of Mutual upon the conversion of Mutual from a state mutual savings bank to a state stock savings bank.

Mutual was originally organized in 1890 as the Mutual Building and Loan Association. In 1994, Mutual became an Indiana savings bank and changed its name to "Mutual Savings Bank." Mutual currently conducts its business from five offices in Johnson County, Indiana. Its main office and two other offices are in Franklin and it also has offices in Trafalgar and Nineveh. Mutual's principal business consists of attracting deposits from the general public, originating long-term, fixed-rate loans secured primarily by first mortgage liens on one- to four-family real estate and other commercial and consumer loans. Its deposit accounts are insured up to applicable limits by the Savings Association Insurance Fund of the FDIC.

LENDING ACTIVITIES

Mutual has historically concentrated its lending activities on the origination of loans secured by first mortgage liens for the purchase, construction or refinancing of one- to four-family residential real property. One- to four-family residential mortgage loans continue to be the major focus of its loan origination activities, representing 51.53% of its total loan portfolio at December 31, 2005. Mutual also offers commercial real estate loans, commercial loans and consumer loans. Mortgage loans secured by commercial real estate totaled approximately 17.41% of Mutual's total loan portfolio at December 31, 2005, while commercial loans totaled approximately 13.21%, and consumer loans totaled approximately 10.11% of its total loans at December 31, 2005. To a limited extent, Mutual also offers multi-family (0.29%) and construction loans (4.21%), which include both residential and commercial.

Under Indiana law, the total loans and extensions of credit by an Indiana-chartered savings bank to a borrower outstanding at one time and not fully secured may not exceed 15% of the bank's capital and unimpaired surplus. At December 31, 2005, 15% of Mutual's capital and unimpaired surplus was $2.2 million. An additional amount up to 10% of capital and unimpaired surplus may be loaned to the same borrower if such loan is fully secured by readily marketable collateral having a market value, as determined by reliable and continuously available price quotations, at least equal to the amount of such additional loans outstanding.

Back to Index
3

LOAN PORTFOLIO DATA. The following table sets forth the composition of Mutual's loan portfolio by loan type and security type as of the dates indicated, including a reconciliation of gross loans receivable after consideration of the allowance for loan losses and loans in process.

	At December 31,			
	2005		2004	
	Amount	Percent of Total	Amount	Percent of Total
	(In Thousands)			
TYPE OF LOAN				
Real Estate Mortgage Loans:				
Land	$ 1,385	3.24%	$ 1,368	1.37%
One-to-Four-Family	54,894	51.53	52,125	52.19
Multi-Family	314	0.29	338	0.34
Commercial	20,604	17.41	21,629	21.66
Construction	4,481	4.21	4,765	4.77
Consumer Loans:				
Home Equity	4,175	3.92	3,813	3.82
Automobiles	3,801	3.57	3,876	3.88
Lines of Credit	2,036	1.91	3,563	3.57
Other	752	0.71	419	0.42
Commercial Loans	14,078	13.21	$ 7,982	7.98
Gross Loans Receivable	$ 106,520	100.00%	$ 99,878	100.00%
TYPE OF SECURITY				
Land	$ 1,385	3.24%	$ 1,368	1.37%
One-to-four-family	54,894	51.53	52,125	52.19
Multi-family	314	0.29	338	0.34
Commercial Real Estate	20,604	17.41	21,629	21.66
Automobiles	3,801	3.57	3,876	3.88
Other Security	23,429	21.99	18,583	18.60
Unsecured	2,093	1.97	1,959	1.96
Gross Loans Receivable	106,520	100.00%	99,878	100.00%
DEDUCT:				
Deferred Loan Fees	37		44	
Allowance for Loan Losses	926		1,012	
Net Loans Receivable	$ 105,557		$ 98,822	
MORTGAGE LOANS:				
Adjustable-Rate	$ 32,457		$ 27,955	
Fixed-Rate	44,740		47,505	
Total	$ 77,197		$ 75,460	

The following table sets forth certain information at December 31, 2005, regarding the dollar amount of loans maturing in Mutual's loan portfolio based on the contractual terms to maturity. Demand loans having no stated schedule of repayments and no stated maturity and overdrafts are reported as due in one year or less. This schedule does not reflect the effects of possible prepayments or enforcement of due-on-sale clauses. Management expects prepayments will cause actual maturities to be shorter.

Back to Index
4

	Balance Outstanding at December 31, 2005	Due During Years Ended December 31,					
		2006	2007 to 2008	2009 to 2010	2011 to 2015	2016 to 2025	2026 and Following
				(In Thousands)			
Real Estate Mortgage Loans:							
Land	$ 1,385	$ 317	$ 108	$ 35	$ 269	$ 656	$ --
One- to Four-Family	54,894	3,813	392	823	7,110	21,837	20,919
Multi-Family	314	1	--	--	63	250	--
Commercial	20,604	1,152	1,421	191	1,380	13,989	2,471
Construction	4,481	3,704	777	--	--	--	--
Consumer Loans:							
Home Equity	4,175	129	219	251	2,632	944	--
Automobiles	3,801	67	1,097	2,356	281	--	--
Lines of Credit	2,036	2,036	--	--	--	--	--
Other	752	318	191	223	20		--
							--
Commercial Loans	14,078	3,662	2,946	1,734	2,474	2,345	917
Total	$ 106,520	$ 15,199	$ 7,151	$ 5,613	$ 14,229	$ 40,021	$ 24,307

The following table sets forth as of December 31, 2005, the dollar amount of all loans due after one year that have fixed interest rates or adjustable rates.

	Due After December 31, 2006		
	Fixed Rates	Variable Rates	Total
		(In Thousands)	
Real Estate Mortgage Loans:			
Land	$ 760	$ 307	$ 1,067
One- to Four-Family	36,643	14,401	51,044
Multi-Family	--	313	313
Commercial	3,128	16,324	19,452
Construction	--	777	777
Consumer Loans:			
Home Equity	--	4,046	4,046
Automobiles	3,735	--	3,735
Lines of Credit	--	--	--
Other	434	--	434
Commercial Loans	3,300	7,115	10,415

Total	$ 48,000	$ 43,283	$ 91,283

ONE- TO FOUR-FAMILY RESIDENTIAL LOANS. Mutual's primary lending activity consists of the origination of one- to four-family residential mortgage loans secured by property located in its primary market area. Mutual generally does not originate one- to four-family residential mortgage loans if the ratio of the loan amount to the lesser of the current cost or appraised value of the property exceeds 95%. Mutual generally requires private mortgage insurance on loans with a loan-to-value ratio in excess of 80%. The cost of such insurance is factored into the annual percentage rate on such loans. All properties also have title and, to the extent applicable, flood insurance.

Back to Index

Mutual also offers second mortgages on one- to four-family residential properties at a fixed rate. Second mortgages are generally written for up to 80% of the available equity (the appraised value of the property less any first mortgage amount).

Mutual's current underwriting criteria for one- to four-family residential loans focus on the collateral securing the loan, income, debt-to-income ratio, stability of earnings and credit history of a potential borrower, in making credit decisions. Mutual also has incorporated uniform underwriting criteria based on Freddie Mac lending criteria, recognizing that the sale of mortgage loans has become an important tool in liquidity and interest rate risk management. In 2005, we partnered with a larger financial institution which enabled us to offer products and pricing to individuals seeking non-conventional loans (more than 80% financing) and first-time home buyers. These loans comply with the underwriting standards required by the other financial institution, which wholly owns the loan at closing. Mutual originates fixed-rate loans which provide for the payment of principal and interest over a period of up to 30 years.

In addition, Mutual offers loans that are fixed for the first one, three, five or seven years and then have an adjustable rate for subsequent years. The adjustable-rate mortgage loans that it originates provide for a maximum interest rate adjustment of 2% over a one-year period and a maximum adjustment of 5% over the life of the loan. Mutual's residential adjustable-rate mortgages are amortized for terms up to 30 years. Although Mutual would generally prefer to originate mortgage loans that have adjustable rather than fixed interest rates, the current low-interest rate environment has reduced borrower demand for adjustable-rate mortgage loans. Mutual also offers fixed-rate second mortgages.

All of the fixed-rate loans that Mutual originates for sale are written to Freddie Mac standards or to the standards required by the financial institution with whom we have a contract to sell loans. Mutual generally sells any owner-occupied mortgages that are for terms of more than 12 years. It retains the servicing rights on the loans that it sells to Freddie Mac.

Adjustable-rate mortgage loans decrease the risk associated with changes in interest rates by periodically re-pricing, but involve other risks because, as interest rates increase, the underlying payments by the borrower also increase, thus increasing the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Upward adjustment of the contractual interest rate is also limited by the maximum periodic and lifetime interest rate adjustment permitted by the loan documents, and, therefore, is potentially limited in effectiveness during periods of rapidly rising interest rates. Mutual retains all adjustable-rate mortgage loans that it originates and, at December 31, 2005, approximately 42.04% of its one- to four-family residential loans had adjustable rates of interest.

All of the one- to four-family residential mortgage loans that Mutual originates include "due-on-sale" clauses, which give it the right to declare a loan immediately due and payable in the event that, among other things, the borrower sells or otherwise disposes of the real property subject to the mortgage and the loan is not repaid. However, Mutual occasionally permits assumptions of existing residential mortgage loans on a case-by-case basis.

At December 31, 2005, approximately $54.9 million, or 51.53% of Mutual's portfolio of loans, consisted of one- to four-family residential loans. Approximately $181,000, or 0.33% of total one- to four-family residential loans, was included in non-performing loans as of that date.

COMMERCIAL REAL ESTATE LOANS. Our commercial real estate loans at December 31, 2005, were secured by churches, office buildings and other commercial properties ($20.6 million), and apartments consisting of five or more units ($314,000). Mutual typically originates commercial real estate loans with terms no greater than 20 years. Mutual generally requires a loan-to-value ratio of no more than 80% on commercial real estate loans. Mutual originates both fixed-rate and adjustable-rate commercial loans.

Back to Index
6

Commercial real estate loans generally are larger than one- to four-family residential loans and involve a greater degree of risk. Commercial real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Payments on these loans depend to a large degree on results of operations and management of the properties and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general. Accordingly, the nature of the loans makes them more difficult for management to monitor and evaluate. In addition, balloon loans may involve a greater degree of risk to the extent the borrower is unable to obtain financing or cannot repay the loan when the loan matures or a balloon payment is due.

At December 31, 2005, approximately $20.6 million, or 17.41% of Mutual’s total loan portfolio, consisted of commercial real estate loans. On the same date, no commercial real estate loans were included in non-performing assets.

At December 31, 2005, approximately $314,000, or 0.29% of Mutual’s total loan portfolio, consisted of mortgage loans secured by multi-family dwellings. Multi-family residential real estate loans generally are secured by multi-family rental properties, such as walk-up apartments. At December 31, 2005, one multi-family loan for less than $1,000 was included in non-performing loans.

Multi-family loans, like commercial real estate loans, involve greater risk than do residential loans and carry larger loan balances. This increased credit risk is a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties, and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family real estate typically depends upon the successful operation of the related real estate property. If the cash flow from the project is reduced, the borrower’s ability to repay the loan may be impaired. Also, the loans-to-one-borrower limitation limits Mutual’s ability to make loans to developers of apartment complexes and other multi-family units.

CONSTRUCTION LOANS. Mutual offers construction loans to individuals for the purpose of constructing one- to four-family residences, but only where the borrower commits to permanent financing on the finished project with Mutual or another qualified lender. During the construction phase, the loan agreement requires monthly interest payments by the borrower on the amount drawn on the loan. When the construction of the residence is completed, the construction rider terminates and the loan converts into a one- to four-family residential mortgage loan.

Mutual also offers construction loans to builders or developers who are on Mutual’s approved list for the construction of residential properties on a speculative basis (*i.e.*, before the builder/developer obtains a commitment from a buyer), or for the construction of commercial or multi-family properties. In such cases, Mutual typically structures the loan as a short-term loan with a fixed interest rate, with interest payable quarterly. Construction loans to builders or developers typically have a higher interest rate than residential construction loans to individuals unless Mutual has the long-term commitment for financing. Mutual also offers construction loans to businesses and organizations for the purpose of constructing business-related facilities, including, but not limited to, the new construction and remodeling of small office buildings and church facilities. At December 31, 2005, approximately $3.0 million or 2.80% of Mutual’s total loan portfolio consisted of residential construction loans and $1.5 million or 1.41% of its total loan portfolio consisted of commercial construction loans. At December 31, 2005, there were no construction loans included in non-performing assets.

The maximum loan-to-value ratio for a construction loan is based upon the nature of the construction project. For example, a construction loan to an individual for the construction of a one- to four-family residence may be written with a maximum loan-to-value ratio of 95%, while a construction loan for a commercial project may be written with a maximum loan-to-value ratio of 80%. Inspections generally are made prior to any disbursement under a construction loan, and Mutual normally charges a commitment fee for construction loans.

Back to Index
7

While providing Mutual with a comparable, and in some cases higher, yield than conventional mortgage loans, construction loans sometimes involve a higher level of risk. For example, if a project is not completed and the borrower defaults, Mutual may have to hire another contractor to complete the project at a higher cost. Also, a project may be completed, but may not be salable, resulting in the borrower defaulting and Mutual's taking title to the project.

CONSUMER LOANS. Mutual's consumer loans at December 31, 2005, consisted primarily of variable- and fixed-rate home equity loans ($4.2 million representing 3.92% of our total loan portfolio) and lines of credit ($2.0 million representing 1.91% of our total loan portfolio) and automobile loans ($3.8 million representing 3.57% of our total loan portfolio). Consumer loans tend to have shorter terms and higher yields than permanent residential mortgage loans. At December 31, 2005, Mutual's consumer loans aggregated approximately $10.7 million, or 10.11%, of its total loan portfolio. At December 31 2005, two consumer loans for less than $1,000 were included in non-performing loans.

Home equity lines of credit are generally written for up to 80% of the appraised value less any first mortgage amount. Mutual generally will write automobile loans for up to 100% of the acquisition price for a new automobile and the lower of the purchase price or the trade-in value for a used automobile. The repayment schedule of loans covering both new and used vehicles is consistent with the expected life and normal depreciation of the vehicle.

Consumer loans may entail greater risk than residential mortgage loans, particularly in the case of consumer loans that are unsecured or are secured by rapidly depreciable assets, such as automobiles. Further, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance. In addition, consumer loan collections depend on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

COMMERCIAL LOANS. Mutual offers commercial loans, which consist primarily of loans to businesses that are secured by assets other than real estate, with examples of such assets being equipment, inventory and receivables. In some cases the loans are unsecured. As of December 31, 2005, commercial loans amounted to $14.1 million, or 13.21%, of Mutual's total loan portfolio. Commercial loans tend to bear somewhat greater risk than residential mortgage loans, depending on the ability of the underlying enterprise to repay the loan. As of December 31, 2005, no commercial loans were included in non-performing loans.

The following table shows Mutual's loan origination and repayment activity during the periods indicated. During the years presented no loans were purchased.

	Year Ended December 31, 2005	2004
	(In Thousands)	
Loans Originated:		
Real Estate Mortgage Loans:		
Land	$ 723	$ 337
One-to-Four-Family	4,954	3,065
Commercial	10,770	9,950
Construction	8,749	8,181
Consumer Loans:		
Home Equity and Home Improvement	753	776
Other	7,748	7,415
Commercial Loans	11,206	5,871
Total Originations	44,903	35,595
Reductions:		
Principal Loan Repayments	38,141	33,600
Transfers from Loans to Real Estate Owned	120	170
Total Reductions	38,261	33,770
Decrease in Other Items	(93)	(42)
Net Increase	$ 6,735	$ 1,867

ORIGINATION AND OTHER FEES. Mutual realizes income from origination fees, late charges, checking account service charges and fees for other miscellaneous services. Late charges are generally assessed if payment is not received within a specified number of days after it is due. The grace period depends on the individual loan documents.

NON-PERFORMING AND PROBLEM ASSETS

Mutual reviews loans on a regular basis and loans are placed on a non-accrual status when the loans become contractually past due 90 days or more. Mutual's policy is that all earned but uncollected interest on all loans be reviewed monthly to determine if any portion thereof should be classified as uncollectible for any loan past due less than 90 days. Mutual sends a written notice when loans are 30 days past due and sends a letter or makes verbal contact when loans are 60 days past due. Loans that reach 90 days past due are brought before the Asset Classification Committee. The Asset Classification Committee discusses all delinquent loans at its monthly meetings and decides what additional actions should be taken with respect to each delinquent loan. Management is authorized to commence foreclosure proceedings for any loan upon making a determination that it is prudent to do so. All loans for which foreclosure proceedings have been commenced are placed on non-accrual status.

NON-PERFORMING ASSETS. At December 31, 2005, $303,000, or 0.24% of Mutual's total assets, were non-performing assets (loans delinquent more than 90 days, non-accruing loans and foreclosed assets) compared to $195,000, or 0.15%, of our total assets at December 31, 2004.

Back to Index

9

The table below sets forth the amounts and categories of our non-performing assets.

	Year Ended December 31, 2005	2004
	(In Thousands)	
Non-Performing Assets:		
Non-Performing Loans	$ 183	$ 25
Foreclosed Assets	120	170
Total Non-Performing Assets	$ 303	$ 195
Non-Performing Loans to Total Loans	0.28%	0.20%
Non-Performing Assets to Total Assets	0.24%	0.15%

At December 31, 2005, Mutual held loans delinquent from 30 to 89 days totaling $1.3 million.

There was one loan for $25,000 and five loans totaling $183,000 past due 90 days or more and still accruing interest at December 31, 2004 and 2005, respectively, for which interest was fully reserved. No loans at December 31, 2004 or 2005 were on non-accrual status.

The following table reflects the amount of loans in a delinquent status as of the dates indicated:

	At December 31, 2005				At December 31, 2004			
	30 - 89 Days		90 Days or More		30 - 89 Days		90 Days or More	
	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans
				(In Thousands)				
Real Estate Mortgage Loans:								
One-to-Four-Family	4	$ 248	2	$ 181	5	$ 303	1	$ 25
Multi-Family	--	--	1	1	1	4	--	--
Construction	1	280	--	--	--	--	--	--
Home Equity and Home Improvement	1	20	--	--	1	23	--	--
Other Consumer Loans	11	97	2	1	9	96	--	--
Commercial Loans	7	693	--	--	4	1,456	--	--
Total	24	$ 1,338	5	$ 183	20	$ 1,883	1	$ 25
Delinquent Loans to Total Loans	1.18%	1.26%	0.25%	0.17%	1.02%	1.89%	0.05%	0.03%

CLASSIFIED ASSETS. Mutual's Asset Classification Policy provides for the classification of loans and other assets such as debt and equity securities considered to be of lesser quality as "substandard," "doubtful" or "loss" assets. An asset is considered "substandard" if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. "Substandard" assets include those characterized by the "distinct possibility" that the institution will sustain "some loss" if the deficiencies are not corrected. Assets classified as "doubtful" have all of the weaknesses inherent in those classified "substandard," with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable." Assets classified as "loss" are those considered "uncollectible" and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

An insured institution is required to establish general allowances for loan losses in an amount deemed prudent by management for loans classified substandard or doubtful, as well as for other problem loans. General allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies problem assets as “loss,” it is

Back to Index

required either to establish a specific allowance for losses equal to 100% of the amount of the asset so classified or to charge off such amount.

At December 31, 2005 and 2004, the aggregate amount of Mutual's classified loans, and of its general and specific loss allowances were as follows:

	Year Ended December 31,			
	2005		2004	
	(In Thousands)			
Substandard Loans	$	1,961	$	299
Doubtful Loans		--		10
Loss Loans		1		--
Total Classified Loans	$	1,962	$	309
General Loss Allowance	$	604	$	859
Specific Loss Allowance		322		153
Total Allowances	$	926	$	1,012

Substandard loans increased to $2.0 million at December 31, 2005 from $299,000 at December 31, 2004 as a result of management's decision to classify a $1.5 million commercial real estate loan. Management decided to classify this loan due to concerns over the financial performance of the borrower.

Assets that do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated "special mention" by management. At December 31, 2005 and 2004, Mutual classified $532,000 and $2.1 million of loans as "special mention." The "special mention" classification refers to assets that do not currently expose Mutual to a significant degree of risk but do possess credit deficiencies or potential weakness deserving management's close attention.

Third Century charges off loans that are identified as losses in the period the loans are deemed uncollectible.

Mutual regularly reviews its loan portfolio to determine whether any loans require classification in accordance with applicable regulations. Not all of Mutual's classified assets constitute non-performing assets.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is maintained to absorb losses inherent in the loan portfolio. The allowance is based on ongoing, quarterly assessments of the probable estimated losses inherent in the loan portfolio. The allowance is increased by the provision for loan losses, which is charged against current period operating results and decreased by the amount of charge-offs, net of recoveries. Mutual's methodology for assessing the appropriateness of the allowance consists of several key elements, which include the general allowance, specific allowances for identified problem loans, and the unallocated allowance.

The general allowance is calculated by applying loss factors to outstanding loans based upon Mutual's historical loss experience and may be adjusted for significant factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date. The general allowance is utilized to estimate incurred losses on Mutual's homogeneous unclassified loan pools.

Specific allowances are established in cases where management has identified significant conditions or circumstances related to a credit that management believes indicate the probability that a loss has been incurred in excess of the amount determined by the application of the formula allowance. The loans that are reviewed for specific allowances are generally those loans internally classified as substandard, doubtful or loss.

Back to Index

The unallocated allowance is based upon management's evaluation of various conditions, the effects of which are not directly measured in the determination of the formula and specific allowances. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific credits. The conditions evaluated in connection with the unallocated allowance may include existing general economic and business conditions affecting Mutual's key lending areas, credit quality trends, collateral values, loan volumes and concentrations, seasoning of the loan portfolio, specific industry conditions within portfolio segments, recent loss experience in particular segments of the portfolio, duration of the current business cycle, bank regulatory examination results, and findings of an independent third party conducting reviews of the loan portfolio.

SUMMARY OF LOAN LOSS EXPERIENCE. The following table analyzes changes in the allowance for loan losses during the years ended December 31, 2005 and 2004.

	Year Ended December 31, 2005	Year Ended December 31, 2004
	(In Thousands)	
Balance at Beginning of Period	$ 1,012	$ 1,055
Charge-Offs:		
One-to-Four-Family Mortgage Loans	15	--
Consumer Loans	43	37
Commercial Loans	43	74
Total Charge-Offs	101	111
Recoveries:		
One-to-Four-Family Mortgage Loans	--	2
Consumer Loans	14	2
Commercial Loans	1	28
Total Recoveries	15	32
Net Charge-Offs	86	79
Provision for Losses on Loans	--	36
Balance End of Period	$ 926	$ 1,012
Allowance for Loan Losses as a Percent of Total Loss Outstanding	0.87%	1.01%
Ratio of Net Charge-Offs during year to Average Loans Outstanding	0.08%	0.08%

Back to Index

ALLOCATION OF ALLOWANCE FOR LOAN LOSSES. The following table presents an analysis of the allocation of Mutual's allowance for loan losses at the dates indicated.

	At December 31,			
	2005		2004	
	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans
	(In Thousands)			
Balance at End of Period Applicable to:				
Land	$ --	1.30%	$ --	1.37%
Real Estate Mortgage Loans:				
One- to Four-Family	127	51.53	170	52.19
Commercial and Multi-Family	202	19.64	226	22.00
Construction Loans	21	4.21	30	4.77
Home Equity and Home Improvements	1	3.92	--	3.82
Other Consumer Loans	151	6.19	140	7.87
Commercial Loans	391	13.21	104	7.98
Unallocated	33	--	342	--
Total	$ 926	100.00%	$ 1,012	100.00%

OTHER SOURCES OF REVENUE

TRUST SERVICES. Mutual's Trust Department provides agency services, trust services, guardianships and estate services to individuals and families. The Trust Department establishes and manages trusts, administers estates, establishes power of attorney arrangements and offers individual retirement accounts in addition to other products and services. As of December 31, 2005, the Trust Department had 141 accounts representing $7.9 million, including funeral trusts. For the year ended December 31, 2005, revenues generated by the Trust Department totaled $65,000.

CREDIT CARD UNDERWRITING. Mutual also issues Mutual Savings Bank Credit Cards, which are personal unsecured lines of credit in amounts from $2,500 to $50,000. The annual percentage rate is 9.90%, which is recognized as loan interest income. There is no annual fee. The Bank recognized interchange income of $76,000 as of December 31, 2005 and $109,000 as of December 31, 2004.

OTHER FEES. Mutual also realizes income from checking account service charges, safe deposit fees and fees for other miscellaneous services.

INVESTMENTS AND FEDERAL HOME LOAN BANK STOCK

Mutual's investment policy is designed primarily to maximize the yield on the investment portfolio subject to minimal liquidity risk, default risk, interest rate risk, and prudent asset/liability management. Mutual has retained an investment advisor registered with the Securities and Exchange Commission to provide it with investment and financial advice including recommendations regarding risk strategies and risk assessment, investment purchases and sales, and dealer selection.

Mutual's investment portfolio consists of U.S. government agency securities, state revenue bonds, mortgage backed securities, corporate obligations and Federal Home Loan Bank stock. At December 31, 2005 approximately $10.3 million or 8.00% of its total assets, consisted of such investments. All of Mutual's securities, except for Federal Home Loan Bank stock, were classified as held to maturity at December 31, 2005.

Back to Index

The following table sets forth the carrying value and market value of Mutual's investments at the dates indicated.

	At December 31,			
	2005		2004	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)			
Held to Maturity:				
Agency and Treasury Securities	$ 5,289	$ 5,256	$ 10,455	$ 10,445
State and Municipal	400	394	-	-
Mortgage Backed Securities	2,580	2,538	-	-
Corporate Obligations	941	936	-	-
FHLB Stock [1]	1,041	1,041	1,020	1,020
Total Investment Securities	$ 10,251	$ 10,165	$ 11,475	$ 11,465

[1] Market value is based on the price at which the stock may be resold to the FHLB of Indianapolis.

At December 31, 2005, investment securities, excluding Federal Home Loan Bank stock, which has no stated maturity, will mature as follows: $5.4 million by December 31, 2006, $1.6 million by December 31, 2007, $1.8 million by December 31, 2008 and $400,000 by December 31, 2010. At December 31, 2005, the weighted average yield on agency securities and FHLB stock was 3.27% and 4.24%, respectively.

SOURCES OF FUNDS

GENERAL. Deposits have traditionally been Mutual's primary source of funds for use in lending and investment activities. In addition to deposits, Mutual derives funds from scheduled loan payments, loan prepayments, retained earnings and income on earning assets. While scheduled loan payments and income on earning assets are relatively stable sources of funds, deposit inflows and outflows can vary widely and are influenced by prevailing interest rates, market conditions and levels of competition. Mutual can use borrowings from the Federal Home Loan Bank of Indianapolis in the short-term to compensate for reductions in deposits or deposit inflows at less than projected levels. Mutual occasionally borrows on a longer-term basis, for example to assist in asset/liability management.

DEPOSITS. Mutual attracts deposits principally from within Johnson County through the offering of a broad selection of deposit instruments including fixed-rate certificates of deposit, NOW and other transaction accounts, and savings accounts. Mutual does not actively solicit or advertise for deposits outside of Johnson County. Substantially all of its depositors are residents of Johnson County. Deposit account terms vary, with the principal differences being the minimum balance required, the amount of time the funds remain on deposit and the interest rate. Mutual does not pay a fee for any deposits it receives.

Mutual establishes the interest rates paid, maturity terms, service fees and withdrawal penalties on a periodic basis. Determination of rates and terms are predicated on funds acquisition and liquidity requirements, rates paid by competitors, growth goals, and applicable regulations. Mutual relies, in part, on customer service and long-standing relationships with customers to attract and retain its deposits. Mutual also closely prices its deposits in relation to rates offered by its competitors.

The flow of deposits is influenced significantly by general economic conditions, changes in money market and prevailing interest rates and competition. The variety of deposit accounts Mutual offers has allowed it to be competitive in obtaining funds and to respond with flexibility to changes in consumer demand. Mutual has become more susceptible to short-term fluctuations in deposit flows as

Back to Index

customers have become more interest rate sensitive. Mutual manages the pricing of its deposits in keeping with its asset/liability management and profitability objectives. Based on its experience, Mutual's management believes that Mutual's passbook, NOW, money market savings and non-interest-bearing checking accounts are relatively stable sources of deposits. However, Mutual's ability to attract and maintain certificates of deposit, and the rates paid on these deposits, has been and will continue to be significantly affected by market conditions.

An analysis of Mutual's deposit accounts by type, maturity, and rate at December 31, 2005, is as follows:

Type of Account	Balance at December 31, 2005	% of Deposits	Weighted Average Rate
	(In Thousands)		
Withdrawable:			
Non-Interest Bearing Demand	$ 10,215	11.53%	0.00%
Savings, NOW and Money Market	44,264	49.95	1.62
Total Withdrawable	$ 54,479	61.48%	1.48%
Certificates (Original Terms):			
91 Day	$ 432	0.49%	2.53%
182 Day	1,786	2.02	2.97
Short Term	54	0.06	3.72
12 Month	6,170	6.96	3.30
15 Month	2,153	2.43	2.62
18 Month	3,726	4.20	3.04
24 Month	6,293	7.10	3.06
30 Month	2,153	2.43	3.05
36 Month	2,251	2.54	3.37
42 Month	13	0.01	2.28
48 Month	875	0.99	3.94
60 Month	4,102	4.63	4.39
IRA	4,121	4.65	3.05
Total Certificates	$ 34,129	38.52%	3.26%
Total Deposits	$ 88,608	100.00%	2.13%

Back to Index

The following table sets forth by various interest rate categories the composition of Mutual's term deposits at the dates indicated.

	At December 31, 2005	2004
	(In Thousands)	
1.00% to 1.99%	$ 414	$ 11,056
2.00% to 2.99%	12,455	13,743
3.00% to 3.99%	15,741	6,557
4.00% to 4.99%	4,590	2,752
5.00% to 5.99%	865	985
6.00% to 8.00%	63	479
Total	$ 34,129	$ 35,572

The following table represents, by various interest rate categories, the amounts of term deposits maturing during each of the three years following December 31, 2005, and the total amount maturing thereafter. Matured certificates that have not been renewed as of December 31, 2005, have been allocated based on certain rollover assumptions.

	Amounts at December 31, 2005			
	One Year or Less	Two Years	Three Years	Greater Than Three Years
	(In Thousands)			
1.00% to 1.99%	$ 413	$ 1	$ --	$ --
2.00% to 2.99%				