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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 31, 2011.

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: 001-14077

WILLIAMS-SONOMA, INC.

(Exact name of registrant as specified in its charter)

Delaware	94-2203880
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3250 Van Ness Avenue, San Francisco, CA	94109
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (415) 421-7900

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ü No ____

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

Large accelerated filer ü	Accelerated filer ____
Non-accelerated filer ____ (Do not check if a smaller reporting company)	Smaller reporting company ____

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

As of August 28, 2011, 103,678,962 shares of the registrant s Common Stock were outstanding.

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WILLIAMS-SONOMA, INC.

REPORT ON FORM 10-Q

FOR THE QUARTER ENDED JULY 31, 2011

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

Dollars and shares in thousands, except per share amounts	July 31, 2011	January 30, 2011	August 1, 2010
ASSETS			
Current assets			
Cash and cash equivalents	$ 424,634	$ 628,403	$ 404,037
Restricted cash	14,721	12,512	12,502
Accounts receivable, net	51,406	41,565	37,888
Merchandise inventories, net	556,628	513,381	518,623
Prepaid catalog expenses	41,663	36,825	41,798
Prepaid expenses	39,697	21,120	42,165
Deferred income taxes	85,690	85,612	92,241
Other assets	7,626	8,176	7,718
Total current assets	1,222,065	1,347,594	1,156,972
Property and equipment, net	735,129	730,556	771,635
Non-current deferred income taxes	32,381	32,646	52,129
Other assets, net	20,549	20,966	14,757
Total assets	$ 2,010,124	$ 2,131,762	$ 1,995,493
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities			
Accounts payable	$ 196,843	$ 227,963	$ 184,135
Accrued salaries, benefits and other	78,488	122,440	83,188
Customer deposits	191,889	192,450	190,347
Income taxes payable	13,190	41,997	17,507
Current portion of long-term debt	1,542	1,542	1,714
Other liabilities	25,731	25,324	25,279
Total current liabilities	507,683	611,716	502,170
Deferred rent and lease incentives	195,691	202,135	221,086
Long-term debt	7,064	7,130	7,197
Other long-term obligations	49,499	51,918	58,383
Total liabilities	759,937	872,899	788,836
Commitments and contingencies			
Shareholders equity			
Preferred stock, $.01 par value, 7,500 shares authorized, none issued	0	0	0
Common stock, $.01 par value, 253,125 shares authorized, issued and outstanding: 103,992, 104,888 and 106,483 shares at July 31, 2011, January 30, 2011 and August 1, 2010, respectively	1,040	1,049	1,065
Additional paid-in capital	478,024	466,885	462,106
Retained earnings	755,672	777,939	732,290
Accumulated other comprehensive income	15,451	12,990	11,196
Total shareholders equity	1,250,187	1,258,863	1,206,657
Total liabilities and shareholders equity	$ 2,010,124	$ 2,131,762	$ 1,995,493

See Notes to Condensed Consolidated Financial Statements.

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WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
Dollars and shares in thousands, except per share amounts	July 31, 2011	August 1, 2010	July 31, 2011	August 1, 2010
Net revenues	$ 814,750	$ 775,554	$ 1,585,575	$ 1,493,191
Cost of goods sold	506,029	488,827	980,971	935,906
Gross margin	308,721	286,727	604,604	557,285
Selling, general and administrative expenses	244,636	235,530	488,819	473,627
Interest expense, net	69	123	70	251
Earnings before income taxes	64,016	51,074	115,715	83,407
Income tax expense	24,707	20,315	44,791	33,110
Net earnings	$ 39,309	$ 30,759	$ 70,924	$ 50,297
Basic earnings per share	$ 0.38	$ 0.29	$ 0.68	$ 0.47
Diluted earnings per share	$ 0.37	$ 0.28	$ 0.66	$ 0.46
Shares used in calculation of earnings per share:				
Basic	104,467	107,668	104,795	107,370
Diluted	106,766	110,224	107,071	109,895

See Notes to Condensed Consolidated Financial Statements.

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WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Twenty-Six Weeks Ended	
	July 31,	August 1,
Dollars in thousands	2011	2010
Cash flows from operating activities:		
Net earnings	$ 70,924	$ 50,297
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	65,899	73,882
(Gain)/loss on sale/disposal of assets	646	(2,033)
Impairment of assets	172	2,032
Amortization of deferred lease incentives	(13,999)	(19,709)
Deferred income taxes	(4,830)	(6,327)
Tax benefit from exercise of stock-based awards	5,865	8,011
Stock-based compensation expense	12,256	15,269
Changes in:		
Accounts receivable	(9,048)	6,345
Merchandise inventories	(42,669)	(52,160)
Prepaid catalog expenses	(4,839)	(9,021)
Prepaid expenses and other assets	(17,262)	(17,952)

Accounts payable	(42,240)	(2,561)								
Accrued salaries, benefits and other current and long-term liabilities	(46,523)	(18,710)								
Customer deposits	(846)	(4,991)								
Deferred rent and lease incentives	7,648	(743)								
Income taxes payable	(28,885)	(30,740)								
Net cash used in operating activities	(47,731)	(9,111)								
Cash flows from investing activities:										
Purchases of property and equipment	(62,525)	(30,889)								
Restricted cash deposits	(2,209)	(12,502)								
Proceeds from sale of assets	41	10,715								
Other	(200)	0								
Net cash used in investing activities	(64,893	1.46	3,613	1.92						
Home equity lines of credit	18,676	7.88	12,142	5.31	6,161	2.95	7,162	3.77	7,096	3.77
Savings account loans	549	0.23	420	0.18	336	0.16	428	0.23	422	0.22
Total loans	237,100	100.00%	228,522	100.00%	209,048	100.00%	189,828	100.00%	187,999	100.00%
Less:										
Loans in process	(3,357)		(5,562)		(9,144)		(6,668)		(4,081)	
Unearned loan origination fees, net	(731)		(841)		(969)		(1,116)		(1,231)	
Allowance for loan losses	(2,645)		(2,180)		(1,910)		(1,840)		(1,675)	
Total loans, net	$230,367		$219,939		$197,025		$180,204		$181,012	

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Loan Maturity Schedule. The following table sets forth the maturity of the Company's loan portfolio at June 30, 2010. Demand loans, loans having no stated maturity, and overdrafts are shown as due in one year or less. This table shows contractual maturities and does not reflect repricing or the effect of prepayments. Actual maturities may differ.

	At June 30, 2010						
	One to Four Family	Construction and Land	Non-Residential and Multi-Family	Home Equity and Second Mortgage	Home Equity Lines of Credit	Consumer Loans and Savings Account Loans	Total
	(In Thousands)						
Amounts Due:							
Within 1 Year	$ 378	$ 6,570	$ 2,014	$ 113	$ -	$ 702	$ 9,777
After 1 year							
1 to 3 years	1,797	2,783	990	361	44	1,131	7,106
3 to 5 years	2,543	-	2,225	662	158	960	6,548
5 to 10 years	21,345	48	10,256	1,486	654	31	33,820
10 to 15 years	34,121	779	13,458	1,912	17,670	-	67,940
Over 15 years	85,047	-	25,334	1,301	150	77	111,909
Total due after one year	144,853	3,610	52,263	5,722	18,676	2,199	227,323
Total	$ 145,231	$ 10,180	$ 54,277	$ 5,835	$ 18,676	$ 2,901	$ 237,100

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The following table sets forth the dollar amount of all loans at June 30, 2010 due after June 30, 2011 which have fixed interest rates and floating or adjustable interest rates.

	Fixed Rates	Floating or Adjustable Rates	Total
		(In thousands)	
Real estate mortgage			
One- to four-family	$ 75,813	$ 69,040	$ 144,853
Home equity and second mortgage	3,610	-	3,610
Nonresidential and multi-family	25,656	26,607	52,263
Construction and Land	5,476	246	5,722
Home equity lines of credit	-	18,676	18,676
Consumer loans and savings account loans	113	2,086	2,199
Total	$ 110,668	$ 116,655	$ 227,323

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

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

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

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

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

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

The Automated Valuation Models (AVM) is used for home equity loans and lines of credit in amounts of $100,000 or less or with loan-to-values of less than 70%. Should we deem an AVM to be inadequate given the circumstances of a particular loan, a full appraisal may be requested at the borrower's expense.

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

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

Multi-Family and Nonresidential (Commercial) Mortgages. Our nonresidential real estate lending consists primarily of mortgage loans for the acquisition or refinance of service/retail and mixed-use properties, churches and non-profit properties, professional facilities and other commercial real estate. The maximum loan-to-value ratio on all multi-family properties or on office/professional properties under $200,000 is 80%. All other nonresidential properties have a 75% limit. The maximum term on a fixed- rate loan is 20 years. We offer a 30-year term on an adjustable-rate loan. We will provide multi-family and nonresidential financing for both owner-occupied properties and for investor properties. There was a significant increase in the balance of mortgage loans secured by nonresidential real estate as of June 30, 2010 as opposed to the balance one year earlier. This is attributable to a large transaction that took place in September 2009. The bank took advantage of an opportunity to acquire participating interests in seven large performing loans from another bank's portfolio. The total purchase was approximately $10,600,000. All of the loans are current as of June 30, 2010.

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

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therefore, have greater credit risk than one to four family residential mortgages or consumer loans. In addition, these loans generally result in larger balances to single borrowers, or related groups of borrowers, and also generally require substantially greater evaluation and oversight efforts.

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

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

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

Loans to One Borrower. Under federal law, savings institutions have, subject to certain exemptions, lending limits to one borrower in an amount equal to the greater of $500,000 or 15% of the institution's unimpaired capital and surplus. Accordingly, based on our financial condition as of June 30, 2010, our loans to one borrower regulatory lending limit was approximately $7.2 million. Our largest borrower at that date had 38 loans outstanding with an aggregate balance of $5.9 million, representing mortgages secured by liens on commercial real estate. The Board of Directors evaluates the creditworthiness of large borrowers on a case-by-case basis, and the Board is willing to lend up to the regulatory limit for what it determines to be quality loans.

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

Loan Commitments. We give written commitments to prospective borrowers on all residential and non-residential mortgage loans. The total amount of commitments to extend credit for mortgage and consumer loans as of June 30, 2010, was approximately $5.6 million, excluding undisbursed portions of construction loans totaling $3.4 million. We also had $13.5 million of unfunded commitments on lines of credit as of that date.

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

Asset Quality

Loan Delinquencies and Collection Procedures. When a loan is 90 days delinquent, the Board may determine to refer it to an attorney for repossession or foreclosure. Reasonable attempts are made to collect from borrowers prior to referral to an attorney for collection. In certain instances, we may modify the loan or grant a limited moratorium on loan payments to enable the borrower to reorganize his or her financial affairs, and we attempt to work with the borrower to establish a repayment schedule to cure the delinquency.

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

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

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

	At June 30,				
	2010	2009	2008	2007	2006
	(Dollars in thousands)				
One- to four-family mortgage loans	$ 1,454	$ 1,280	$ 1,180	$ 867	$ 402
Multi-family mortgage loans	-	203	—	—	—
Nonresidential loans	-	-	1,122	841	—
Construction loans	-	-	649	245	—
Consumer loans	-	-	—	—	—
Home equity lines of credit	-	-	38	111	—
Total non-performing loans	$ 1,454	$ 1,483	$ 2,989	$ 2,064	$ 402
Real estate owned	$ 233	$ 206	$ —	$ —	$ —
Total non-performing assets	$ 1,687	$ 1,689	$ 2,989	$ 2,064	$ 402
Total non-performing loans to total loans	0.62%	0.67%	1.50%	1.13%	0.21%
Total non-performing loans to total assets	0.45%	0.48%	1.06%	0.77%	0.15%
Total non-performing assets to total assets	0.52%	0.55%	1.06%	0.77%	0.15%

At June 30, 2010 $1.2 million of the non-performing loans was to one borrower as discussed under "Allowance for Loan Losses". We did not have any troubled debt restructurings (wherein the borrower is granted a concession that we would not otherwise consider under current market conditions) as of the dates shown in the above table.

As of June 30, 2010, there were no loans not reflected in the above table as to which known information about possible credit problems of borrowers caused management to have serious doubts about the ability of such borrowers to comply with present loan repayment terms and which may result in such loans being disclosed as non-performing in the future, other than the special mention loans discussed under "Classified Assets".

During the year ended June 30, 2010, gross interest income of less than $104,000 would have been recorded on loans accounted for on a non-accrual basis if those loans had been current, and $18,000 in interest on such loans was included in income for the year ended June 30, 2010.

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

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

	Year Ended June 30,		
	2010	2009	2008
	(In thousands)		
Impaired loans without a valuation allowance	$ 3,824	$ 1,713	$ --
Impaired loans with a valuation allowance	3,977	4,155	4,123
Total impaired loans	$ 7,801	$ 5,868	$ 4,123
Valuation allowance related to impaired loans	$ 983	$ 561	$ 888

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

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

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

As of June 30, 2010, 2009 and 2008 our classified loans were as follows.

	At June 30,		
	2010	2009	2008
	(In thousands)		
Special Mention	$ 7,449	$ 6,533	$ 3,001
Substandard	1,886	1,689	2,989
Doubtful	—	—	—
Loss	—	—	—
Total	$ 9,335	$ 8,222	$ 5,990

Special mention loans at June 30, 2010, 2009, and 2008 include one $3.0 million loan secured by a tract of land in Wildwood, New Jersey and discussed below. Also included in special mention at June 30, 2010 are the following: one $3.0 million participation loan on an office building complex included because lease up of part of the complex has been slower than expected, and two participation loans totaling $1.4 million on a residential development project experiencing slower than expected sales. All three of these loans were current as of June 30, 2010.

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

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

The Bank's loan loss experience in recent periods has been low. Over the last five fiscal years, the Bank had loan charge offs totaling $298,000 and recoveries totaling $121,000. Provisions to the allowance in recent periods have been more influenced by current economic conditions than by the Bank's recent loss experience. The allowance includes a significant provision on a land loan secured by a tract of land in Wildwood, New Jersey due to the ongoing concerns about the financial condition of the borrower on this loan. Monthly payments were current as of June 30, 2010, however payments are being received not from the borrower but from the borrower's business partner, who could cease payment at any time as he is not a party to the loan agreement and has no legal obligation to make payments on this loan. The most recent appraisal the Bank has on this property was prepared in 2004, and although that "as is" appraisal for this undeveloped site was greater than the outstanding balance of the loan, the Bank has designated the loan as special mention in light of the uncertainty related to the development of the property. The issues that could impede the development include zoning, wetlands preservation, site improvements and environmental cleanup. The bank has established a specific reserve of $545,000 against the balances of six impaired loans to a troubled borrower. The loans have balances totaling $1,243,000, they are secured by first liens against ten residential properties, eight properties are located in Trenton NJ, and two are located in Freehold, NJ. The borrowing entities have filed bankruptcy and we are concerned that resolution of the situation will be prolonged.

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

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

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

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

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

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

	For the Year Ended June 30, 2010	2009	2008	2007	2006
	(Dollars in thousands)				
Allowance balance (at beginning of period)	$2,180	$1,910	$1,840	$1,675	$1,500
Provision for loan losses	379	531	70	156	186
Charge-offs:					
One- to four-family mortgage loans		—	—	—	—
Construction loans	23	100	—	—	—
Commercial		156	—	—	—
Consumer loans	1	5	—	—	13
Total charge-offs	24	261	—	—	13
Recoveries:					
One- to four-family mortgage loans	110	—	—	—	—
Construction loans		—	—	—	—
Commercial		—	—	—	—
Consumer loans		—	—	9	2
Total recoveries	110	—	—	9	2
Net (charge-offs) recoveries	86	(261)	—	9	(11)
Allowance balance (at end of period)	$2,645	$2,180	$1,910	$1,840	$1,675
Total loans outstanding	$233,743	$222,960	$199,904	$183,160	$183,918
Average loans outstanding(1)	$228,239	$216,095	$186,244	$182,672	$185,954
Allowance for loan losses as a percent of total loans outstanding	1.13%	0.98%	0.96%	1.00%	0.91%
Allowance for loan losses to non-performing loans	181.91%	147.00%	63.90%	89.15%	416.67%
Net charge-offs to average loans	0.04%	0.12%	0.00%	0.00%	0.00%

(1) Average balances for fiscal year 2010 are derived from daily average balances, while for the prior years the average balances are derived from month-end average balances

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

	At June 30, 2010		2009		2008		2007		2006	
	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans
	(Dollars in thousands)									
At end of period allocated to:										
Real estate mortgage										
One- to four-family	$ 1,357	61.25%	$ 918	62.36%	$ 273	62.04%	$ 279	61.82%	$ 264	62.41%
Home equity and second mortgages	20	2.46	26	3.18	20	4.02	18	4.63	18	4.80
Multi-family	87	4.25	90	4.49	30	5.85	162	5.70	166	5.92
Nonresidential	471	18.65	401	15.48	575	14.48	503	14.43	376	13.46
Land	447	1.94	451	1.75	618	1.93	489	2.11	498	2.28
Construction	146	2.35	169	6.22	170	7.40	67	5.85	71	5.22
Consumer	57	0.99	23	1.03	45	1.17	89	1.46	108	1.92
Home equity lines of credit	60	7.88	44	5.31	15	2.95	20	3.77	14	3.77
Loans on savings accounts	-	0.23	—	0.18	—	0.16	—	0.23	—	0.22
Unallocated	--	0.00	58	0.00	164	0.00	213	0.00	160	0.00
Total allowance	$ 2,645	100.00%	$ 2,180	100.00%	$ 1,910	100.00%	$ 1,840	100.00%	$ 1,675	100.00%

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Securities Portfolio

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

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

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

U.S. generally accepted accounting principles require that securities be categorized as "held to maturity," "trading securities" or "available-for-sale," based on management's intent as to the ultimate disposition of each security. U.S. generally accepted accounting principles allows debt securities to be classified as "held to maturity" and reported in financial statements at amortized cost only if the reporting entity has the positive intent and ability to hold these securities to maturity. Securities that might be sold in response to changes in market interest rates, changes in the security's prepayment risk, increases in loan demand, or other similar factors cannot be classified as "held to maturity."

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

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

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

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

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

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

Collateralized mortgage obligations are mortgage-derivative products that aggregate pools of mortgages and mortgage-backed securities and create different classes of securities with varying maturities and amortization schedules as well as a residual interest with each class having different risk characteristics. The cash flows from the underlying collateral are usually divided into "tranches" or classes whereby tranches have descending priorities with respect to the distribution of principal and interest repayment of the underlying mortgages and mortgage-backed securities as opposed to pass through mortgage-backed securities where cash flows are distributed pro rata to all security holders. Unlike mortgage-backed securities from which cash flow is received and risk is shared pro rata by all securities holders, cash flows from the mortgages and mortgage-backed securities underlying collateralized mortgage obligations are paid in accordance with a predetermined priority to investors holding various tranches of the securities or obligations. William Penn Bank's investment in non-government agency collateralized mortgage obligations has increased in the last two years. The balance of its investments in these securities was $16.4 million as of June 30, 2010, $13.4 million as of June 30, 2009 and $6.1 million as of June 30, 2008. All of our non-government agency collateral mortgage obligations make up our available-for-sale portfolio. All of our other investments are considered held-to- maturity.

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

	At June 30,		
	2010	2009	2008
		(In thousands)	
Securities Available for Sale:			
Mutual funds	$13	$10	$5
Collateralized Mortgage Obligations	16,434	—	—
Total Available for sale	$16,447	10	5
Securities Held to Maturity:			
U.S. Government corporations and agencies securities	$37,971	$32,371	$48,005
Mortgage-backed securities	4,977	6,908	10,631
Collateralized Mortgage Obligations:			
U.S. agency	4,767	5,828	4,041
Private label	—	13,408	336
Corporate debt securities	—	201	—
Municipal bonds	299	299	—
Total Held to Maturity	$48,014	$59,015	$63,013

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The following tables set forth certain information regarding the amortized cost, weighted average yields and maturities of our investment and mortgage-backed securities portfolio at June 30, 2010. These tables show contractual maturities and do not reflect repricing or the effect of prepayments. Actual maturities may differ.

	At June 30, 2010										
	One Year or Less		One to Five Years		Five to Ten Years		More Than Ten Years		Total Securities		
	Amortized cost	Weighted Average Yield	Amortized cost	Weighted Average Yield	Amortized cost	Weighted Average Yield	Amortized cost	Weighted Average Yield	Amortized cost	Weighted Average Yield	Fair Value
	(Dollars in thousands)										
Mutual funds	$13	1.50%	$-	- %	$-	- %	$-	- %	$13	1.50%	$13
U.S. Government corporations and agencies securities	2,000	2.98	14,000	1.16	15,051	3.02	6,920	4.66	37,971	2.63	38,355
Mortgage-backed securities	-	-	49	6.37	181	3.03	4,747	3.90	4,977	3.89	5,187
Collateralized Mortgage obligations:											
U.S. agency	564	4.00	11	4.00	13	1.03	4,179	1.48	4,767	1.78	4,842
Private labeled	-	-	877	5.50	5,276	4.17	9,075	4.05	15,228	4.18	16,434
Municipal Bonds	-	-	-	-	299	3.50	-	-	299	3.50	305
Total	$2,577	3.20%	$14,937	1.43%	$20,820	3.32%	$24,921	3.76%	$63,255	3.04%	$65,136

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Sources of Funds

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

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

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

We traditionally have preferred to obtain deposits from within our market area and have discouraged non-local deposits. We obtained $1,998,000 of brokered deposits during fiscal year ended June 30, 2010 to demonstrate our ability to acquire funds from alternative sources as part of emergency preparedness. These deposits remain outstanding at year end.

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

	Year Ended June 30,					
	2010		2009		2008	
	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate
	(Dollars in thousands)					
Noninterest-bearing demand accounts	$1,660	— %	$1,496	— %	$1,522	— %
NOW accounts	14,447	0.35	13,240	0.83	12,597	1.36
Money market accounts	41,612	1.03	38,456	1.94	37,989	3.49
Savings and club accounts	13,790	0.76	13,214	1.30	14,026	2.40
Certificates of deposit	101,453	2.50	94,687	3.49	93,766	4.52
Total deposits	$172,962		$161,093		$159,900	

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

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The following table shows the amount of our certificates of deposit of $100,000 or more by time remaining until maturity as of June 30, 2010.

	At June 30, 2010 (In thousands)
Maturity Period	
Within three months	$ 11,810
Three through six months	7,259
Six through twelve months	7,453
Over twelve months	15,876
	$ 42,398

Borrowings. We periodically borrow funds from the Federal Home Loan Bank of Pittsburgh to supplement deposits as a source of funds. As of June 30, 2010, our borrowings totaled $89.0 million and had a weighted average cost of 3.79%. As a strategy to lock in rates on funding beginning in the late 1990s we took long term advances to protect against rising rates. Rates, however, fell to historic lows instead of rising. These borrowings had been a drain on our profitability and we determined in early December 2007 to undertake a refinancing of these advances, as we expected the improvement in our net interest margin resulting from the refinancing would make it worth incurring a significant penalty for the pre-payment of the advances. The penalty was a $1.5 million charge to earnings during the quarter ended December 31, 2007. We pre-paid $25.0 million of advances with a weighted average rate of 5.87% and took replacement advances totaling $30.0 million with a weighted average rate of 3.84%.

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

	At or For the Year Ended June 30,		
	2010	2009	2008
	(Dollars in thousands)		
Federal Home Loan Bank Advances:			
Average balance outstanding	$ 89,583	$ 85,385	$ 70,000
Maximum amount outstanding at any month-end during the period	92,000	89,000	72,000
Balance outstanding at end of period	89,000	89,000	72,000
Weighted average interest rate during the period	4.16%	4.46%	5.19%
Weighted average interest rate at end of period	3.79%	4.37%	4.53%

Additional information regarding our borrowings is included in Note 9 to the Consolidated Financial Statements incorporated by reference herein.

Subsidiaries

The Company's only subsidiary is the Bank. The Bank has one subsidiary: WPSLA Investment Corporation, incorporated under Delaware law in 2000 to hold securities. At June 30, 2010, this subsidiary held securities with a carrying value of approximately $32.0 million, representing about half of our total securities portfolio of $63.3 million at that date.

Personnel

As of June 30, 2010, we had 33 full-time employees and 4 part-time employees. Our employees are not represented by a collective bargaining unit. We believe our relationship with our employees is good.

Competition

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

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

REGULATION

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

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

Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) was signed into law. The Dodd-Frank Act is intended to effect a fundamental restructuring of federal banking regulation. Among other things, the Dodd-Frank Act creates a new Financial Stability Oversight Council to identify systemic risks in the financial system and gives federal regulators new authority to take control of and liquidate financial firms. The Dodd-Frank Act eliminates our current primary federal regulator and subjects savings and loan holding companies to greater regulation. The Dodd-Frank Act additionally creates a new independent federal regulator to administer federal consumer

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protection laws. The Dodd-Frank Act is expected to have a significant impact on our business operations as its provisions take effect. Among the provisions that are likely to affect us are the following:

Elimination of OTS. The Dodd-Frank Act calls for the elimination of the OTS, which is our primary federal regulator and the primary federal regulator of the Bank within 12 to 18 months of enactment. At that time, the primary federal regulator of William Penn Bancorp, Inc. will become the Board of Governors of the Federal Reserve System (the "Federal Reserve"), and the primary federal regulator for the Bank will become the Office of the Comptroller of the Currency ("OCC") if we retain our federal savings bank charter. The Federal Reserve and OCC will generally have rulemaking, examination, supervision and oversight authority over our operations and the FDIC will retain secondary authority over the Bank. Prior to the elimination of the OTS, the Federal Reserve and OCC will provide a list of the current regulations issued by the OTS that each will continue to apply. OTS guidance, orders, interpretations, policies and similar items under which we and other savings and loan holding companies and federal savings associations operate will continue to remain in effect until they are superseded by new guidance and policies from the OCC or Federal Reserve.

New Limits on MHC Dividend Waivers. Effective as of the date of transfer of OTS's duties, the Dodd-Frank Act will make significant changes in the law governing waivers of dividends by mutual holding companies. After that date, a mutual holding company may only waive the receipt of a dividend from a subsidiary if no insider of the mutual holding company or their associates or tax-qualified or nontax-qualified employee stock benefit plan holds any shares of the class of stock to which the waiver would apply, the mutual holding company gives written notice of its intent to waive the dividend at least 30 days prior to the proposed payment date and the Federal Reserve does not object. The Federal Reserve will not object to a dividend waiver if it determines that the waiver would not be detrimental to the safe and sound operation of the savings association, the mutual holding company's board determines that the waiver is consistent with its fiduciary duties and the mutual holding company has waived dividends prior to December 1, 2009. In addition, waived dividends must be taken into account in determining the appropriate exchange ratio for a second-step conversion of a mutual holding company unless the mutual holding company has waived dividends prior to December 1, 2009.

Holding Company Capital Requirements. Effective as of the transfer date, the Federal Reserve will be authorized to establish capital requirements for savings and loan holding companies. These capital requirements must be countercyclical so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, consistent with safety and soundness. Savings and loan holding companies will also be required to serve as a source of financial strength for their depository institution subsidiaries. Within five years after enactment, the Dodd-Frank Act requires the Federal Reserve to apply consolidated capital requirements that are no less stringent than those currently applied to depository institutions to depository institution holding companies that were not supervised by the Federal Reserve as of May 19, 2009. Under these standards, trust preferred securities will be excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by a bank or savings and loan holding company with less than $15 billion in assets.

Federal Preemption. A major benefit of the federal thrift charter has been the strong preemptive effect of the Home Owners' Loan Act ("HOLA"), under which we are chartered. Historically, the courts have interpreted the HOLA to "occupy the field" with respect to the operations of federal thrifts, leaving no room for conflicting state regulation. The Dodd-Frank Act, however, amends the HOLA to specifically provide that it does not occupy the field in any area of state law. Henceforth, any preemption determination must be made in accordance with the standards applicable to national banks, which have themselves been scaled back to require case-by-case determinations of whether state consumer protection laws discriminate against national banks or interfere with the exercise of their powers before these laws may be pre-empted.

Deposit Insurance. The Dodd-Frank Act permanently increases the maximum deposit insurance amount for banks, savings institutions and credit unions to $250,000 per depositor, retroactive to January 1, 2009, and extends unlimited deposit insurance to non-interest bearing transaction accounts through December 1, 2013. The Dodd-Frank Act also broadens the base for FDIC insurance assessments. Assessments will now be based on the average consolidated total assets less tangible equity capital of a financial institution. The Dodd-Frank Act requires the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. The Dodd-Frank Act eliminates the federal statutory prohibition against the payment of interest on business checking accounts.

Qualified Thrift Lender Test. Under the Dodd-Frank Act, a savings association that fails the qualified thrift lender test will be prohibited from paying dividends, except for dividends that: (i) would be permissible for a national bank; (ii) are necessary to meet obligations of a company that controls the savings association; and (iii) are specifically approved by the OCC and the Federal Reserve. In addition, a savings association that fails the qualified thrift lender test will be deemed to have violated Section 5 of the Home Owners' Loan Act and may become subject to enforcement actions there under.

Corporate Governance. The Dodd-Frank Act will require publicly traded companies to give stockholders a non-binding vote on executive compensation at their first annual meeting taking place six months after the date of enactment and at least every three years thereafter and on so-called "golden parachute" payments in connection with approvals of mergers and acquisitions. The new legislation also authorizes the SEC to promulgate rules that would allow stockholders to nominate their own candidates using a company's proxy materials. Additionally, the Dodd-Frank Act directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of $1.0 billion, regardless of whether the company is publicly traded or not. The Dodd-Frank Act gives the SEC authority to prohibit broker discretionary voting on elections of directors and executive compensation matters.

Transactions with Affiliates and Insiders. Effective one year from the date of enactment, the Dodd-Frank Act expands the definition of affiliate for purposes of quantitative and qualitative limitations of Section 23A of the Federal Reserve Act to include mutual funds advised by a depository institution or its affiliates. The Dodd-Frank Act will apply Section 23A and Section 22(h) of the Federal Reserve Act (governing transactions with insiders) to derivative transactions, repurchase agreements and securities lending and borrowing transaction that create credit exposure to an affiliate or an insider. Any such transactions with affiliates must be fully secured. The current exemption from Section 23A for transactions with financial subsidiaries will be eliminated. The Dodd-Frank Act will additionally prohibit an insured depository institution from purchasing an asset from or selling an asset to an insider unless the transaction is on market terms and, if representing more than 10% of capital, is approved in advance by the disinterested directors.

Consumer Financial Protection Bureau. The Dodd-Frank Act creates a new, independent federal agency called the Consumer Financial Protection Bureau ("CFPB"), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB will have examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions will be subject to rules promulgated by the CFPB but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB will have authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower's ability to repay. In addition, the Dodd-Frank Act will allow borrowers to raise certain defenses to foreclosure if they receive any loan other than a "qualified mortgage" as defined by the CFPB. The Dodd-Frank Act permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations. Federal preemption of state consumer protection law requirements, traditionally an attribute of the federal savings association charter, has also been modified by the Dodd-Frank Act and now requires a case-by-case determination of preemption by the OCC and eliminates preemption for subsidiaries of a bank. Depending on the implementation of this revised federal preemption standard, the operations of the Bank could become subject to additional compliance burdens in the states in which it operates.

Regulation of William Penn Bank

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

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

Federal Deposit Insurance. The Bank's deposits are insured to applicable limits by the FDIC. The maximum deposit insurance amount has been permanently increased from $100,000 to $250,000 by the Dodd-Frank Act. On October 13, 2008, the FDIC established a Temporary Liquidity Guarantee Program under which the FDIC fully guarantees all non-interest-bearing transaction accounts until December 31, 2009 (the "Transaction Account Guarantee Program") and all senior unsecured debt of insured depository institutions or their qualified holding companies issued between October 14, 2008 and June 30, 2009, with the FDIC's guarantee expiring by June 30, 2012 (the "Debt Guarantee Program"). Senior unsecured debt would include federal funds purchased and certificates of deposit standing to the credit of the bank. After November 12, 2008, institutions that did not opt out of the Programs by

December 5, 2008 were assessed at the rate of ten basis points for transaction account balances in excess of $250,000 and at a rate between 50 and 100 basis points of the amount of debt issued. In May, 2009, the Debt Guarantee Program issue end date and the guarantee expiration date were both extended, to October 31, 2009 and December 31, 2012, respectively. Participating holding companies that have not issued FDIC-guaranteed debt prior to April 1, 2009 must apply to remain in the Debt Guarantee Program. Participating institutions will be subject to surcharges for debt issued after that date. Effective October 1, 2009, the Transaction Account Guarantee Program was extended until December 31, 2010, with an assessment of between 15 and 25 basis points after January 1, 2010. The Company and the Bank did not opt out of the Debt Guarantee Program. The Bank did not opt out of the original Transaction Account Guarantee Program or its extension. The Dodd-Frank Act has extended unlimited deposit insurance to non-interest-bearing transaction accounts until December 31, 2013.

The FDIC has adopted a risk-based premium system that provides for quarterly assessments based on an insured institution's ranking in one of four risk categories based on their examination ratings and capital ratios. Well-capitalized institutions with the CAMELS ratings of 1 or 2 are grouped in Risk Category I and, until 2009, were assessed for deposit insurance at an annual rate of between five and seven basis points with the assessment rate for an individual institution determined according to a formula based on a weighted average of the institution's individual CAMELS component ratings plus either five financial ratios or the average ratings of its long-term debt. Institutions in Risk Categories II, III and IV were assessed at annual rates of 10, 28 and 43 basis points, respectively.

Pursuant to the Federal Deposit Insurance Reform Act of 2005 (the "Reform Act"), the FDIC is authorized to set the reserve ratio for the Deposit Insurance Fund annually at between 1.15% and 1.5% of estimated insured deposits. Due to recent bank failures, the FDIC determined that the reserve ratio was 1.01% as of June 30, 2008. In accordance with the Reform Act, as amended by the Helping Families Save Their Home Act of 2009, the FDIC has established and implemented a plan to restore the reserve ratio to 1.15% within eight years. For the quarter beginning January 1, 2009, the FDIC raised the base annual assessment rate for institutions in Risk Category I to between 12 and 14 basis points while the base annual assessment rates for institutions in Risk Categories II, III and IV were increased to 17, 35 and 50 basis points, respectively. For the quarter beginning April 1, 2009 the FDIC set the base annual assessment rate for institutions in Risk Category I to between 12 and 16 basis points and the base annual assessment rates for institutions in Risk Categories II, III and IV at 22, 32 and 45 basis points, respectively. An institution's assessment rate could be lowered by as much as five basis points based on the ratio of its long-term unsecured debt to deposits or, for smaller institutions based on the ratio of certain amounts of Tier 1 capital to adjusted assets. The assessment rate may be adjusted for Risk Category I institutions that have a high level of brokered deposits and have experienced higher levels of asset growth (other than through acquisitions) and could be increased by as much as ten basis points for institutions in Risk Categories II, III and IV whose ratio of brokered deposits to deposits exceeds 10%. Reciprocal deposit arrangements like CDARS® were treated as brokered deposits for Risk Category II, III and IV institutions but not for institutions in Risk Category I. An institution's base assessment rate would also be increased if an institution's ratio of secured liabilities (including FHLB advances and repurchase agreements) to deposits exceeds 25%. The maximum adjustment for secured liabilities for institutions in Risk Categories I, II, III and IV would be 8, 11, 16 and 22.5 basis points, respectively, provided that the adjustment may not increase an institution's base assessment rate by more than 50%.

The FDIC imposed a special assessment equal to five basis points of assets less Tier 1 capital as of June 30, 2009, payable on September 30, 2009, and reserved the right to impose additional special assessments. In November, 2009, instead of imposing additional special assessments, the FDIC amended the assessment regulations to require all insured depository institutions to prepay their estimated risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012 on December 30, 2009. For purposes of estimating the future assessments, each institution's base assessment rate in effect

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on September 30, 2009 was used, assuming a 5% annual growth rate in the assessment base and a 3 basis point increase in the assessment rate in 2011 and 2012. The prepaid assessment will be applied against actual quarterly assessments until exhausted. Any funds remaining after June 30, 2013 will be returned to the institution. If the prepayment would impair an institution's liquidity or otherwise create significant hardship, it may apply for an exemption. Requiring this prepaid assessment does not preclude the FDIC from changing assessment rates or from further revising the risk-based assessment system.

In addition, all FDIC-insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation ("FICO"), an agency of the Federal government established to recapitalize the Federal Savings and Loan Insurance Corporation. The FICO assessment rates, which are determined quarterly, averaged .01% of insured deposits on an annualized basis in fiscal year 2009. These assessments will continue until the FICO bonds mature in 2017.

Regulatory Capital Requirements. Office of Thrift Supervision capital regulations require savings institutions to meet three minimum capital standards: (1) tangible capital equal to 1.5% of total adjusted assets, (2) "Tier 1" or "core" capital equal to at least 4% (3% if the institution has received the highest possible rating on its most recent examination) of total adjusted assets, and (3) risk-based capital equal to 8% of total risk-weighted assets. In assessing an institution's capital adequacy, the Office of Thrift Supervision takes into consideration not only these numeric factors but also qualitative factors, and has the authority to establish higher capital requirements for individual institutions where necessary.

At June 30, 2010, William Penn Bank was in compliance with the minimum capital standards and qualified as "well capitalized."

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

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

The risk-based capital standard for savings institutions requires the maintenance of total capital of 8% of risk-weighted assets. Total capital equals the sum of core and supplementary capital. The components of supplementary capital include, among other items, cumulative perpetual preferred stock, perpetual subordinated debt, mandatory convertible subordinated debt, intermediate-term preferred stock, the portion of the allowance for loan losses not designated for specific loan losses and up to 45% of unrealized gains on equity securities. The portion of the allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, supplementary

capital is limited to 100% of core capital. For purposes of determining total capital, a savings institution's assets are reduced by the amount of capital instruments held by other depository institutions pursuant to reciprocal arrangements and by the amount of the institution's equity investments (other than those deducted from core and tangible capital).

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

Dividend and Other Capital Distribution Limitations. A savings institution, like William Penn Bank, that is a subsidiary of a savings and loan holding company must file an application or a notice with the Office of Thrift Supervision at least thirty days before making a capital distribution, such as paying a dividend to William Penn Bancorp. The Office of Thrift Supervision imposes various restrictions or requirements on the ability of savings institutions to make capital distributions, including cash dividends. A savings institution must file an application for prior approval of a capital distribution if: (i) it is not eligible for expedited treatment under the applications processing rules of the Office of Thrift Supervision; (ii) the total amount of all capital distributions, including the proposed capital distribution, for the applicable calendar year would exceed an amount equal to the savings institution's net income for that year to date plus the institution's retained net income for the preceding two years; (iii) it would not adequately be capitalized after the capital distribution; or (iv) the distribution would violate an agreement with the Office of Thrift Supervision or applicable regulations. If an application is not required, then a notice must be filed. The Office of Thrift Supervision may disapprove a notice or deny an application for a capital distribution if: (i) the savings institution would be undercapitalized following the capital distribution; (ii) the proposed capital distribution raises safety and soundness concerns; or (iii) the capital distribution would violate a prohibition contained in any statute, regulation or agreement.

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

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

Qualified Thrift Lender Test. Savings institutions must meet a qualified thrift lender test or they become subject to the business activity restrictions and branching rules applicable to national banks. To qualify as a qualified thrift lender, a savings institution must either (i) be deemed a "domestic building and loan association" under the Internal Revenue Code by maintaining at least 60% of its total assets in specified types of assets, including cash, certain government securities, loans secured by and other assets related to residential real property, educational loans and investments in premises of the institution or (ii) satisfy the statutory qualified thrift lender test set forth in the Home Owners' Loan Act by maintaining at least 65% of its portfolio assets in qualified thrift investments (generally defined to include residential mortgages and related equity investments, certain mortgage-related securities, small business loans, student loans and credit card loans). For purposes of the statutory qualified thrift lender test, portfolio assets are defined as total assets minus goodwill and other intangible assets, the value of property used by the institution in conducting its business, and specified liquid assets up to 20% of total assets. A savings institution must maintain its status as a qualified thrift lender on a monthly basis in at least nine out of every twelve months. William Penn Bank met the qualified thrift lender test as of June 30, 2010 and in each of the last twelve months and, therefore, qualifies as a qualified thrift lender.

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

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

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

The Federal Home Loan Banks are required to provide funds for the resolution of troubled savings institutions and to contribute to affordable housing programs through direct loans or interest subsidies on advances targeted for community investment and low- and moderate-income housing projects. These contributions have adversely affected the level of Federal Home Loan Bank dividends paid and could continue to do so in the future. No dividends were received from FHLB in 12 months ended June 30, 2010. Dividends totaling $60,000 were received in the 12 months ended June 30, 2009. In addition, these requirements could result in the Federal Home Loan Banks imposing a higher rate of interest on advances to their members.

The USA Patriot Act. William Penn Bank is subject to regulations implementing the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, or the USA Patriot Act. The USA Patriot Act gave the federal government powers to address

terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. By way of amendments to the Bank Secrecy Act, Title III of the USA Patriot Act took measures intended to encourage information sharing among bank regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative obligations on a broad range of financial institutions, including banks, thrifts, brokers, dealers, credit unions, money transfer agents and parties registered under the Commodity Exchange Act.

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

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

- Establishment of a program specifying procedures for obtaining identifying information from customers seeking to open new accounts, including verifying the identity of customers within a reasonable period of time.

- Establishment of appropriate, specific, and, where necessary, enhanced due diligence policies, procedures, and controls designed to detect and report money laundering.

- Prohibitions on establishing, maintaining, administering or managing correspondent accounts for foreign shell banks (foreign banks that do not have a physical presence in any country), and compliance with certain record keeping obligations with respect to correspondent accounts of foreign banks.

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

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

Thrift Supervision could also take any one of a number of discretionary supervisory actions, including the issuance of a capital directive and the replacement of senior executive officers and directors. Significantly and critically undercapitalized institutions are subject to additional mandatory and discretionary measures.

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

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

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

Regulation of William Penn Bancorp

General. William Penn Bancorp is a savings and loan holding company within the meaning of Section 10 of the Home Owners' Loan Act. It is required to file reports with the Office of Thrift Supervision and is subject to regulation and examination by the Office of Thrift Supervision. William Penn Bancorp will need to obtain regulatory approval from the Office of Thrift Supervision before engaging in certain transactions, such as mergers with or acquisitions of other financial institutions. In addition, the Office of Thrift Supervision will have enforcement authority over William Penn Bancorp and any non-savings institution subsidiaries. This permits the Office of Thrift Supervision to restrict or prohibit activities that it determines to be a serious risk to William Penn Bank. This regulation is intended

primarily for the protection of the depositors in William Penn Bank and not for the benefit of stockholders of William Penn Bancorp.

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

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

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

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

Acquisition of Control. Under the federal Change in Bank Control Act, a notice must be submitted to the Office of Thrift Supervision if any person (including a company), or group acting in concert, seeks to acquire "control" of a savings and loan holding company or savings association. An acquisition of "control" can occur upon the acquisition of 10% or more of the voting stock of a savings and loan holding company or savings institution or as otherwise defined by the Office of Thrift Supervision. Under the Change in Bank Control Act, the Office of Thrift

Supervision has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the anti-trust effects of the acquisition. Any company that so acquires control would then be subject to regulation as a savings and loan holding company.

Item 1A. Risk Factors

Not applicable.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

As of June 30, 2010, our investment in premises and equipment, net of depreciation and amortization, totaled $1.1 million. We currently have three full-service offices, as shown in the table below.

Office Location	Year Facility Opened	Leased or Owned	Net Book Value at June 30, 2010 (In thousands)
Levittown	1967	Owned	$ 41
Morrisville	1973	Owned	$ 100
Richboro	1984	Owned	$ 204

We also own a five-acre tract of land in Levittown, Pennsylvania with a net book value as of June 30, 2010 of approximately $474,000. There are presently two buildings on this property. Our operations center occupies one building and the other building is leased to a physicians group surgical center. We have the necessary approvals and the construction of a new building on the vacant land on this site to serve as a new full-service office location is in process.

We also own two adjacent single-family residential properties in Furlong, Pennsylvania (within Bucks County) with a book value as of June 30, 2010 of approximately $299,000. We are currently holding these properties as a potential future office site.

Item 3. Legal Proceedings

William Penn Bank, from time to time, is a party to routine litigation which arises in the normal course of business, such as claims to enforce liens, condemnation proceedings on properties in which it holds security interests, claims involving the making and servicing of real property loans, and other issues incident to its business. There were no lawsuits pending or known to be contemplated against William Penn Bancorp or William Penn Bank as of June 30, 2010 that were expected to have a material effect on operations or income.

Item 4. [RESERVED]

PART II

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

(a) Market Information. The information contained under the section captioned "Stock Market Information" in the Company's Annual Report to Shareholders for the fiscal year ended June 30, 2010 (the "Annual Report") filed as Exhibit 13 to this Annual Report on Form 10-K is incorporated herein by reference.

(b) Use of Proceeds. Not applicable.

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

Item 6. Selected Financial Data

Not applicable.

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

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

Item 7A. Quantative and Qualitative Disclosures About Market Risk

Not applicable.

Item 8. Financial Statements and Supplementary Data

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

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

Not applicable.

Item 9A. Controls and Procedures.

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

(b) Internal Control Over Financial Reporting. Management's Report on Internal Control Over Financial Reporting incorporated herein by reference from the Annual Report. There were no changes in the Company's internal control over financial reporting that occurred during the Company's

last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information.

Not applicable.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information contained under the sections captioned "Corporate Governance," "Section 16(a) Beneficial Ownership Reporting Compliance" and "Proposal I -- Election of Directors" in the Company's definitive Proxy Statement for the 2010 Annual Meeting of Shareholders is incorporated herein by reference.

The Company has adopted a Code of Ethics that applies to its principal executive officer, principal financial officer, principal accounting officer or controller or persons performing similar functions. A copy of the Company's Code of Ethics will be provided to any person without charge upon written request to Charles Corcoran, Chief Financial Officer, William Penn Bancorp, Inc., 8150 Route 13, Levittown, Pennsylvania 19057.

Item 11. Executive Compensation

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

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

(a) Security Ownership of Certain Beneficial Owners

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

(b) Security Ownership of Management

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

(c) Changes in Control

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

(d) Securities Authorized for Issuance Under Equity Compensation Plans

Not applicable.

Item 13. Certain Relationships and Related Transactions and Director Independence

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

Item 14. Principal Accounting Fees and Services

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

PART IV

Item 15. Exhibits, Financial Statement Schedules

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

(1) The consolidated balance sheet of William Penn Bancorp, Inc. as of June 30, 2010 and 2009 and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the two years in the period ended June 30, 2010, together with the related notes and the independent auditors' report of S. R. Snodgrass, A.C., independent registered accounting firm, at and for the years ended June 30, 2010 and 2009.

(2) Schedules omitted as they are not applicable.

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

Number	Description
3(i)	Charter of William Penn Bancorp, Inc. *
3(ii)	Bylaws of William Penn Bancorp, Inc. *
4.1	Specimen Stock Certificate of William Penn Bancorp, Inc. *
10.1 †	Directors Consultation and Retirement Plan **
10.2 †	Deferred Compensation Plan for Directors **
10.3 †	Restated Deferred Compensation Plan **
13	Annual Report to Stockholders for fiscal year ended June 30, 2010
21	Subsidiaries of the Registrant
23	Consent of S. R. Snodgrass, A.C.
31	Rule 13a-14(a)/15d-14(a) Certifications
32	Section 1350 Certification

† Management contract or compensatory plan or arrangement.
* Incorporated by reference from the Registrant's Registration Statement on Form S-1 (File No. 333-148219)
** Incorporated by reference from the identically numbered exhibits to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2008.

SIGNATURES

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

WILLIAM PENN BANCORP, INC.

Date: September 28, 2010		/s/ Terry L. Sager
	By:	Terry L. Sager President and Chief Executive Officer (Duly Authorized Representative)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on September 28, 2010.

/s/ Terry L. Sager
Terry L. Sager
President, Chief Executive Officer and Director
(Principal Executive Officer)

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

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

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

/s/ Craig Burton
Craig Burton
Director

/s/ Glenn Davis
Glenn Davis
Director

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