FEDERAL TRUST CORP
Form 10KSB
March 30, 2005
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U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2004	**Commission File Number 33-27139**

FEDERAL TRUST CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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

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

Common Stock, par value $.01 per share

(Title of Class)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

Check if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained in this form, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. x

Revenues for the fiscal year ended December 31, 2004: $27,000,000

The aggregate market value of the common stock of the Registrant held by non-affiliates of the Registrant (7,276,618 shares) on March 22, 2005, was approximately $74,585,335. The average bid and ask price of Registrant s common stock on March 22, 2005 was $10.25 per share. For the purposes of this response, directors, officers and holders of 5% or more of the Registrant s common stock are considered the affiliates of the Registrant at that date.

The number of shares outstanding of the Registrant s common stock, as of March 11, 2005 was 8,073,563 shares.

DOCUMENTS INCORPORATED BY REFERENCE:

1. Portions of the Proxy Statement for the 2004 Annual Meeting of Shareholders filed electronically with the Securities and Exchange Commission on or about April 10, 2005. (Part III)

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Federal Trust Corporation and Subsidiary (Registrant   ).

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

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PART I

ITEM 1. DESCRIPTION OF BUSINESS

General

Federal Trust Corporation (Federal Trust) was organized in February 1989 for the purpose of becoming the unitary savings and loan holding company of Federal Trust Bank (the Bank), a federally-chartered stock savings bank. Federal Trust, the Bank and the Bank s subsidiaries are collectively referred to herein as the Company . The Company s headquarters are located in Sanford, Florida. Federal Trust conducts business as a savings and loan holding company, and its principal asset is the capital stock of the Bank. As a savings and loan holding company, Federal Trust has greater flexibility than the Bank to diversify and expand its business activities, either through newly formed subsidiaries or through acquisitions.

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

Subsidiaries

Federal Trust Bank is chartered as a Federal-stock savings bank and is primarily engaged in the business of obtaining funds in the form of deposits and Federal Home Loan Bank (FHLB) advances and investing such funds in permanent loans on residential and commercial real estate, in various types of commercial, construction and consumer loans and in investment securities.

The Federal Deposit Insurance Corporation (FDIC), an agency of the United States Government, insures through the Savings Association Insurance Fund (SAIF), all depositors of the Bank up to $100,000 in accordance with the rules and regulations of the FDIC. The Bank is subject to comprehensive regulation, examination and supervision by the Office of Thrift Supervision (OTS) and the FDIC, which is intended primarily for the benefit of depositors. See Regulation and Supervision.

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

Critical Accounting Policies

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

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to; (1) the length of time and the extent to which fair value has been less than cost; (2) the financial condition and near-term prospects of the issuer; and (3) our intent and ability to retain the investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

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During 2004, we recorded an other-than-temporary impairment write-down of approximately $1,055,000. The charge related to our $9.5 million investment in Freddie Mac and Fannie Mae adjustable rate preferred stock, which is included in our investment securities, available for sale portfolio. These investment grade securities declined in value in 2004 due to the recent events at Freddie Mac and Fannie Mae, coupled with the record low interest rates which caused the dividend payment rate to decline from the original rates at the time of issuance. While we believe that the value of these investments will recover in the future as the dividend rates adjust, we are unable to determine at this time when and how much the prices will recover.

A variety of factors impact the carrying value of the loan portfolio including the calculation of the allowance for loan losses, the valuation of underlying collateral, the timing of loan charge-offs and the amount and amortization of loan fees and deferred origination costs.

We believe that the determination of the allowance for loan losses represents a critical accounting policy. The allowance for loan losses is maintained at a level management considers to be adequate to absorb probable loan losses inherent in the portfolio, based on evaluations of the collectibility and historical loss experience of loans. Credit losses are charged and recoveries are credited to the allowance. Provisions for loan losses are based on our review of the historical loan loss experience and such factors which, in management s judgment, deserve consideration under existing economic conditions in estimating probable credit losses. The allowance is based on ongoing assessments of the probable estimated losses inherent in the loan portfolio. Our methodology for assessing the appropriate allowance level consists of several key elements described below.

Larger commercial loans that exhibit probable or observed credit weaknesses are subject to individual review. Where appropriate, reserves are allocated to individual loans based on our estimate of the borrower s ability to repay the loan given the availability of collateral, other sources of cash flows, and available legal options. Included in the review of individual loans are those that are impaired as provided in Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan* as amended. Any specific reserves for impaired loans are measured based on the fair market value of the underlying collateral. We evaluate the collectibility of both principal and interest when assessing the need for a special reserve. Historical loss rates are applied to other commercial loans not subject to specific reserve allocations.

Homogenous loans, such as installment and residential mortgage loans, are not individually reviewed by management. Reserves are established for each pool of loans based on the expected net charge-offs. Loss rates are based on the average net charge-off history by loan category.

Historical loss rates for commercial and consumer loans may be adjusted for significant factors that, in management s judgment, reflect the impact of any current conditions or loss recognition. Factors which management considers in the analysis include the effects of the local economy, trends in the nature and volume of loans (delinquencies, charge-offs, nonaccrual and problem loans), changes in the internal lending policies and credit standards, collection practices, and examination results from bank regulatory agencies and our internal credit review function. Specific reserves on individual loans and historical loss rates are reviewed throughout the year and adjusted as necessary based on changing borrower and collateral conditions and actual collection and charge-off experience.

Based on the procedures discussed above, management believes that the allowance for loan losses is adequate to absorb estimated loan losses associated with the loan portfolio at December 31, 2004. Actual results could differ from these estimates. However, since the allowance is affected by management s judgment and uncertainties, there is the likelihood that materially different amounts would be reported under different conditions or assumptions. To the extent that the economy, collateral values, reserve factors, or the nature and volume of problem loans change, we may need to adjust the provision for loan losses. Material additions to our provision for loan losses would result in a decrease in net earnings and capital.

The allowance for loan losses is also discussed as part of Results of Operations and in Note 3 to the consolidated financial statements. The significant accounting policies are discussed in Note 1 to the consolidated financial statements.

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Forward Looking Statements

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

Strategy

Our operating strategy has been and continues to be focused on building a strong community bank branch network serving Central Florida through the origination and bulk purchase of residential mortgage loans, and expansion of a commercial loan portfolio. Residential loans are typically secured by a first mortgage on a dwelling and commercial loans are secured by real estate and, where appropriate, the working assets of the borrower (such as accounts receivable, inventory, and equipment). To a lesser extent, we provide loans to consumers secured by the equity in their homes.

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

Market Area and Competition

We have six full-service branch offices located in: in Sanford, Winter Park, New Smyrna Beach, Casselberry, Deltona and Orange City Florida. Sanford, which is located approximately 20 miles northeast of downtown Orlando, is the second largest city in Seminole County and is the county seat. Winter Park is located 13 miles southeast of Sanford and approximately 7 miles northeast of downtown Orlando, in the heart of the greater metropolitan Orlando area which encompasses Orange, Seminole, Lake, and Osceola Counties in Central Florida. The total population of the four County area is estimated at $1.7 million, with the majority in Orange and Seminole Counties. The New Smyrna Beach is located in the of Volusia County on the Atlantic Ocean approximately 33 miles northeast of our Sanford office and 15 miles south of Daytona Beach, Florida. Casselberry is located in Seminole County between our Sanford and Winter Park Offices. Deltona and Orange City are both located in the Western part of Volusia County along the Interstate 4 corridor between Orlando and Daytona Beach. Our administrative and operation offices are housed in Sanford.

Our primary market area is Orange, Seminole and Volusia Counties, and to a lesser extent Lake and Osceola Counties. Although best known as a tourist destination, with over 20 million visitors a year, the Central Florida area has become a center for industries such as aerospace and defense, electro-optics and lasers, computer simulated training, computer networking and data management. In addition, motion picture production, professional and amateur sports, and distribution makes the local economy more diverse each year. Many companies, including some in the Fortune 500, have chosen the greater Orlando area as a base for corporate, regional, and divisional headquarters. The area is also home to the University of Central Florida with an enrollment of 44,000, one of the fastest growing schools in the state university system, as well as Valencia Community College and Seminole Community College whose combined enrollment exceeds 85,000. Winter Park is home to Rollins College, the oldest college in Florida founded in 1885. In addition, Stetson University, Florida s first private university is located in Volusia County.

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

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Consolidation within the banking industry, and in particular within Florida, has been dramatic over the past eight years. As of September 30, 2002, the four largest banking institutions in the state controlled approximately 52% of the bank deposits. In 1994, the four largest controlled less than 29% of the deposits. In the past two years, the three largest financial institutions headquartered in Central Florida have been acquired by larger institutions headquartered outside of the state. As a result, Federal Trust is now the largest independent financial institution with headquarters and all of our branch locations in the Central Florida market place.

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

Lending Activities

General. Our residential lending includes the origination and purchase of mortgage loans for purchasing or constructing residential real property, primarily secured by first liens on such property. These loans are typically conventional loans which are not insured by the Federal Housing Agency (FHA) or partially secured by the Veterans Administration (VA). Loans with fixed rates beyond five years are generally sold into the secondary market. Loans with fixed rates of five years or less are considered for portfolio. Interest rates for construction loans are tied to the prime rate and float daily during the construction period and are fixed upon completion. To a lesser extent, we also make home equity loans which generally float daily with the prime rate. Other consumer related loans are savings loans secured by certificates of deposit at an interest rate above the rate paid on the certificate.

As part of our strategy, we have emphasized commercial lending during the past three years. Commercial loans are comprised of loans to small businesses secured by real estate used in the enterprise and, where appropriate, the working assets of the business. We also make commercial real estate loans for the acquisition and development of undeveloped land, and income producing properties. Commercial loans are priced on a floating prime rate basis and fixed at repricing intervals not to exceed five years. As a matter of policy, commercial loans are guaranteed by the borrowers principals.

Credit Risk. Since our primary business is the origination and acquisition of loans, that activity entails potential credit losses, the magnitude of which depends on a variety of economic factors affecting borrowers which are beyond the control of the Bank. While guidelines have been instituted and credit review procedures have been put into place to protect us from credit losses, some losses may inevitably occur.

Loan Portfolio Composition. Our net loan portfolio, which is total loans plus premiums paid for loans purchased less loans in process, deferred loan origination fees and costs and allowance for loan losses, totaled $521.3 million at December 31, 2004, representing 86% of total assets at such date. At December 31, 2003, our net loan portfolio was $398.4 million or 85% of total assets.

Residential mortgage loans, not including construction loans, still comprise the largest group of loans in our loan portfolio, amounting to $374.6 million or 70.8% of the total loan portfolio at December 31, 2004, compared to $302.1 million or 75.4% of the total loan portfolio at December 31, 2003. We offer adjustable rate mortgage (ARM) loans with maturities up to 30 years. As of December 31, 2004, approximately 95.5% of these loans were ARM loans and 4.5% of these loans were fixed-rate. Fixed-rate loans are generally underwritten to secondary market standards to insure liquidity and interest rate risk protection. Residential lot loans amounted to $41.4 million or 7.8% of total loans at December 31, 2004. These loans are secured by developed lots ready for construction of single-family homes. Residential construction loans amounted to $5.4 million or 1.0% of total loans. These loans are generally on property throughout Central Florida and are underwritten directly to the individual or family for their primary residence or second home.

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Commercial real estate secured loans amounted to $56.3 million or 10.6% of the total loan portfolio at December 31, 2004. This portfolio includes loans to businesses to finance their office, manufacturing or retail facilities. Commercial land, development and construction loans amounted to $38.1 million or 7.2% or total loans. The land loans are generally larger parcels of property held for investment. The development and construction loans include loans for the acquisition and development of both residential and commercial projects. The construction loans are made directly to the builders of single and multi-family homes for pre-sold or speculative units. We also finance the construction of commercial facilities, generally for the owner/operator.

Commercial loans at December 31, 2004, were $13.3 million or 2.5% of total loans. These loans are generally secured by the assets of the borrower including accounts receivable, inventory and fixed assets, including company owned real estate and are usually also guaranteed by the owners.

Consumer loans, consisting of installment loans and savings account loans at December 31, 2004, were $657,000 or 0.1% of the total loan portfolio.

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The following table sets forth information on our loan portfolio by type.

	At December 31,									
	2004		2003		2002		2001		2000	
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
	($ in thousands)									
Residential Lending:										
Mortgages	$ 374,581	70.8%	$ 302,083	75.4%	$ 246,234	79.2%	$ 203,729	74.2%	$ 164,387	70.3%
Lot Loans	41,369	7.8	20,816	5.2	8,742	2.8	5,534	2.0	2,846	1.2
Construction	5,405	1.0	780	0.2	1,822	0.6	8,760	3.2	11,405	4.9
Total Residential lending	421,355	79.6	323,679	80.8	256,799	82.6	218,023	79.4	178,638	76.4
Commercial Lending:										
Real Estate Secured	56,267	10.6%	47,918	12.0%	32,061	10.3%	26,782	9.9	23,868	10.3
Land, Development and Construction	38,091	7.2	16,524	4.1	14,598	4.7	23,451	8.5	25,238	10.8
Commercial loans	13,257	2.5	11,639	2.9	6,568	2.1	3,078	1.1	1,505	0.6
Total Commercial lending	107,615	20.3	76,081	19.0	53,227	17.1	53,311	19.5	50,611	21.7
Consumer Loans	657	0.1	864	0.2	969	0.3	3,111	1.1	4,436	1.9
Total loans	529,627	100.0%	400,624	100.0%	310,995	100.0%	274,445	100.0%	233,685	100.0%
Add (deduct):										
Allowance for loan losses	(3,835)		(2,779)		(2,110)		(1,765)		(1,634)	
Net premiums, discounts, deferred fees and costs	3,524		3,346		2,902		2,320		1,729	
Loans in process	(7,985)		(2,790)		(3,189)		(10,813)		(10,885)	
Net loans	$ 521,331		$ 398,401		$ 308,598		$ 264,187		$ 222,895	

Contractual Repayments. Scheduled contractual principal repayments of loans do not reflect the actual life of such assets. The average life of loans is substantially less than their average contractual terms because of prepayments. In addition, due-on-sale clauses on loans generally give us the right to declare a conventional loan immediately due and payable in the event, among other things, that the borrower sells the real property subject to the mortgage and the loan is not repaid. The average life of mortgage loans tends to increase, however, when current mortgage loan rates are substantially higher than rates on existing mortgage loans and, conversely, decreases when rates on existing mortgages are substantially higher than current mortgage loan rates. Residential lot loans generally mature in five years and are typically repaid or convert to a construction loan when the owner begins construction of the residence. Construction loans generally mature in one year or less.

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The following table shows the contractual maturities of the Bank s loan portfolio at December 31, 2004. Loans that have adjustable rates are shown as amortizing to final maturity rather than when the interest rates are next subject to change. The table does not include prepayments or scheduled principal repayments.

	Residential	Commercial	Consumer	Total Loans
	(in thousands)			
Amounts due:				
Within 1 year	$ 4,393	$ 39,098	$ 171	$ 43,662
1 to 3 years	12,519	28,443	365	41,327
3 to 5 years	28,029	28,987	46	57,062
5 to 10 years	8,942	4,671	75	13,688
10 to 20 years	21,234	4,168	0	25,402
Over 20 years	346,238	2,248	0	348,486
Total due after 1 year	416,962	68,517	486	485,965
Total amounts due	$ 421,355	$ 107,615	$ 657	$ 529,627

Loans Due After December 31, 2005. The following table sets forth at December 31, 2004, the dollar amount of all loans due after December 31, 2005, classified according to whether such loans have fixed or adjustable interest rates.

	Due after December 31, 2005		
	Fixed	Adjustable	Total
	(In thousands)		
Residential lending	$ 17,257	$ 399,705	$ 416,962
Commercial lending	25,768	42,749	68,517
Consumer loans	166	320	486
Total	$ 43,191	$ 442,774	$ 485,965

Purchase, Origination, and Sale of Loans. Florida has historically experienced a rate of population growth in excess of national averages. However, the real estate development and construction industries in Florida have been sensitive to cyclical changes in economic conditions and the demand for and supply of residential units. In 2004, the demand for real estate mortgage loans remained strong, but could be affected as interest rates continue to rise.

Our loan portfolio consists of purchased and originated loans. When loans are acquired in the secondary market, we generally purchase loan packages of $2 million to $25 million of single-family residential mortgages, comprised of new and seasoned ARM loans. While we prefer to purchase loan packages comprised of Florida real estate, because of pricing and the limited number of Florida loan packages that are available, we also purchase packages of loans outside of Florida. The loan packages undergo an individual loan underwriting review prior to closing.

Loans that we originate are generally on real estate located in our primary lending area of Central Florida. Sources for residential mortgage loan originations include direct solicitation by employed loan originators, depositors, other existing customers, advertising and referrals from real estate brokers, mortgage brokers and developers. Our residential mortgage loans are originated in accordance with written underwriting standards approved by the Board of Directors. Most fixed rate loan originations are eligible for sale to Fannie Mae and other investors in the secondary market. In addition, if the size of a particular loan request exceeds our legal or internal lending limit, we may seek to sell a participation in that loan to a correspondent bank. From time to time, we also purchase participations from our correspondents.

Consumer loan originations are attributable largely to depositors and walk-in customers and referrals, while commercial and commercial real estate loan originations are primarily attributable to Bank loan officers and referrals. All loan applications are evaluated by staff at the administrative and operations office in Sanford to ensure compliance with our underwriting standards. See Lending Activities - Loan Portfolio Composition - Loan Underwriting Policies.

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The following table sets forth the amount of loans originated, purchased, sold and repaid during the periods indicated (in thousands).

	For the Year Ended December 31,				
	2004	2003	2002	2001	2000
Originations:					
Mortgage loans:					
Loans on existing property	$ 62,999	$ 44,416	$ 97,263	$ 67,728	$ 66,693
Land, Development and Construction loans	66,719	20,681	27,674	67,678	44,495
Total mortgage loans	129,718	65,097	124,937	135,406	111,188
Commercial loans	7,337	12,373	15,187	5,751	1,734
Consumer loans	635	701	529	2,469	2,161
Total loans originated	137,690	78,171	140,653	143,626	115,083
Purchases	178,482	176,828	97,897	53,933	29,802
Total loans originated and purchased	$ 316,172	$ 254,999	$ 238,550	$ 197,559	$ 144,885
Sales and principal repayments:					
Loans sold	(28,632)	(39,560)	(28,072)	(33,764)	(24,598)
Principal repayments	(158,537)	(125,810)	(173,928)	(123,035)	(82,914)
Total loans sold and principal repayments	$ (187,169)	$ (165,370)	$ (202,000)	$ (156,799)	$ (107,512)
Increase in total loans (before net items)	$ 129,003	$ 89,629	$ 36,550	$ 40,760	$ 37,373

Loan Underwriting. Our lending activities are subject to strict underwriting standards and loan origination procedures prescribed by our Board of Directors and management. Loan applications are obtained to determine the borrower s ability to repay, and the more significant items on these applications are verified through the use of credit reports, financial statements and confirmations. Our lending policy for real estate loans generally requires that collateral be appraised by an independent, outside appraiser approved by the Board of Directors.

Loans are approved at various management levels up to and including the Loan Committee of the Board of Directors. Loan approvals are made in accordance with a AChart of Delegated Authority@ approved by our Board of Directors. Generally, loans less than $300,000 are approved by authorized officers and underwriters. Loans in excess of $300,000 to $2,000,000 require the concurrence of three or more authorized officers. Loans greater than $2,000,000 require approval of the Board of Directors Loan Committee. For loan approvals, the aggregate loans to the borrower and their related interest are used for determination of the appropriate lending authority required for any new loans or renewals.

To ensure that underwriting standards and loan policies are being followed, an internal loan review process has been put in place. Additionally, our external auditor and the OTS perform independent testing of the Bank s underwriting and credit quality.

General Lending Policies. Our policy for real estate loans is to have a valid mortgage lien on real estate securing a loan and to obtain a title insurance policy, which insures the validity and priority of the lien. Borrowers must also obtain hazard insurance policies prior to closing, and when the property is in a flood prone area, flood insurance is required.

We are permitted to lend up to 100% of the appraised value of real property securing a mortgage loan. However, if the amount of a conventional, residential loan (including a construction loan or a combination construction and permanent loan) originated or refinanced exceeds 90% of the appraised value, federal regulations require that private mortgage insurance be obtained on that portion of the principal amount of the loan that exceeds 80% of the appraised value of the property. We originate single family residential mortgage loans up to a 97% loan-to-value ratio if the required private mortgage insurance is obtained. Loans over 97% loan-to-value ratio, if originated, would be under special community support programs or one of the Federal Housing Administration, Veterans Administration or USDA Rural Housing Service or insurance programs. The loan-to-value ratio on a home loan secured by a junior lien generally does not exceed 100%, including the amount of the first mortgage on the collateral. With respect to home loans granted for construction or combination construction/permanent financing, we will lend up to 95% of the appraised value of the property on an as completed basis. The loan-to-value ratio on multi-family residential and commercial real estate loans is generally limited to 80% of value.

The maximum amount that could have been loaned by the Bank to one borrower and the borrower s related entities at December 31, 2004, was approximately $6.3 million. We have no loans in our portfolio that exceed our loans to one borrower limit.

Consumer loans are considered to be loans to natural persons for personal, family or household purposes, and these loans may be unsecured, secured by personal property or secured by liens on real estate which, when aggregated with prior liens, equals or exceeds the appraised value of the collateral property.

Federal savings and loan association regulations permit the Bank to invest in loans secured by non-residential or commercial real estate up to four times our regulatory capital. At December 31, 2004, this limit allowed us to invest in non-residential or commercial real estate loans in an aggregate amount up to $167.4 million. At such date, we had $56.3 million in loans secured by non-residential or commercial real estate.

The risk of non-payment of loans is inherent in all loans. However, we carefully evaluate all loan applicants and attempt to minimize our credit risk exposure by use of thorough loan application and approval procedures that we have established for each category of loan. In determining whether to make a loan, we consider the borrower s credit history, analyze the borrower s income and ability to service the loan, and evaluate the need for collateral to secure recovery in the event of default. An allowance for loan losses is maintained based upon assumptions and judgments regarding the ultimate collectability of loans in our portfolio and a percentage of the outstanding balances of specific loans when their ultimate collectability is considered questionable.

Income from Lending Activities/Loan Servicing. Fees are earned in connection with loan commitments and originations, loan modifications, late payments, assumptions related to changes of property ownership and for miscellaneous services related to loans. We also receive fees for servicing loans owned by others. At December 31, 2004, we were servicing $80.8 million in loans for other institutions, which produces servicing income, net of amortization of mortgage servicing rights. Income from these activities varies from period to period with the volume and type of loans originated, sold and purchased, which in turn is dependent upon prevailing mortgage interest rates and their effect on the demand for loans in our market area. During 2002, we made a strategic decision to have a third party begin servicing our residential mortgage loans on behalf of the Company. This third party charges standard servicing and administration fees for these services.

Loan fees and direct costs typically are charged at the time of loan origination and may be a flat fee or a percentage of the amount of the loan. Under current accounting standards such fees cannot typically be recognized as income and are deferred and taken into income over the contractual life of the loan, using a level yield method. If a loan is prepaid or refinanced, all remaining deferred fees with respect to such loan are taken into income at that time.

Non-performing Loans and Foreclosed Assets. When a borrower fails to make a required payment on a loan, we attempt to collect the payment by contacting the borrower. If a payment on a loan has not been received by the end of a grace period,

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notices are sent at that time, with follow-up contacts made thereafter. In most cases, the delinquencies are cured promptly. If the delinquency exceeds 90 days and is not cured through normal collection procedures, more formal measures are instituted to remedy the default, including the commencement of foreclosure proceedings.

If foreclosure is affected, the property is sold at a public auction in which we typically participate as a bidder. If we are the successful bidder, the acquired real estate property is then included in our foreclosed assets account until it is sold. Under federal regulations, we are permitted to finance sales of foreclosed assets by loans to facilitate@, which may involve more favorable interest rates and terms than generally would be granted under our underwriting guidelines. At December 31, 2004, we had no loans to facilitate the sale of foreclosed assets.

Loans are placed on non-accrual status when, in the judgment of management, the probability of collection of interest is deemed to be insufficient to warrant further accrual. When a loan is placed on non-accrual status, previously accrued, but unpaid interest is deducted from interest income. Our policy is to not accrue interest on loans past due 90 days or more.

Assets acquired as a result of foreclosure or by deed-in-lieu of foreclosure are classified as foreclosed assets until they are sold. When assets are acquired, they are recorded at the lower of cost or fair value less estimated selling costs at the date of acquisition and any write-down resulting therefrom, is charged to the allowance for loan losses.

The following table sets forth certain information regarding our non-accrual loans and foreclosed assets, the ratio of such loans and foreclosed assets to total assets as of the date indicated, and certain other related information.

	At December 31,				
	2004	**2003**	**2002**	**2001**	**2000**
	($ in thousands)				
Non-accrual loans:					
Mortgage:					
Construction	$ 5	$ 229	$ 293	$ 418	$ 248
Residential	1,862	6,167	5,221	2,629	1,999
Commercial				481	773
Total mortgage	1,867	6,396	5,514	3,528	3,020
Commercial loans	720			39	
Consumer loans	13		65	22	23
Total non-accrual	$ 2,600	$ 6,396	$ 5,579	$ 3,589	$ 3,043
Total non-accrual loans to total loans	0.5%	1.6%	1.8%	1.3%	1.4%
Total non-accrual loans to total assets	0.4%	1.4%	1.5%	1.2%	1.2%
Total allowance for loss to total non-accrual loans	147.5%	43.4%	37.8%	49.2%	53.7%

Total foreclosed assets	$ 326	$ 1,007	$ 858	$ 714	$ 431
Total non-accrual loans and foreclosed assets to total assets	0.5%	1.6%	1.7%	1.4%	1.4%

At December 31, 2004, the Bank had no accruing loans which were contractually past due 90 days or more as to principal and interest and no troubled debt restructurings as defined by Statement of Financial Accounting Standards No. 15. Nonaccrual loans for which interest has been reduced totaled approximately $2.6 million and $6.4 million at December 31, 2004 and 2003, respectively. For the year ended December 31, 2004, interest income that would have been recorded under the original terms of non-accrual loans and interest income actually recognized is summarized below (in thousands):

Interest income that would have been recorded	$ 210
Interest income recognized	(122)
Interest income foregone	$ 88

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Classified Assets Potential Problem Loans. Federal regulations and the Bank s policies require the classification of loans and other assets, such as debt and equity securities, considered to be of lesser quality as substandard , doubtful or loss assets. An asset is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. In addition, the Bank s policies require that assets which do not currently expose the insured institution to sufficient risk to warrant classification as substandard but possess other weaknesses are designated special mention by management.

If an asset is classified, the estimated fair value of the asset is determined and if that value is less than the then carrying value of the asset, the difference is established as a specific reserve. If an asset is classified as loss, the amount of the asset classified as loss is reserved. General reserves or general valuation allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities but, unlike specific reserves, are not allocated to particular assets.

No assets were classified doubtful or loss at December 31, 2004. There were 7 loans for a total of $3.5 million that were graded special mention and 45 loans for $3.0 million classified substandard at December 31, 2004.

Provisions for Loan Losses

A provision for loan losses is generally charged to earnings based upon management s evaluation of the inherent losses in our loan portfolio. During 2004, our gross loans increased by $129.0 million and management charged $1,180,000 to our provision for loan losses. Also during 2004, we recognized $154,000 in charge-offs against our allowance, but collected $30,000 in recoveries from prior charge-offs.

While we believe that our allowance for loan losses is adequate as of December 31, 2004, the provisions are based on the current and anticipated future operating conditions, thereby causing these estimates to be susceptible to changes that could result in a material adjustment to results of operations in the near term. The amount needed in the allowance for loan losses is based on the particular circumstances of the individual non-performing loans, including the type, amount, and value of the collateral, if any. In addition, the overall composition and amount of the performing loans in the portfolio at the time of evaluation is considered to determine the adequacy of the allowance, and, as a result, will vary over time. Although more emphasis is being placed on originating new commercial real estate, land and development loans, the composition of our loan portfolio continues to be concentrated primarily on residential mortgage loans, which tend to have a lower risk of loss. Loan repayments are dependent on loan underwriting and also on economic, operating and other conditions that may be beyond our control. Therefore, actual losses in future periods could differ materially from amounts provided in the current period and could result in a material adjustment to operations.

In addition to the continuing internal assessment of the loan portfolio, our loan portfolio is also subject to examination by the Company s primary regulator, the OTS, which will periodically review the loan portfolio and access the adequacy of the allowance for loan losses.

Allowance for Loan Losses

A number of factors are considered when establishing our allowance for loan losses. For loan loss purposes, the loan portfolio is segregated into the following broad segments: residential real estate loans to United States citizens; residential real estate loans to foreign borrowers; commercial real estate loans; land, development and construction loans; commercial business loans and other loans. A general allowance for losses is then provided for each of the aforementioned categories, which consists of two components. General loss percentages are calculated based upon historical analyses. A supplemental portion of the allowance is calculated for inherent losses which probably exist as of the evaluation date even though they might not have been identified by the more objective processes used for the portion of the allowance described above. This is due to the risk of error and/or inherent

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imprecision in the process. This portion of the allowance is particularly subjective and requires judgments based on qualitative factors which do not lend themselves to exact mathematical calculations such as; trends in delinquencies and nonaccruals; migration trends in the portfolio; trends in volume, terms, and portfolio mix; new credit products and/or changes in the geographic distribution of those products; changes in lending policies and procedures; loan review reports on the efficacy of the risk identification process; changes in the outlook for local, regional and national economic conditions; concentrations of credit; and peer group comparisons.

Specific allowances are provided in the event that the specific collateral analysis on each classified loan indicates that the probable loss upon liquidation of collateral would be in excess of the general percentage allocation. The provision for loan losses is debited or credited in order to bring the allowance for loan losses to the required level as determined above.

The allowance for loan losses at December 31, 2004, was $3.8 million, or 147.5% of non-performing loans and .74% of total loans net of loans in process (LIP) compared to $2.8 million, or 43.4% of non-performing loans and .70% of total loans net of LIP at December 31, 2003. The allowance at December 31, 2004, consisted of reserves for the performing loans in the portfolio and reserves against certain loans based on management s evaluation of these loans. As the amount of commercial loans in the portfolio increases, the allowance will be adjusted accordingly.

Although we believe that we use the best information available to determine the allowance, unforeseen market conditions could result in adjustments and net earnings could be significantly affected if circumstances differ substantially from the assumptions used in making the final determination. Future additions to our allowance for loan losses will be the result of periodic loan, property, and collateral reviews and thus cannot be predicted in advance. In addition, federal regulatory agencies, as an integral part of the examination process, periodically review our allowance for loan losses. Such agencies may require us to recognize additions to the allowance level based upon their judgment of the information available to them at the time of their examination.

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The following table sets forth information with respect to our allowance for loan losses during the periods indicated. The allowances shown in the table below should not be interpreted as an indication that charge-offs in future periods will occur in these amounts or proportions or that the allowance indicates future charge-off amounts or trends ($ in thousands).

	At December 31,				
	2004	2003	2002	2001	2000
Average loans outstanding, net of LIP	$ 447,773	$ 366,488	$ 279,934	$ 245,069	$ 214,755
Allowance at beginning of year	2,779	2,110	1,765	1,634	1,438
Charge-offs:					
Residential real estate loans	(106)	(30)	(173)	(211)	(150)
Construction loans			(10)	(27)	
Commercial real estate loans					
Commercial loans	(48)		(39)	(187)	
Consumer loans		(1)	(36)		
Total loans charged-off	(154)	(31)	(258)	(425)	(150)
Recoveries	30	50	158	16	17
Net recoveries (charge-offs)	(124)	19	(100)	(409)	(133)
Provision for loan losses	1,180	650	445	540	329
Allowance at end of year	$ 3,835	$ 2,779	$ 2,110	$ 1,765	$ 1,634
Ratio of net (recoveries) charge-offs to average loans outstanding	.03%	(.01)%	.04%	.17%	.06%
Ratio of allowance to period-end total loans, net of LIP	.74%	.70%	.69%	.67%	.73%
Period-end total loans, net of LIP	$ 521,642	$ 397,834	$ 307,806	$ 263,632	$ 222,800

The following table represents information regarding our total allowance for loan losses, as well as the allocation of such amounts to the various categories of loans ($ in thousands).

At December 31,									
2004		2003		2002		2001		2000	
Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans	Amount	% of Loans to Total Loans

Residential lending	$ 2,488	79.6%	$ 1,886	80.8%	$ 1,409	82.6%	$ 1,097	79.4%	$ 723	76.4%
Commercial lending	1,055	20.3	825	19.0	566	17.1	456	19.5	750	21.7
Consumer loans	292	.1	68	.2	135	.3	212	1.1	161	1.9
Total allowance for loan losses	$ 3,835	100.0%	$ 2,779	100.0%	$ 2,110	100.0%	$ 1,765	100.0%	$ 1,634	100.0%

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Investment Activities

Mortgage-Backed Securities. We purchase mortgage-backed securities and other collateralized mortgage obligations, which are guaranteed as to principal and interest by FNMA and FHLMC, agencies of the Federal government. We also purchased mortgage-backed securities issued by entities that are not Federal Government agencies. The securities are permissible investments for a savings institution and were acquired primarily for their liquidity, yield, and credit characteristics. Such securities may be used as collateral for borrowings. The mortgage-backed securities that were purchased are backed by either fixed-rate or adjustable-rate mortgage loans. At December 31, 2004, these securities totaled $24.2 million.

Other Investments. As a condition of our membership in the Federal Home Loan Bank of Atlanta we are required to own FHLB stock. The other investments in the portfolio, with the exception of the corporate equity securities, are eligible for inclusion in our liquidity base when calculating our regulatory liquidity requirement. We also purchase municipal bonds and corporate equity and debt securities. At December 31, 2004, we did not have any securities pledged to the FHLB as collateral under its short-term credit agreement.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to: (1) the length of time and the extent to which fair value has been less than cost; (2) the financial condition and near-term prospects of the issuer; and (3) our intent and ability to retain the investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

During 2004, we recorded an other-than-temporary impairment write-down of approximately $1,055,000. The charge related to our $9.5 million investment in Freddie Mac and Fannie Mae adjustable rate preferred stock, which is included in the corporate equity amount in the following tables. These investment grade securities declined in value in 2004 due to the recent events at Freddie Mac and Fannie Mae, coupled with the record low interest rates which caused the dividend payment rate to decline from the original rates at the time of issuance. While we believe that the value of these investments will recover in the future as the dividend rates adjust, we are unable to determine at this time when and how much the prices will recover.

The following table sets forth the carrying values of our total investments and liquidity as of the dates indicated (in thousands).

	At December 31,		
	2004	**2003**	**2002**
Short-term investments:			
Interest-earning deposits	$ 3,836	$ 666	$ 14,515
Debt securities:			
Government agency	2,977	1,963	
Municipal bonds	1,056	5,988	205
Corporate debt	3,915		2,164
Mortgage-backed securities	24,152	15,755	11,725
Equity securities:			
FHLB stock	7,385	5,660	2,860

Corporate equity	9,072	9,909	7,426
Total investment portfolio	$ 52,393	$ 39,941	$ 38,895

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The following table sets forth the remaining maturity and weighted-average yields as of December 31, 2004 and 2003:

	Less than One Year		Five Through Ten Years		More than Ten Years		Total	
	Carrying Value	Yield	Carrying Value	Yield	Carrying Value	Yield	Carrying Value	Yield
	($ in thousands)							
At December 31, 2004:								
Interest-earning deposits	$ 3,836	2.10%	$	%	$	%	$ 3,836	2.10%
FHLB stock	7,385	3.75					7,385	3.75
Government agency securities			992	5.14	1,985	6.58	2,977	5.68
Municipal bonds					1,056	6.58	1,056	6.58
Corporate debt			3,915				3,915	3.95
Mortgage-backed securities							24,152	4.09
Corporate equity securities							9,072	5.41
	$ 11,221	3.19%	$ 4,907	4.19%	$ 3,041	6.58%	$ 52,393	4.26%
At December 31, 2003:								
Interest-earning deposits	$ 666	1.00%	$	%	$	%	$ 666	1.00%
FHLB stock	5,660	3.50					5,660	3.50
Government agency securities			1,963	2.81			1,963	2.81
Municipal bonds					5,988	4.92	5,988	4.92
Mortgage-backed securities							15,755	4.57
Corporate equity securities							9,909	4.91
	$ 6,326	3.24%	$ 1,963	2.81%	$ 5,988	4.92%	$ 39,941	4.40%

Impact of Interest Rates on the Investment Portfolio. From 2001 through the first half of 2004, both long and short-term interest rates moved and stayed low as a result of Federal Reserve action, the weak global economy, terrorist activities and the overseas military actions. As interest rates fell, all financial institutions experienced a dramatic increase in residential loan refinancing activity coupled with a general slowdown in commercial loan originations. During this period, we also experienced a similar increase in prepayments in our mortgage-backed securities portfolio. To replenish our investment portfolio, we purchased other mortgage-backed investments which had lower yields than the previous issues.

In the second half of 2004, the Federal Reserve began increasing short-term interest rates, while longer term rates held steady or declined. During that time, the market value of our investment portfolio was relatively stable, except for the agency adjustable rate preferred stock mentioned above. At December 31, 2004, after recording the $1.1 million other-than-temporary impairment write-down, the Company had a net unrealized pretax gain of $33,000 in the investment portfolio, as compared to unrealized pretax losses of $511,000 at December 31, 2003.

Sources of Funds

General. Deposits are our primary source of funds for use in lending, investments and for other general business purposes. In addition to deposits, funds are obtained from normal loan amortization and prepayments, and from operations. Contractual loan payments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general market interest rates and economic conditions. Borrowings are also used on a short term basis to compensate for seasonal or other reductions in normal sources of funds. FHLB borrowings are also be used on a longer term basis to support expanded lending or investment activities. Borrowings by Federal Trust can also be used by the Bank as an additional source of capital for the Bank. At December 31, 2004, Federal Trust had approximately $2.5 million in borrowings which was used as capital for the Bank.

Deposits. Our primary deposit products include fixed-rate certificate accounts, money-market deposit accounts and both noninterest and interest-bearing transaction accounts. We have a number of different programs that are designed to attract both short-term and long-term deposits.

Deposits have generally been obtained from residents in our primary market area and, to a lesser extent, nationwide, through a network of deposit brokers. The principal methods used to attract in market deposit accounts have included offering a wide variety of services and accounts, competitive interest rates and convenient office locations, including access to automated teller machines (ATMs) and Internet Banking. We currently operate six ATM s and our customers also have access to the Star7 (previously Honor) and other shared ATM networks. We also offer customers Internet Banking with access to their accounts, funds transfer, and bill paying.

The following table shows the distribution of, and certain other information relating to, our deposits by type as of the dates indicated ($ in thousands).

	At December 31,					
	2004		2003		2002	
	Amount	Percent of Deposits	Amount	Percent of Deposits	Amount	Percent of Deposits
Noninterest-bearing checking accounts	$ 21,305	5.3%	$ 6,352	2.0%	$ 6,112	2.2%
Interest-bearing checking accounts	48,792	12.1	15,566	4.9	12,094	4.3
Money-market accounts	76,236	18.9	76,047	24.2	68,893	24.7
Savings accounts	6,237	1.5	8,714	2.8	9,319	3.4
Subtotal	152,570	37.8	106,679	33.9	96,418	34.6
Time deposits:						
Less than 1.00%			236	0.1		
1.00% to 1.99%	52,463	13.0	95,193	30.3	25,963	9.3
2.00% to 2.99%	161,975	40.1	84,104	26.7	54,144	19.4
3.00% to 3.99%	29,041	7.2	14,588	4.6	52,840	19.0
4.00% to 4.99%	5,945	1.5	9,174	2.9	29,319	10.5
5.00% to 5.99%	930	.2	2,915	0.9	16,892	6.1
6.00% to 6.99%	677	.1	1,234	0.4	2,355	0.9
7.00% to 7.99%	515	.1	507	0.2	600	0.2
Total time deposits	251,546	62.2	207,951	66.1	182,113	65.4
Total deposits	$ 404,116	100.0%	$ 314,630	100.0%	$ 278,531	100.0%

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The following table shows the average amount of and the average rate paid on each of the following categories during the periods indicated ($ in thousands).

	Year Ended December 31,					
	2004		2003		2002	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Noninterest-bearing checking accounts	$ 10,076	%	$ 7,102	%	$ 5,837	%
Money market and interest-bearing checking accounts	109,654	1.84	92,525	1.91	56,066	2.87
Savings	7,520	1.46	9,446	1.73	7,621	1.82
Time deposits	228,876	2.37	188,975	2.73	176,721	3.83
Total deposits	$ 356,126	2.12%	$ 298,048	2.38%	$ 246,245	3.46%

The variety of deposit accounts that we offer has increased our ability to retain deposits and has allowed us to be competitive in obtaining new funds, although the threat of disintermediation (the flow of funds away from savings institutions into direct investment vehicles such as government and corporate securities) still exists. Our ability to attract and retain deposits and our cost of funds has been, and will continue to be, significantly affected by competition and market interest rates.

On a weekly basis, we review the rates offered by other deposit institutions in our market area and make adjustments to the rates we offer to meet our funding needs and to be competitive with the local market. Our deposits increased to $404.1 million at December 31, 2004, from $314.6 million at December 31, 2003.

The following table sets forth jumbo certificates of $100,000 and over at December 31, 2004, maturing as follows (in thousands):

	Amount
Due three months or less	$ 24,544
Due over three months to six months	30,824
Due over six months to one year	56,130
Due over one year	40,692
	$ 152,190

Federal Home Loan Bank Advances. The Bank has an agreement to obtain advances from the FHLB. Such advances may be made pursuant to several different credit programs. Each credit program has its own interest rate based on the range of maturities. The FHLB has limitations on the total amount and terms of advances available to the Bank based on, among other things, asset size, capital strength, earnings and the amount of collateral available to be pledged for such advances. Prepayment of FHLB advances would incur prepayment penalties. At December 31, 2004, we had $143.7 million in borrowings outstanding.

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A summary of advances from the Federal Home Loan Bank of Atlanta are as follows ($ in thousands):

Maturing During the Year Ending December 31,	Interest Rate	At December 31, 2004	2003	2002
2004	1.15(1)	$	$ 25,500	$
2005	2.00	25,000	25,000	
2005	2.44(1)	15,000		
2005	1.70	5,000		
2005	1.56	5,000		
2005	2.84	10,000		
2006	1.24(2)		5,000	
2006	0.58(1)(2)		5,000	
2006	3.13	5,000		
2007	5.22	2,200	2,200	2,200
2007	2.01(5)	15,000		
2007	1.26(2)		5,000	5,000
2008	1.98(2)	5,000	5,000	
2008	1.12(2)		5,000	
2008	1.01(2)		5,000	
2009	2.05(3)	5,000		
2009	3.11(4)	10,000		
2011	3.73		25,000	25,000
2014	2.93(6)	5,000		
2014	3.03(7)	11,500		
2014	3.22(8)	25,000		
		$ 143,700	$ 107,700	$ 32,200

(1) Daily advance or adjustable rate.
(2) FHLB has the option to call every three months.
(3) FHLB has the option to call every three months beginning in February 2006.
(4) FHLB has the option to call every three months beginning in July 2006.
(5) FHLB has a one-time call option in June 2005.
(6) FHLB has the option to call every three months beginning in December 2006.
(7) FHLB has the option to call every three months beginning in September 2007.
(8) FHLB has the option to call every three months beginning in December 2007.

The security agreement with FHLB includes a blanket floating lien requiring the Bank to maintain qualifying first mortgage loans, discounted at 75% of the unpaid principal balances, as pledged collateral in an amount equal to at least 100% of the total advances outstanding. The FHLB also requires the purchase of FHLB common stock in proportion to the amount of advances outstanding. The FHLB stock is also pledged as collateral for these advances.

The overnight, variable rate advances reprice daily and may be repaid at any time without penalty. Fixed rate advances incur a prepayment penalty if repaid prior to maturity, and the interest rate is fixed for the term of the advance.

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Other Borrowings. In 2003 we had a line of credit agreement with a correspondent bank that enabled us to borrow up to $6,000,000. The line of credit bore interest at the prime lending rate plus 50 basis points and was secured by all the Bank s common stock. Borrowings under the line of credit agreement were to mature five years after the date of the borrowing. At December 31, 2002, the outstanding balance under the line of credit agreement was approximately $915,000.

During 2003, Federal Trust entered into a new loan agreement with another correspondent bank. Under this agreement, we can borrow up to $6,000,000 under a revolving line of credit (LOC) for general operations and up to $2,000,000 on a separate nonrevolving line of credit (ESOP LOC) for common stock purchases relating to our Employee Stock Ownership Plan. Both lines are secured by all the Bank s common stock and have interest rates of prime minus 12.5 basis points as long as we maintain certain loan-to-book value percentages. Proceeds from the LOC were used, in part, to pay off the old line of credit. The new loan agreement also has certain covenants that the Company is required to meet. In August 2004, the outstanding balance of the LOC was repaid from a portion of the proceeds of the secondary stock offering. The following summarizes the balances and other information pertaining to these loans at December 31, 2004 ($ in thousands):

	Outstanding Balance	Available Balance	Interest Rate	Interest Due	Principal Due
LOC	$	$ 6,000	5.125%	Quarterly	Beginning in June 2005 principal amortizes over 10 year schedule-due June 2015
ESOP LOC	885	1,115	5.125%	Quarterly	Annual principal repayments of 10% of outstanding balance increasing 5% per year, due in full in June 2009
Total	$ 885	$ 7,115			

Total interest expense on other borrowings for the years ended December 31, 2004, 2003 and 2002, was approximately $124,000, $137,000 and $84,000, respectively.

Junior Subordinated Debentures. On September 17, 2003, the Statutory Trust I sold adjustable-rate Trust Preferred Securities due September 17, 2033 in the aggregate principal amount of $5,000,000 (the Trust Preferred Securities) in a pooled trust preferred securities offering. The interest rate on the Trust Preferred Securities adjusts quarterly, to a rate equal to the then current three-month London Interchange Bank Offering Rate (LIBOR), plus 295 basis points (5.45% at December 31, 2004). In addition, Federal Trust contributed capital of $155,000 to the Statutory Trust I for the purchase of the common securities of the Statutory Trust I. The proceeds from these sales were paid to Federal Trust in exchange for $5,155,000 of its adjustable-rate Junior Subordinated Debentures (the Debentures) due September 17, 2033. The Debentures have the same terms as the Trust Preferred Securities. The sole asset of the Statutory Trust I, the obligor on the Trust Preferred Securities, is the Debentures.

Federal Trust guaranteed the Statutory Trust I s payment of distributions on, payments on any redemptions of, and any liquidation distribution with respect to, the Trust Preferred Securities. Cash distributions on both the Trust Preferred Securities and the Debentures are payable quarterly in arrears on March 17, June 17, September 17 and December 17 of each year.

The Trust Preferred Securities are subject to mandatory redemption: (i) in whole, but not in part, upon repayment of the Debentures at stated maturity or, at the option of Federal Trust, their earlier redemption in whole upon the occurrence of certain changes in the tax treatment or capital treatment of the Trust Preferred Securities, or a change in the law such that the Statutory Trust I would be considered an Investment Company; and (ii) in whole or in part at any time on or after September 17, 2008, contemporaneously with the optional redemption by Federal Trust of the Debentures in whole or in part. The Debentures are redeemable prior to maturity at the option of Federal Trust: (i) on or after September 17, 2008, in whole at any time or in part from time to time; or (ii) in whole, but not in part, at any time within 90 days following the occurrence and continuation of certain changes in the tax treatment or capital treatment of the Trust Preferred Securities, or a change in law such that the Statutory Trust I would be considered an Investment Company, required to be registered under the Investment Company Act of 1940.

The following table sets forth certain information relating to the Bank s borrowings at the dates indicated:

	At or For the Year Ended December 31,		
	2004	2003	2002
	($ in thousands)		
FHLB advances:			
Average balance outstanding	$ 118,729	$ 95,983	$ 48,214
Maximum amount outstanding at any month end during the year	$ 143,700	$ 123,200	$ 54,200
Balance outstanding at end of year	$ 143,700	$ 107,700	$ 54,200
Weighted average interest rate during the year	2.34%	2.44%	4.91%
Weighted average interest rate at end of year	2.73%	2.04%	3.05%
Other borrowings and junior subordinated debentures:			
Average balance outstanding	$ 11,482	$ 7,091	$ 1,688
Maximum amount outstanding at any month end during the year	$ 13,706	$ 14,011	$ 5,915
Balance outstanding at end of year	$ 9,089	$ 13,706	$ 3,054
Weighted average interest rate during the year	4.44%	4.63%	4.98%
Weighted average interest rate at end of year	5.22%	3.96%	4.75%
Total borrowings:			
Average balance outstanding	$ 130,211	$ 103,074	$ 49,902
Maximum amount outstanding at any month end during the year	$ 157,406	$ 137,211	$ 57,615
Balance outstanding at end of year	$ 152,789	$ 121,406	$ 55,115
Weighted average interest rate during the year	2.53%	2.59%	4.91%
Weighted average interest rate at end of year	3.02%	2.25%	3.07%

Expansion Activities

The Sanford branch office, which originally opened in October 1998, relocated in February 2002 to a new 3,000 square- foot facility with three drive-up lanes and a fourth lane which has a drive-up ATM. The new location is adjacent to our corporate headquarters building where the branch originally opened and provides our customers with easier access and extended hours.

The Casselberry branch office opened in December 2002, in a new 3,000 square foot facility with two drive-up lanes and a third lane which has a drive-up ATM. The office is located on Semoran Boulevard (State Road 436) which is a main thorough-fare in Seminole and Orange Counties.

In June 2003, we opened our second Volusia County branch in Deltona, Florida, in a 1,500 square foot, short-term leased facility in a retail plaza. In June 2004, we completed construction and opened our permanent Deltona branch, a 2,500 square foot free-standing facility located at a key intersection on an out-parcel of a grocery store and retail plaza. The branch also has two drive-up lanes and a third lane which has a drive-up

ATM. The short-term lease on the retail plaza expires in December 2005 and the former branch space has been subleased to a third party.

In October 2003, we opened our third Volusia County branch in Orange City, Florida, in a 3,000 square foot free-standing facility with two drive-up lanes and a third lane which has a drive-up ATM. The office is located on Enterprise Boulevard, which is a main commercial artery in Orange City.

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We are looking to further expand our branch network in 2005. We own a parcel of land in Port Orange, Florida and have leased a site in Lake Mary, Florida. We expect to begin construction of new free-standing branch facilities on both sites in the first half of 2005 and have the branches opened before the end of the year. The Port Orange site is located in Eastern Volusia County between our New Smyrna branch and Daytona Beach. The Lake Mary site is in Seminole County, between our existing Sanford and Casselberry branches.

Employees

At December 31, 2004, the Bank had a total of 72 full-time employees. We consider relations with our employees to be excellent. We currently maintain a comprehensive employee benefit program providing, among other benefits, hospitalization and major medical insurance, long-term disability insurance, life insurance, education assistance, an employee stock ownership plan (ESOP) and a 401K Plan. These benefits are considered by management to be competitive with employee benefits provided by other major employers in our market areas. Our employees are not represented by any collective bargaining group.

Other Subsidiaries

At December 31, 2004, Federal Trust had no subsidiaries other than the Bank and its investment in Statutory Trust I. The total equity investment in the Bank at December 31, 2004 was $41.9 million.

Bank Subsidiaries

There are no limits on the amount a savings institution may invest in its operating subsidiaries, either separately or in the aggregate. The Bank had one operating subsidiary, FTB Financial, Inc. (FTBF). FTBF, which commenced operations in 1996, engaged in the business of selling insurance annuities, stocks and bond investment products. FTBF ceased operations in September 2003 and had only minimal activity over the previous three years. The Bank s other subsidiary; Vantage Mortgage Service Center, Inc. (Vantage) originated residential mortgages (FHA and VA) in the Gainesville, Florida market. Vantage ceased operations during March 2001 and was dissolved in September 2001.

Legal Proceedings

There are no material pending legal proceedings to which the Company is a party, or to which any of its property is subject.

Monetary Policies

The results of our operations are affected by credit policies of monetary authorities, particularly the Federal Reserve Board. The instruments of monetary policy employed by the Federal Reserve Board include open market operations in U.S. government securities, changes in the discount rate on member bank borrowings, changes in reserve requirements against member bank deposits. In view of changing conditions in the national economy and in the financial markets, as well as the effect of action by monetary and fiscal authorities, including the Federal Reserve Board, no prediction can be made as to our possible future changes in interest rates, deposit levels, loan demand or our business and earnings.

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REGULATION AND SUPERVISION

General

Federal Trust is a non-diversified savings and loan holding company within the meaning of the Home Owners Loan Act (HOLA). Federal Trust and the Bank operate in a highly regulated environment. Our business activities, which are governed by statute, regulation and administrative policies, are supervised by a number of federal regulatory agencies, including the OTS, the Federal Deposit Insurance Corporation (FDIC) and, to a limited extent, the Federal Reserve Board. As a Florida corporation, Federal Trust is subject to the Florida Business Corporation Act (FBCA) and the regulation by the Florida Department of State under its authority to implement the FBCA.

The federal banking agencies have broad discretion in connection with their supervisory and enforcement activities and policies, including policies concerning the classification of assets and the establishment of loan loss reserves for regulatory purposes. Any change in such regulation or banking laws, whether by the OTS, FDIC or the United States Congress, can have a material adverse impact on our operations.

The following summarizes some of the regulatory requirements that are applicable to our operations.

Regulation of Federal Trust

Restrictions on the Acquisition of Savings Institutions. Section 1467a of the HOLA provides that no holding company, directly or indirectly or acting in concert with one or more persons, or through one or more subsidiaries, or through one or more transactions, may acquire control of an insured savings institution at any time without the prior approval of the OTS. In addition, any holding company that acquires such control becomes a savings and loan holding company subject to registration, examination and regulation under HOLA and the regulations promulgated thereunder. The OTS considers acquirers to have conclusively gained control of a savings bank if they:

- acquire more than 25% of any class of voting stock;
- acquire irrevocable proxies representing more than 25% of any class of voting stock;
- acquire a combination of shares and irrevocable proxies representing more than 25% of any class of voting stock; or
- control, in any manner, the majority of the directors of the savings bank.

An acquirer must file for approval of control with the OTS or file to rebut the presumptions before acquiring 10% or more of any class of voting stock of the savings bank and again prior to acquiring more than 25% of any class of voting stock of the savings bank and if it has any of the control factors enumerated in 12 C.F.R., Section 574.4(c), which include, but are not limited to:

the acquirer would be one of the two largest shareholders of any class of voting stock;

the acquirer and/or the acquirer s representative or nominees would constitute more than one member of the savings bank s Board of Directors; and

the acquirer, or nominee or management official of the acquirer, would serve as the Chairman of the Board of Directors, Chairman of the Executive Committee, Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, or in any similar policy making authority in the savings bank.

A person or company are presumed to be acting in concert with members of the person s immediate family (which includes a person s spouse, father, mother, children, brothers, sisters and grandchildren, father, mother, brothers and sisters of the person s spouse, and the spouse of the person s child, brother or sister). Persons will be presumed to be acting in concert with each other where:

both own stock in a savings bank and both are also management officials, controlling shareholders, partners, or trustees of another company; or

one person provides credit to another or is instrumental in obtaining financing for another person to purchase stock of the savings bank.

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A person or company is presumed to be acting in concert with any trust for which such person or company serves as trustee.

Intra-Company Transactions. Federal Trust s authority to engage in transactions with related parties or affiliates, or to make loans to certain insiders, are governed by Sections 23A and 23B of the Federal Reserve Act and Regulation W adopted by the Board of Governors of the Federal Reserve System to implement these sections of the Federal Reserve Act. Federal Trust, as the parent-holding company of the Bank, is an affiliate of the Bank.

Sections 23A and 23B generally:

- limit the extent to which a bank or its subsidiaries may engage in covered transactions with any one affiliate to an amount equal to 10% of the institution s capital stock and surplus;

- contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus; and

- require that all such transactions be on terms substantially the same, or at least as favorable, to a bank or its subsidiaries as those provided to a non-affiliate.

The term covered transaction includes the making of loans, purchase of assets, issuance of a guarantee and similar other types of transactions. In addition to the restrictions imposed by Sections 23A and 23B, no savings bank may:

- loan or otherwise extend credit to an affiliate, except for any affiliate which engages only in activities which are permissible for bank holding companies or loans between affiliates which are 80% or more owned by the same parent company; or

- purchase or invest in any stocks, bonds, debentures, notes or similar obligations any affiliate, except for affiliates which are subsidiaries of the bank or savings bank.

The Bank s authority to extend credit to executive officers, directors and 10% shareholders, as well as entities controlled by such persons, is governed by Section 22(g) and 22(h) of the Federal Reserve Act and Regulation O thereunder. Among other things, these regulations require such loans to be made on terms substantially similar to those offered to unaffiliated individuals, place limits on the amount of loans the Bank may make to such persons, based in part, on the Bank s capital position, and require certain approval procedures to be followed. The OTS regulations, with certain minor variances, apply Regulation O to savings banks. At December 31, 2004, the Bank had an aggregated total of $64,000 outstanding in loans or other extensions of credit to the Company s directors and executive officers.

Support of Subsidiary Depository Banks. Under OTS policy, Federal Trust is expected to act as a source of financial strength to and to commit resources to support the Bank. This support may be required at times when, in the absence of such OTS policy, Federal Trust might not be inclined to provide such support. In addition, any capital loans by Federal Trust to the Bank must be subordinate in right of payment to depositors and to certain other indebtedness of the Bank. In the event of bankruptcy, any commitment by a holding company to a federal bank regulatory agency to maintain the capital of a subsidiary depository institution will be assumed by the bankruptcy trustee and will be entitled to a priority of payment.

Payment of Dividends. The principal source of cash flow of Federal Trust, including cash flow to pay cash dividends, has been the sale of common stock of Federal Trust, the $6,000,000 revolving line of credit and dividends from the Bank. There are statutory and regulatory limitations on the payment of dividends by the Bank. The ability of the Bank to pay a dividend to Federal Trust is governed by the OTS s capital distribution regulation. Under the regulation, the Bank may make a capital distribution without the approval of the OTS, provided the OTS is notified 30 days before declaration of the capital distribution. The Bank must also meet the following requirements: (i) it has a regulatory rating in one of the two top examination categories; (ii) it is not of supervisory concern, and will remain adequately or well-capitalized, as defined in the OTS prompt corrective action regulations, following the proposed distribution; and (iii) the distribution does not exceed the Bank s net income for the calendar year-to-date plus retained net income for the previous two calendar years (less any dividends previously paid). If the Bank does not meet the above-stated requirements, it must obtain the prior approval of the OTS before declaring any proposed distributions. The OTS can prohibit a proposed capital distribution by a savings institution, which would otherwise be permitted by the regulation if the OTS determines that such distribution would constitute an unsafe or unsound practice.

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Federal Trust paid $.05 per share in dividends during 2003 and $.09 per share in dividends during 2004.

34 Act Reporting. As a publicly traded company with its shares of common stock registered under the Securities Act of 1933, Federal Trust is required to file periodic public disclosure reports with the Securities and Exchange Commission, pursuant to the Securities and Exchange Act of 1934, and the regulations promulgated thereunder. A Form 10-KSB is a required annual report that must contain a complete overview of Federal Trust s business, financial, management, regulatory, legal, ownership and organizational status. Federal Trust must file Form 10-KSB by March 31 of each year.

Similarly, Form 10-QSB must contain information concerning Federal Trust on a quarterly basis. Although Form 10-KSB requires the inclusion of audited financial statements, unaudited statements are sufficient for inclusion on Form 10-QSB Additionally, any significant non-recurring events that occur during the subject quarter, as well as changes in securities, any defaults and the submissions of any matters to a vote of security holders, must also be reported on Form 10-QSB.

Recently, the national securities exchanges, including the American Stock Exchange adopted a rule requiring the audit committees of Boards of Directors of reporting corporations, such as Federal Trust, to undertake certain organizational and operational steps. The Securities and Exchange Commission also adopted a similar rule. These standards require our audit committee to be comprised of independent, non-employee directors who are financially literate. Furthermore, the audit committee has adopted a formal charter defining the scope for its operations. The Securities and Exchange Commission s rule also requires our auditors to review the financial statements contained in our Form 10-KSB s, in addition to our Form 10-QSB s.

Sarbanes-Oxley Act. The primary purpose of the Sarbanes-Oxley Act is to protect investors by improving the accuracy and reliability of disclosures made pursuant to the federal securities laws.

The Sarbanes-Oxley Act amends the Securities Exchange Act of 1934 to prohibit a registered public accounting firm from performing specified non-audit services contemporaneously with an audit. The Sarbanes-Oxley Act also vests the audit committee of an issuer with responsibility for the appointment, compensation, and oversight of any registered public accounting firm employed to perform audit services. It requires each audit committee member to be a member of the Board of Directors of the issuer, and to be otherwise independent. The Sarbanes-Oxley Act further requires the Chief Executive Officer and Chief Financial Officer of an issuer to make certain certifications as to each annual or quarterly report.

In addition, the Sarbanes-Oxley Act requires officers to forfeit certain bonuses and profits under certain circumstances. Specifically, if an issuer is required to prepare an accounting restatement due to the material non-compliance of the issuer as a result of misconduct with any financial reporting requirement under the securities laws, the Chief Executive Officer and Chief Financial Officer of the issuer shall be required to reimburse the issuer for: (1) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the Securities and Exchange Commission of the financial document embodying such financial reporting requirement; and (2) any profits realized from the sale of securities of the issuer during that 12-month period.

The Sarbanes-Oxley Act also requires:

Disclosure of all material off-balance sheet transactions and relationships that may have material effect upon the financial status of an issuer; and

The presentation of pro forma financial information in a manner that is not misleading, and which is reconcilable with the financial condition of the issuer under generally accepted accounting principles.

The Sarbanes-Oxley Act also prohibits insider transactions in stock held within pension plans during lock-out periods, and any profits on such insider transactions are to be disgorged. In addition, there is a prohibition of company loans to executives, except in certain circumstances. Further, the Sarbanes-Oxley Act adds a criminal penalty of fines and imprisonment of up to ten years for securities fraud.

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Florida Business Corporation Act. Federal Trust is subject to the provisions of the FBCA, which authorizes the establishment of Florida corporations and sets forth the corporate governance standards for their operations. Some of the more pertinent provisions include:

- General powers of a corporation;
- Shareholders rights;
- Notice, conduct of meetings and voting rights;
- Director and officer requirements and duties;
- Election of directors;
- Terms of directors;
- Compensation of directors;
- Contract rights of offers;
- Indemnification of directors, officers, employees and agents;
- Business combinations and mergers; and
- Corporate Dissolutions.

The FBCA also provides for super majority voting requirements for shareholders, which may be considered to be anti-takeover provisions. At the 1999 Annual Meeting of Shareholders, the Shareholders approved the Articles of Amendments to our Articles of Incorporation, which require certain super majority voting requirements. Specifically, Article V, *Powers and Governance*, was amended to provide that Special Meetings of Shareholders can be called by 20% or more of all of the outstanding shares; Article VIII, *Amendment*, was amended to provide that any provisions of the Articles of Incorporation can be amended by vote of a majority of all of the outstanding shares of our capital stock; and Article IX, as added to the Articles of Amendment to the Articles of Incorporation to require the vote *Control Share Acquisition and Business Combinations*, of not less than 66% of the outstanding shares of common stock.

Regulation of the Bank

Capital Requirements. The OTS and the FDIC have adopted capital regulations, which establish a Tier 1 core capital definition and a minimum 3% leverage capital ratio requirement for the most highly-rated savings banks and holding companies (i.e., those savings banks and holding companies with a composite rating of 1 under the Uniform Financial Institutions Rating System by the Federal Financial Institution Examination Council) that are not anticipating or experiencing significant growth. All other savings banks are required to meet a minimum leverage ratio of at least 4% to 5%. A savings bank that is not in the highest-rated category or that is anticipating or experiencing significant growth will have to meet a minimum leverage ratio of at least 4%.

Under the OTS risk-based regulations, a savings bank must classify its assets and certain off-balance sheet activities into categories and maintain specified levels of capital for each category. The least capital is required for the category deemed by the FDIC to have the least risk, and the most capital is required for the category deemed by the FDIC to have the greatest risk. Under the regulations, certain assets are excluded for purposes of determining risk-based capital. Such assets include intangible assets, unconsolidated subsidiaries, investments in securities subsidiaries, ineligible equity investments and reciprocal holding of capital instruments with other financial institutions. In addition, the OTS may consider deducting other assets or in other subsidiaries on a case-by case basis or based on the general characteristics or functional nature of the subsidiaries.

Prompt Corrective Action. Federal banking regulatory agencies has established certain capital and other criteria which define the categories under which a particular financial institution may be classified. Constraints are imposed on operation, management, and capital distributions depending on the category in which a financial institution is classified. Among other things, the regulations define the relevant capital measures for the five capital categories. For example, a savings bank is deemed to be well capitalized if it has a total risk-based capital ratio (total capital to risk-weighted assets) of 10% or greater, a Tier 1 risk-based capital ratio (Tier 1 capital to risk-weighted assets) of 6% or greater, and a Tier 1 leverage capital ratio (Tier 1 capital to adjusted to total assets) of 5% or greater, and is not subject to a regulatory order, agreement or directive to meet and maintain a specific capital level for any capital measure.

A savings bank is deemed to be adequately capitalized if it has a total risk-based capital ratio of 8% or greater, and, generally, a Tier 1 leverage capital ratio of 4% or greater, and the bank does not meet the definition of a well capitalized bank. A savings bank is deemed to be critically undercapitalized if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2%. In addition, the OTS is authorized to downgrade a savings bank to a lower capital category than the savings bank to a lower capital category than the savings bank s capital ratios would otherwise indicate, based upon safety and soundness considerations (such as when the bank has received a less than satisfactory examination rating for any of the equivalent regulatory rating categories).

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Both the risk-based capital guidelines and the leverage ratio are minimum requirements, applicable only to top-rated savings banks. Savings banks operating at or near these levels are expected to have well-diversified risk, excellent asset quality, high liquidity, good earnings and, in general, have to be considered strong banking organizations and rated composite 1 under the regulatory rating system adopted by the OTS. Savings banks with lower ratings and savings banks with high levels of risk or that are experiencing or anticipating significant growth would be expected to maintain ratios 1% to 2% above the stated minimums.

At December 31, 2004, the Bank exceeded each of its capital requirements. The following table sets forth the regulatory capital calculations of the Bank at December 31, 2004 ($ in thousands):

	Tier I		Risk-Based	
	Amount	Percent of Assets	Amount	Percent of Assets
Regulatory capital	$ 41,813	7.0%	$ 45,648	11.5%
Requirement	23,924	4.0	31,687	8.0
Excess	$ 17,889	3.0%	$ 13,961	3.5%

Standards for Safety and Soundness. Federal banking agencies have prescribed for all insured depository institutions and their holding companies, standards relating to internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate-risk exposure, asset growth, and compensation, fees and benefits and such other operational and managerial standards as the agency deems appropriate. In addition, the federal banking regulatory agencies have prescribed by regulation standards specifying:

Maximum classified assets to capital ratios;

Minimum earnings sufficient to absorb loses without impairing capital;

To the extent feasible, a minimum ratio of market value to book value for publicly traded shares of depository banks or the depository bank holding companies; and

such other standards relating to asset quality, earnings and valuation as the agency deems appropriate.

If the OTS determines that a savings bank is not in compliance with the safety and soundness guidelines, it may require the institution to submit an acceptable plan to achieve compliance with the guidelines. A savings bank is required to submit an acceptable compliance plan to the OTS within 30 days after receipt of a request for such a plan. Failure to submit or implement a compliance plan may subject the savings bank to regulatory sanctions.

Insurance of Deposit Accounts. The FDIC is the administrator for the Savings Association Insurance Fund (SAIF) and the Bank Insurance Fund (BIF), independently setting insurance premiums for each Fund. The Bank s deposit accounts are insured by the SAIF.

The FDIC applies a risk-based assessment system for insured depository institutions that takes into account the risks attributable to different categories and concentrations of assets and liabilities. In accordance with its rule, the FDIC assigns a depository institution to one of three capital categories based on the institution s financial information, as of the reporting period ending seven months before the assessment period. A depository institution s assessment rate depends on the capital category and supervisory category to which it is assigned. There are nine assessment risk classifications (i.e., combinations of capital groups and supervisory subgroups) to which different assessment rates are applied.

The current regular semi-annual SAIF assessments range between 0% (for well capitalized and financially sound savings banks with a few minor weaknesses) to 0.27% of deposits for a savings bank in the lowest category (i.e., undercapitalized and posing a substantial probability of loss to the FDIC, unless effective corrective action is taken). The Bank s assessment at December 31, 2004 was .0074 basis points on deposits and the Bank paid approximately $49,000 in SAIF assessments during the year ended December 31, 2004.

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Qualified Thrift Lender Test (QTL). The HOLA requires savings institutions to meet a QTL test. The QTL test, requires savings institutions to maintain at least 65% of its portfolio assets (as defined by regulation) in qualified thrift investments, primarily residential mortgages and related investments on a monthly basis in nine out of every 12 months. As of December 31, 2004, the Bank exceeded the QTL test, maintaining 83.4% of its portfolio assets in qualified thrift investments.

Brokered Deposits. In accordance with the Federal Deposit Insurance Corporation Improvement Act of 1991, the FDIC has implemented restrictions on the acceptance of brokered deposits. In general, only well capitalized financial institutions may accept brokered deposits. As a well capitalized savings bank, the Bank is able to accept some brokered deposits to fund its liquidity and loan demand needs. At December 31, 2004, the Bank had $94.4 million in brokered deposits.

Gramm-Leach-Bliley Act. The Gramm-Leach-Bliley Act of 1999, amongst other items, established a minimum federal standard of financial privacy. Financial institutions are required to have written privacy policies that must be disclosed to customers. The disclosure of a financial institution s privacy policy must take place at the time a customer relationship is established and not less than annually during the continuation of the relationship. The act also limits when and how financial institutions may share their customers personal information with both affiliated and nonaffiliated entities.

USA Patriot Act. The terrorist attacks in September 2001, have led to the adoption of the Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, commonly known as the USA Patriot Act. Part of the USA Patriot Act is the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001. This act requires the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to financial institutions. These measures include enhanced recordkeeping and reporting requirements for certain financial transactions that are of primary money laundering concern, due diligence requirements concerning the beneficial ownership of 22 certain types of accounts, and restrictions or prohibitions on certain types of accounts with foreign financial institutions. Among its other provisions, this law requires each financial institution to: (i) establish an anti-laundering program; (ii) establish due diligence policies, procedures and controls with respect to private banking accounts and correspondent banking accounts involving foreign individuals and certain foreign banks; and (iii) avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign bank that does not have a physical presence in this country. In addition, the law contains a provision encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities. The law expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours.

Interstate Banking. Federally chartered savings banks are allowed to branch nationwide to the extent allowed by federal statute. This ability permits savings bank with interstate networks to diversify their loan portfolios and lines of business. The OTS authority preempts any state law purporting to regulate branching by federal savings banks. Prior approval of the OTS is required for a savings bank to branch interstate or intrastate. To obtain supervisory clearance for branching, an applicant s regulatory capital must meet or exceed the minimum requirements established by law and by the OTS regulations. In addition, the savings bank must have a satisfactory record under the Community Reinvestment Act (CRA). The Bank does not conduct interstate branching operations and does not plan to do so in the foreseeable future.

The Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Interstate Act) eliminated many existing restrictions on interstate banking by authorizing interstate acquisitions of financial institutions by bank holding companies without geographic limitations. Under the Interstate Act, existing restrictions on interstate acquisitions of banks by bank holding companies were repealed. Bank holding companies located in Florida are able to acquire any Florida-based bank, subject to certain deposit percentage and other restrictions. The legislation also provides that *de novo* branching by an out-of-state bank is permitted only if it is expressly permitted by the laws of the host state. The authority of a bank to establish and operate branches within a state is subject to applicable state branching laws. Florida law permits interstate branching through the acquisition of a bank in existence for more than three years, but prohibits *de novo* branching by out of state banks.

OTS Assessments. Savings banks are required by OTS regulation to pay assessments to the OTS to fund the operations of the OTS. The general assessment, to be paid on a semiannually basis, is computed upon the savings bank s total assets, including consolidated subsidiaries, as reported in the savings bank s latest quarterly thrift financial report. The Bank paid approximately $102,000 in OTS assessments for the year-ended December 31, 2004.

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Federal Home Loan Bank System

The Bank is a member of the Federal Home Loan Bank (FHLB) System which consists of 12 regional FHLBs. The FHLB provides a central credit facility primarily for member institutions. As a member of the FHLB-Atlanta, the Bank is required to acquire and hold shares of capital stock in that FHLB in an amount at least equal to the lesser of 0.20% of total assets or $25 million plus 4.5% of outstanding advances. The Bank is in compliance with this requirement and at December 31, 2004, the Bank held $7.4 million in FHLB stock. FHLB advances must be secured by specified types of collateral and may be obtained only for the purpose of providing funds to finance residential housing.

The FHLBs are required to provide funds for the resolution of insolvent savings institutions and to contribute funds for affordable housing programs. These requirements could reduce the amount of dividends that the FHLBs pay to their members and could also result in the FHLBs imposing a higher rate of interest on advances to members. For the year ended December 31, 2004, dividends paid by the FHLB-Atlanta to the Bank amounted to approximately $215,000 for a yield of approximately 3.8%. Should dividends be reduced, or interest on FHLB advances increased, the consolidated net interest income might also be reduced for the Bank. Furthermore, there can be no assurance that the value of the FHLB-Atlanta stock held by the Bank will not decrease as a result of any new legislation.

Federal Reserve System

The Federal Reserve regulations require depository institutions to maintain non-interest-earning reserves against their transaction accounts (primarily NOW and regular checking accounts). The Federal Reserve regulations generally require that reserves of 3% must be maintained against aggregate transaction accounts of $47.6 million or less (subject to adjustment by the Federal Reserve) plus 10% of accounts in excess of $47.6 million. The first $7.0 million of otherwise reservable balances (subject to adjustments by the Federal Reserve) are exempted from the reserve requirements. The Bank is in compliance with the foregoing requirements. The balances maintained to meet the reserve requirements imposed by the Federal Reserve may be used to satisfy liquidity requirements imposed by the OTS. Because required reserves must be maintained in the form of either vault cash, a non-interest-bearing account at a Federal Reserve or a pass-through account as defined by the Federal Reserve, the effect of this reserve requirement is to reduce the Bank s interest-earning assets. FHLB System members are also authorized to borrow from the Federal Reserve discount window, however, Federal Reserve regulations require institutions to exhaust all FHLB sources before borrowing from a Federal Reserve.

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ITEM 2. DESCRIPTION OF PROPERTIES

The following table sets forth certain information on the Company s principal offices, net carrying value and the expiration of leases when applicable at December 31, 2004 ($ in thousands):

	Net Carrying Value of Real Property		
	Owned	**Leased**	**Lease Expiration**
Sanford Branch Office 420 West First Street Sanford, Florida 32771	$ 1,169	N/A	N/A
Winter Park Office 655 West Morse Blvd. Winter Park, Florida 32789	N/A	$ 309	12/31/09
New Smyrna Beach Office 761 East Third Avenue New Smyrna Beach, Florida 32169	N/A	$ 6	08/31/06
Casselberry Office 487 Semoran Boulevard Casselberry, Florida 32707	$ 1,356	N/A	N/A
Orange City Office 2690 Enterprise Road Orange City, Florida 32763	$ 1,366	N/A	N/A
Deltona Office 901 Doyle Road Deltona, Florida 32725	$ 946	N/A	N/A
Administrative Offices (1) 312 West First Street Sanford, Florida 32771	N/A	$ 5,561	8/31/16
Future office locations (2)	$ 356	N/A	4/01/25

Note (1): In October 2001, Federal Trust completed a transaction in which it entered into a 15 year, fixed-rate lease on the office building in Sanford, Florida, which houses the Executive, Administrative, Lending and Operations Departments. The lease provides for a fixed annual rental over the 15 year term. In addition, the agreement provides for the purchase of the office building at the end of the lease term for $1, with an option to purchase the building at any time during the 15 year term at a pre-determined amount. The building has a total of 46,692 rentable square feet of which the Company occupies 22,171 square feet. The remaining 24,521 square feet is rented to various non-affiliated tenants.

Note (2): The Bank owns a parcel of land in Port Orange, Florida and has a ground lease on a parcel of land in Lake Mary, Florida, with lease payments commencing in April 2005. Construction of both branches is expected to commence in the first half of 2005.

Note (3): The Company also had net furniture, fixtures, and equipment of approximately $1,284,000.

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ITEM 3. LEGAL PROCEEDINGS

There are no material pending legal proceedings to which the Company is a party or to which any of its property is subject.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

During the fourth quarter of the fiscal year ended December 31, 2004, no matters were submitted to a vote of the security holders through a solicitation or otherwise.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON STOCK AND RELATED STOCK HOLDER MATTERS AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES

(a) In June 2003, Federal Trust s stock began trading on the American Stock Exchange under the symbol FDT . Prior to that, Federal Trust s common stock traded on the NASDAQ Small Cap Market under the symbol FDTR . As of March 11, 2005, there were 426 registered holders of common stock of Federal Trust, some of which are street name holders. Federal Trust paid cash dividends of $.09 per share during 2004 and $.05 per share during 2003, but did not pay dividends during 2002.

The following table lists the low and high closing stock prices for the periods indicated.

	Calendar Year 2004		Calendar Year 2003	
	Low $	**High $**	**Low $**	**High $**
First Quarter	$ 7.20	$ 7.89	$ 4.12	$ 5.70
Second Quarter	7.46	8.13	5.01	6.30
Third Quarter	7.36	8.56	6.30	7.49
Fourth Quarter	8.13	10.47	7.40	8.15

(b) Not Applicable

(c) There were no stock repurchases during the quarter ended December 31, 2004.

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ITEM 6. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL

CONDITION AND RESULTS OF OPERATIONS

CONSOLIDATED FINANCIAL HIGHLIGHTS

($ in thousands, except per share amounts)

	2004	2003	2002	2001	2000
AT YEAR END:					
Total assets	$ 603,131	468,198	368,054	306,481	248,938
Loans, net	521,331	398,401	308,598	264,187	222,895
Investment Securities	41,172	33,615	21,520	13,948	8,075
Deposits	404,116	314,630	278,531	225,400	181,869
Stockholders Equity	39,387	26,457	25,039	18,531	15,707
Book value per share	4.97	4.05	3.80	3.43	3.17
Shares outstanding (1)	7,942,438	6,526,215	6,591,338	5,409,449	4,947,911
Equity-to-assets ratio	6.53%	5.65%	6.80%	6.05%	6.31%
FOR THE YEAR:					
Interest income	$ 24,591	20,921	19,452	19,950	18,405
Interest expense	10,851	9,750	10,971	13,272	12,581
Net interest income	13,740	11,171	8,481	6,678	5,824
Provision for loan losses	1,180	650	445	540	329
Net interest income after provision for loan losses	12,560	10,521	8,036	6,138	5,495
Other income	2,409	2,358	2,400	2,383	2,019
Other-than-temporary impairment	1,055				
Other expenses	9,334	8,826	7,339	6,538	5,865
Net earnings	3,089	2,777	2,059	1,267	1,225
Basic earnings per share	.44	.42	.34	.25	.25
Diluted earnings per share	.43	.42	.34	.25	.25
Earnings per share excluding the effect of the other-than-temporary impairment					
Basic	$ 0.53	0.42	0.34	0.25	0.25
Diluted	0.52	0.42	0.34	0.25	0.25
Average common shares outstanding	7,082,421	6,548,957	5,991,155	5,060,450	4,947,911
Return on average assets	.59%	.64%	.63%	.47%	.52%
Return on average equity	9.80%	10.79%	9.45%	7.40%	8.02%
Net interest margin	2.80%	2.73%	2.71%	2.58%	2.56%
Average equity to average assets ratio	6.02%	5.95%	6.68%	6.30%	6.44%
Dividend payout ratio	20.36%	11.81%			

(1) Net of unallocated ESOP shares of 119,375 and 135,592 as of December 31, 2004 and December 31, 2003, respectively.

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RESULTS OF OPERATIONS

Overview

For the year ended December 31, 2004, we had net earnings of $3.1 million, compared to $2.8 million for 2003. On a per share basis, basic earnings for 2004 were $.44 and diluted earnings were $.43 compared to $.42 for basic and diluted earnings per share for 2003.

During the fourth quarter of 2004, we recorded an other-than-temporary impairment charge of approximately $659,000 after tax, or $.09 per share. The charge related to a $9.5 million investment in Freddie Mac and Fannie Mae adjustable rate preferred stock. These investment grade securities declined in value in 2004 due to the recent events at Freddie Mac and Fannie Mae coupled with the record low interest rates which caused the dividend payment rate to decline from the original rates at the time of issuance. While we believe that the value of these investments will recover in the future as the dividend rates adjust, we are unable to determine at this time when and how much the prices will recover.

Excluding the effect of the other-than-temporary impairment charge, net earnings for 2004 would have been $3.7 million, an increase of 35% from the $2.8 million net earnings for 2003. The improvement in core earnings for 2004 was attributable to a $2.6 million, or 23% increase in net interest income, partially offset by a $530,000 increase in the provision for loan losses and a $508,000 increase in non-interest expenses.

Total assets at the end of 2004 were $603.1 million, an increase of $134.9 million, or 29% from December 31, 2003. Net loans grew to $521.3 million during 2004, up $122.9 million or 31% from the end of 2003. Funding for our growth in 2004 came from an $89.5 million, or 28% increase in total deposits and a $36 million, or 33% increase in FHLB advances. Total deposits and FHLB advances at December 31, 2004, were $404.1 million and $143.7 million, respectively, compared to $314.6 million and $107.7 million, respectively for the end of 2003.

During 2004, Federal Trust successfully sold 1.4 million additional shares of common stock at $7.50 per share. After deducting the costs of the stock offering, we added $10.0 million of additional capital to support our growth plans. At the end of 2004, stockholders equity was $39.4 million, compare to $26.5 million at December 31, 2003. The book value per share grew to $4.96 at December 31, 2004, from $4.05 at December 31, 2003. We paid cash dividends of $.09 per share in 2004, compared to $.05 per share in 2003.

General

Federal Trust was organized in February 1989 for the purpose of becoming the unitary savings and loan holding company of the Bank, a federally-chartered stock savings bank. Our corporate headquarters are located at 312 West First Street, Sanford, Florida 32771 and our telephone number is (407) 323-1833. The principal source of our revenues on an unconsolidated basis is earnings of the Bank. Various regulatory restrictions and tax considerations limit, directly or indirectly, the amount of dividends the Bank can pay to Federal Trust. In addition, federal law restricts the Bank in the making of investments in or loans to us or our affiliates. See Regulation and Supervision.

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Average Balance Sheet

The following table sets forth, for the periods indicated, information regarding: (i) the total dollar amount of interest income from interest-earning assets and the resultant average yields; (ii) the total dollar amount of interest expense on interest-bearing liabilities and the resultant average cost; (iii) net interest income; (iv) interest rate spread; (v) net interest margin; and (vi) weighted average yields and rates. Average balances are based on average daily balances.

	For The Year Ended December 31,								
	2004			2003			2002		
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
	($ in thousands)								
Interest-earning assets:									
Loans (1)	$ 447,773	$ 23,016	5.14%	$ 366,488	$ 19,591	5.35%	$ 279,934	$ 18,349	6.55%
Securities	35,516	1,290	3.63	34,755	1,112	3.20	16,695	735	4.40
Other interest-earning assets (2)	7,521	285	3.79	7,626	218	2.86	15,871	368	2.32
Total interest-earning assets	490,810	24,591	5.01	408,869	20,921	5.12	312,500	19,452	6.22
Non-interest earning assets	32,883			23,942			13,756		
Total assets	$ 523,693			$ 432,811			$ 326,256		
Interest-bearing liabilities:									
Non-interest bearing demand deposits	$ 10,076			$ 7,102			$ 5,837		
Interest-bearing demand and money-market deposits	109,654	2,019	1.84	92,525	1,764	1.91	56,066	1,607	2.87
Savings deposits	7,520	110	1.46	9,446	163	1.73	7,621	139	1.82
Time deposits	228,876	5,430	2.37	188,975	5,156	2.73	176,721	6,774	3.83
Total deposit accounts	356,126	7,559	2.12	298,048	7,083	2.38	246,245	8,520	3.46
Borrowings (3)	130,211	3,292	2.52	103,074	2,667	2.59	49,902	2,451	4.91
Total interest bearing liabilities	486,337	10,851	2.23	401,122	9,750	2.43	296,147	10,971	3.70
Non-interest bearing liabilities	5,842			5,941			8.324		
Stockholders equity	31,514			25,748			21,785		
Total liabilities and stockholders equity	$ 523,693			$ 432,811			$ 326,256		
Net interest/dividend income		$ 13,740			$ 11,171			$ 8,481	
Interest rate spread (4)			2.78%			2.69%			2.52%

Net interest margin (5)	2.80%	2.73%	2.71%
Ratio of average interest-earning assets to average interest-bearing liabilities	1.01	1.02	1.06

(1) Includes non-accrual loans.
(2) Includes interest-earning deposits and FHLB stock.
(3) Includes FHLB advances, other borrowings, junior subordinated debentures and capital lease obligation.
(4) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.
(5) Net interest margin is net interest income divided by average interest-earning assets.

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Rate/Volume Analysis

The following table sets forth certain information regarding changes in interest income and interest expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to: (i) changes in rate (change in rate multiplied by prior volume); (ii) changes in volume (changes in volume multiplied by prior rate); and (iii) changes in rate-volume (change in rate multiplied by change in volume).

	Year Ended December 31, 2004 vs. 2003 Increase (Decrease) Due to Changes in (In thousands)			
	Rate	Volume	Rate/ Volume	Total
Interest-earning assets:				
Loans	$ (770)	$ 4,349	$ (154)	$ 3,425
Securities	149	24	5	178
Other interest-earning assets	71	(3)	(1)	67
Total	(550)	4,370	(150)	3,670
Interest-bearing liabilities:				
Deposit accounts	(775)	1,382	(131)	476
FHLB advances and other borrowings	(62)	703	(16)	625
Total	(837)	2,085	(147)	1,101
Net change in net interest income before provision for loan losses	$ 287	$ 2,285	$ (3)	$ 2,569

	Year Ended December 31, 2003 vs. 2002 Increase (Decrease) Due to Changes in (In thousands)			
	Rate	Volume	Rate/ Volume	Total
Interest-earning assets:				
Loans	$ (3,385)	$ 5,673	$ (1,046)	$ 1,242
Securities	(201)	795	(217)	377
Other interest-earning assets	86	(191)	(45)	(150)
Total	(3,500)	6,277	(1,308)	1,469

Interest-bearing liabilities:				
Deposit accounts	(2,498)	1,548	(487)	(1,437)
FHLB advances and other borrowings	(1,160)	2,612	(1,236)	216
Total	(3,658)	4,160	(1,723)	(1,221)
Net change in net interest income before provision for loan losses	$ 158	$ 2,117	$ 415	$ 2,690

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Liquidity and Capital Resources at December 31, 2004

General. Like other financial institutions, we must ensure that sufficient funds are available to meet deposit withdrawals, loan commitments, investment needs and expenses. Control of our cash flow requires the anticipation of deposit flows and loan payments. Our primary sources of funds are deposit accounts, FHLB advances and principal and interest payments on loans.

We require funds in the short term to finance ongoing operating expenses, pay liquidating deposits, purchase temporary investments in securities and invest in loans. We fund short-term requirements through advances from the FHLB, the sale of investments, deposit growth and loan principal payments. Management has no plans to significantly change long-term funding requirements. Long-term funds are required to invest in loans for our portfolio, purchase fixed assets and provide for the liquidation of deposits maturing in the future. Long-term funding requirements are obtained from principal payments from maturing loans, the sale of loans and the sale of securities.

The following summarizes the Company s contractual obligations, including certain on-balance-sheet and off-balance-sheet obligations, at December 31, 2004 (in thousands).

	Payments Due by Period				
	Total	Less Than 1 Year	Greater Than 1 Year, Up To 3 Years	Greater Than 3 Years, Up To 5 Years	More Than 5 Years
FHLB advances assumed final maturity	$ 143,700	$ 60,000	$ 22,200	$ 20,000	$ 41,500
Time deposit maturities	251,546	186,028	64,934	584	
Junior subordinated debentures assumed final maturity	5,155				5,155
Accrued Interest Payable	811	811			
Other borrowings	885	89	151	645	
Operating Leases	3,233	328	641	658	1,606
Loan Commitments	7,526	7,526			
Standby Letters of Credit	2,738	2,738			
Undisbursed construction and line of credit loans	19,393	19,393			
Total	$ 434,987	$ 276,913	$ 87,926	$ 21,887	$ 48,261

During the year ended December 31, 2004, our source of funds came primarily from sale of loans of $29.2 million; net principal repayment of loans of $33.3 million; proceeds from the increase in deposits of $89.5 million; increase FHLB advances of $36.0 million; the proceeds from the sale and repayments of securities of $16.1 million and net proceeds of $10.0 million from the sale of common stock. We used cash to fund $178.5 million in loan purchases; $10.0 million in loans originated for sale; the purchase of securities for $24.4 million; the purchase of FHLB stock of $1.7 million; and the purchase of premises and equipment of $1.3 million. Management believes that in the future, funds will continue to be obtained from the above sources.

At December 31, 2004, loans-in-process, or closed loans scheduled to be funded over a future period of time, totaled $8.0 million. Loans committed, but not closed, totaled $7.5 million, available lines of credit totaled $11.4 million and standby letters of credit totaled $2.7 million.

Funding for these amounts is expected to be provided by the sources described above.

In December 2004, the Bank s average liquidity was 9.01%. The Bank s six central Florida offices are expected to generate deposits to provide liquidity for expected loan originations and other investments. The Asset/Liability Management Committee meets regularly and, in part, reviews liquidity levels to ensure that funds are available as needed.

We paid cash dividends per share of $.09 in 2004 and $.05 in 2003. The payment of future dividends will depend on general economic conditions, as well as our overall performance and capital needs.

At December 31, 2004, Federal Trust had $1,477,000 in cash in its account, which will be used primarily for cash dividend payments and operating expenses.

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The following table is a reconciliation of the Bank s stockholders equity calculated in accordance with accounting principles generally accepted in the United States of America (GAAP) to regulatory capital (in thousands):

	At December 31, 2004	
	Tier I	Total Risk-Based
Bank s stockholders equity in accordance with GAAP	$ 41,859	$ 41,859
Add (deduct):		
Unrealized losses on investments	32	32
Excess mortgage servicing rights and Excess net deferred tax assets	(78)	(78)
General valuation allowances		3,835
Regulatory capital	$ 41,813	$ 45,648

At December 31, 2004, the Bank exceeded each of its minimum capital requirements.

Results of Operations

Comparison of the Years Ended December 31, 2004 and 2003

General. The Company had net earnings for 2004 of $3.1 million or $.44 per basic share and $.43 diluted share compared to net earnings of $2.8 million or $.42 per basic and diluted share for 2003. The improvement in the net earnings in 2004 was due to increases in net interest income, partially offset by an increase in other expenses and a non-cash, other-than-temporary impairment charge of approximately $1,055,000.

The charge related to the Bank s $9.5 million investment in Freddie Mac and Fannie Mae adjustable rate preferred stock. These investment grade securities declined in value in 2004 due to the recent events at the Government Sponsored Enterprises (GSE s) coupled with the record low interest rates, which caused the dividend payment rate to decline from the original rates at the time of issuance. The other-than-temporary impairment charge was recorded in 2004 since we are unable to determine at this time when and how much the preferred stock prices will recover. Excluding the $659,000 after-tax effect of the charge, net earnings for 2004 would have been $3.7 million, or 35% higher than the net earnings for 2003. On a per share basis, excluding the impairment charge, basic and fully diluted earnings were $.53 and $.52, respectively, for 2004 compared to $.42 for both basic and fully diluted earnings in 2003.

Interest Income. Interest income was $24.6 million in 2004 compared to $20.9 million in 2003. Interest income on loans increased to $23.0 million in 2004 from $19.6 million in 2003. The increase in interest income on loans in 2004 was primarily attributable to an increase in the average amount of loans outstanding during the year offset partially by a decrease in yield earned on loans. Interest income on securities increased to $1.3 million in 2004 from $1.1 million in 2003 as a result of an increase in the average balance of securities held by the Company and an increase in the yield earned on the securities. Other interest income increased from $218,000 in 2003 to $285,000 during 2004. Management expects the yield earned on the portfolios to fluctuate with general market interest rate movements.

Interest Expense. Interest expense increased during 2004 to $10.9 million compared to $9.8 million in 2003 primarily due to a decrease in the average cost paid partially offset by an increase in the average amount of deposit accounts and borrowings outstanding. Interest expense on deposits increased by $476,000 in 2004 as a result of an increase in the average amount of deposits partially offset by a decrease in average cost paid on deposits. Interest expense on these accounts will increase or decrease according to the general level of interest rates. Interest on borrowings increased to $3.3 million in 2004 from $2.7 million in 2003 due to an increase in the amount of borrowings outstanding, partially offset by a slight decrease in the average cost paid for borrowings. Management expects to continue to use FHLB advances and other borrowings when the rates offered on such funds is favorable when compared to the rates paid on deposits in the local market.

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Provisions for Loan Losses. A provision for loan losses is generally charged to earnings based upon our evaluation of the inherent losses in the loan portfolio. Our provision for loan losses for 2004 was $1,180,000 compared to $650,000 in 2003 based on management s evaluation of the loan portfolio. Total loans portfolio grew by $129.0 million, or 32% in 2004. Of this amount, $72.5 million were residential mortgage loans. As of December 31, 2004, 70.8% of our gross loan portfolio was residential mortgage loans, which historically have had the lowest risk of loss in the overall portfolio, and as a result have had a lower reserve percentage applied to them based on historical loss percentages.

Total charge-offs were $154,000 in 2004 compared to recoveries of $30,000 on loans previously charged-off. For 2003, total charge-offs and recoveries were $31,000 and $50,000, respectively. At December 31, 2004, the allowance for loan losses was $3.8 million, or .74%, of year-end loans compared to $2.8 million, or .70%, of loans at December 31, 2003. Total non-accrual loans at December 31, 2004, were $2.6 million compared to $6.4 million at December 31, 2003. The amount needed in the allowance for loan losses for nonaccrual loans is based on the particular circumstances of the individual loan, including the type, amount, and value of the collateral, if any, and the overall composition and amount of the performing loans in the portfolio at the time of evaluation, and, as a result, will vary over time.

Other Income. Other income increased slightly to $2.4 million for the year ended December 31, 2004.

Other Expense. Other expense increased to $9.3 million in 2004, or 5.8% from $8.8 million in 2003. The increase was the result of increased salary and employee benefits expense, occupancy expenses, professional services and data processing expense. The increase in salary and employee benefits of $361,000 was the result of additions to staff, as a result of the continued growth of the Company and the opening of the new branches in June 2003 and October 2003 and the relocation to our permanent Deltona branch in 2004, which also caused occupancy expense to increase. In addition, staff was added in the commercial and residential loan departments as part of our strategy to increase loan production. Data processing expense increased as a result of an increase in the number of accounts and the opening of the new branches.

Income Taxes. Income taxes increased from $1.3 million (an effective tax rate of 31.5%) in 2003 to $1.5 million (an effective tax rate of 32.6%) in 2004.

Comparison of the Years Ended December 31, 2003 and 2002

General. The Company had net earnings for 2003 of $2.8 million or $.42 per basic and diluted share, compared to net earnings of $2.1 million or $.34 per basic and diluted share for 2002. The improvement in the net earnings in 2003 was due to increases in net interest income, partially offset by an increase in other expenses.

Interest Income. Interest income was $20.9 million in 2003 compared to $19.5 million in 2002. Interest income on loans increased to $19.6 million in 2003 from $18.3 million in 2002. The increase in interest income on loans in 2003 was primarily attributable to an increase in the average amount of loans outstanding during the year offset partially by a decrease in the yield earned on loans. Interest income on securities increased to $1.1 million in 2003 from $735,000 in 2002 as a result of an increase in the average balance of securities held by the Company partially offset by a decrease in yield earned on the securities. Other interest income decreased from $368,000 in 2002 to $218,000 during 2003. We expect the yield earned on the portfolios to fluctuate with general market interest rate movements.

Interest Expense. Interest expense decreased during 2003 to $9.8 million compared to $11.0 million in 2002 primarily due to a decrease in the average cost paid partially offset by an increase in the average amount of deposit accounts and borrowings outstanding. Interest expense on deposits decreased by $1.4 million in 2003 as a result of a decrease in average cost paid on deposits partially offset by an increase in the average amount of deposits. Interest expense on these accounts will increase or decrease according to the general level of interest rates. Interest on borrowings increased to $2.7 million in 2003 from $2.5 million in 2002 due to an increase in the amount of borrowings outstanding, partially offset by a decrease in the average cost paid for borrowings. Management expects to continue to use FHLB advances and other borrowings when the rates offered on such funds is favorable when compared to the rates paid on deposits in the local market.

Provisions for Loan Losses. The provision for loan losses for 2003 was $650,000 compared to $445,000 in 2002 based on our evaluation of the loan portfolio. Our gross loan portfolio grew by $89.6 million, or 29% in 2003. Of this amount, $55.8 million were residential mortgage loans. As of December 31, 2003, 75.4% of our gross loan portfolio was residential mortgage loans, which historically have had the lowest risk of loss in the overall portfolio, and as a result have had a lower reserve percentage applied to them based on historical loss percentages.

Total charge-offs were $31,000 in 2003 compared to recoveries of $50,000 on loans previously charged-off. For 2002, total charge-offs and recoveries were $258,000 and $158,000, respectively. At December 31, 2003, the allowance for loan losses was $2.8 million, or .70%, of year-end loans compared to $2.1 million, or .69%, of loans at December 31, 2002. Total non-accrual loans at December 31, 2003, were $6.4 million compared to $5.6 million at December 31, 2002. The amount needed in the allowance for loan losses for non-accrual loans is based on the particular circumstances of the individual loan, including the type, amount, and value of the collateral, if any, and the overall composition and amount of the performing loans in the portfolio at the time of evaluation, and, as a result, will vary over time.

Other Income. Other income decreased slightly to $2.4 million for the year ended December 31, 2003. Increased gains on sales of loans held for sale and securities were offset by decreased other income. Other income decreased due to a decrease in loan servicing income related to the significant residential loan refinancing activity during 2003 together with our decision to have a third party service the Bank s residential mortgage portfolio.

Other Expense. Other expense increased to $8.8 million in 2003 from $7.3 million in 2002. The increase was the result of increased salary and employee benefits expense, occupancy expenses, professional services and data processing expense. The increase in salary and employee benefits of $583,000 was the result of additions to staff in 2003, as a result of our growth and the opening of three new branches in December 2002, June 2003 and October 2003, which also caused occupancy expense to increase. In addition, staff was added in the commercial loan department as part of our strategy to increase non-real estate commercial lending. Data processing expense increased as a result of an increase in the number of accounts and the opening of the new branches.

Income Taxes. Income taxes increased from $1.0 million (an effective tax rate of 33.5%) in 2002 to $1.3 million (an effective tax rate of 31.5%) in 2003. The effective tax rate decreased in 2003 due to an increase in tax-exempt income in 2003.

Asset /Liability Management

Our profitability, like that of most bank holding companies and financial institutions, is dependent to a large extent upon its net interest income, which is the difference between its interest income on interest-earning assets, such as loans, mortgage-backed securities and investment securities, and its interest expense on interest-bearing liabilities, such as deposits and other borrowings. Financial institutions are affected by general changes in levels of interest rates and other economic factors beyond their control. At December 31, 2004, our one-year interest sensitivity gap (the difference between the amount of interest-earning assets anticipated to mature or reprice within one year and the amount of interest-bearing liabilities anticipated to mature or reprice within one year) as a percentage of total assets was a negative 28.3%. Generally, an institution with a negative gap would experience a decrease in net interest income in a period of rising interest rates or an increase in net interest income in a period of declining interest rates since there will be more liabilities than assets that will either mature or be subject to repricing within the one-year period. However, certain shortcomings are inherent in this rate sensitivity analysis. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different manners to changes in market interest rates. Therefore, no assurance can be given that we will be able to maintain our net interest-rate spread as market interest rates fluctuate.

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We monitor our interest-rate risk through the Asset/Liability Committee which meets bi-weekly and reports the results of the meetings to the Board of Directors. Our policy is to seek to maintain a balance between interest-earning assets and interest-bearing liabilities so that the cumulative one-year gap is within a range established by the Board of Directors and which we believe is conducive to maintaining profitability without incurring undue risk. During 2004, we increased our investment in adjustable-rate and shorter average-life loans and mortgage-related securities, decreased our portfolio of long-term fixed rate investments, like municipal bonds and lengthened the maturities of certificates of deposit and FHLB advances in order to improve our position for rising rates.

The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2004, that are expected to reprice, based upon certain assumptions and contractual maturities, in each of the future periods shown. Adjustable-rate mortgage-backed securities are scheduled according to their next adjustment date and fixed-rate mortgage-backed securities are scheduled according to their maturity date.

	Three Months or Less	More than Three Months to Six Months	More than Six Months to 12 Months	More than One Year to 3 Years	More than Three Years to 5 Years	More than Five Years to 10 Years	More than Ten Years	Total
				($ in thousands)				
Rate-sensitive assets:								
Residential lending	$ 58,327	$ 23,270	$ 37,631	$ 103,196	$ 108,427	$ 19,995	$ 70,509	$ 421,355
Commercial and consumer lending	86,448	805	2,871	7,084	7,950	1,411	1,704	108,272
Mortgage-backed securities	1,797	804	1,672	9,158	4,885	3,444	2,358	24,118
Debt securities	3,995				1,095	2,943		8,033
Corporate equity securities	3,944			4,500			544	8,988
FHLB stock	7,385							7,385
Interest-earning deposits	3,836							3,836
Total interest-earning assets	165,732	24,879	42,174	123,938	122,357	27,793	75,114	581,987
Rate-sensitive liabilities:								
Deposits:								
Demand, money-market and savings accounts	131,265							131,265
Time deposits	39,902	48,140	97,986	64,934	575	9		251,546
FHLB advances	65,000	5,000	10,000	63,700				143,700
Other borrowings	6,040			3,049				9,089
Total interest-bearing liabilities	242,207	53,140	107,986	131,683	575	9		535,600
Interest-sensitivity gap	$ (76,475)	$ (28,261)	$ (65,812)	$ (7,745)	$ 121,782	$ 27,784	$ 75,115	$ 46,387
Cumulative interest-sensitivity gap	$ (76,475)	$ (104,736)	$ (170,548)	$ (178,293)	$ (56,511)	$ (28,727)	$ 46,387	

Cumulative interest-earning assets	$ 165,732	$ 190,611	$ 232,785	$ 356,723	$ 479,080	$ 506,873	$ 581,987
Cumulative interest-bearing liabilities	$ 242,207	$ 295,347	$ 403,333	$ 535,016	$ 535,591	$ 535,600	$ 535,600
Cumulative interest-sensitivity gap as a percentage of total assets	(12.7)%	(17.4)%	(28.3)%	(29.6)%	(9.4)%	(4.8)%	7.7%
Cumulative interest-earning assets as a percentage of cumulative interest-bearing liabilities	68.4%	64.5%	57.7%	66.7%	89.4%	94.6%	108.7%

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Recent Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 R (revised 2004), *Share-Based Payment.* This Statement requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments, which includes stock options, based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. Public entities will adopt this Statement using a modified version of prospective application. Under this application, this Statement will apply to new awards and to awards modified, repurchased, or cancelled after the required effective date and to awards not yet vested that exist as of the effective date. This Statement is effective as of the beginning of the interim period that begins on July 1, 2005. We have not yet determined what effect this Statement will have on our 2005 consolidated financial statements.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Non-monetary Assets An Amendment of APB Opinion No. 29.* This Statement addresses the measurement of exchanges of non-monetary assets and is effective for fiscal periods beginning after June 15, 2005. We believe the overall effect of this Statement will be immaterial to the Company s consolidated financial statements.

In December 2003, the American Institute of Certified Public Accountants issued Statement of Position 03-3, *Accounting for Certain Loans and Debt Securities Acquired in a Transfer* (SOP 03-3). SOP 03-3 addresses accounting for differences between contractual cash flows expected to be collected and an investor s initial investment in loans or debt securities acquired in a transfer if those differences are attributable, at least in part, to credit quality. SOP 03-3 also prohibits carrying over or creation of valuation allowances in the initial accounting of all loans acquired in a transfer that are within the scope of SOP 03-3. The prohibition of the valuation allowance carryover applies to the purchase of an individual loan, a pool of loans, a group of loans, and loans acquired in a purchase business combination. SOP 03-3 is effective for loans acquired in fiscal years beginning after December 15, 2004. We do not anticipate that the adoption of SOP 03-3 will have a material impact on our financial condition or results of operations.

In March 2004, the Emerging Issues Task Force reached a consensus on Issue 03-1, *Meaning of Other-Than-Temporary Impairment* (Issue 03-1). The Task Force reached a consensus on an other-than-temporary impairment model for debt and equity securities accounted for under Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* and cost method investments, and required certain additional financial statement disclosures. The implementation of the *Other-Than-Temporary Impairment* component of this consensus has been postponed. Based on the guidance provided in Issue 03-1, we recognized an impairment of approximately $1,055,000 at December 31, 2004. See footnote 2 for further information on the other-than-temporary impairment at the end of 2004.

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ITEM 7. FINANCIAL STATEMENTS.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Sanford, Florida

Audited Consolidated Financial Statements

At December 31, 2004 and 2003 and For Each of the Three Years in

the Period Ended December 31, 2004

(Together with Report of Independent Registered Public Accounting Firm)

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Report of Independent Registered Public Accounting Firm

Federal Trust Corporation

Sanford, Florida:

We have audited the accompanying consolidated balance sheets of Federal Trust Corporation and Subsidiary (the Company) as of December 31, 2004 and 2003, and the related consolidated statements of earnings, stockholders equity and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

HACKER, JOHNSON & SMITH PA

Orlando, Florida

March 15, 2005

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Consolidated Balance Sheets

($ in thousands, except per share amounts)

	At December 31,	
	2004	**2003**
Assets		
Cash and due from banks	$ 3,645	5,067
Interest-earning deposits	3,836	666
Cash and cash equivalents	7,481	5,733
Securities available for sale	41,172	33,615
Loans, less allowance for loan losses of $3,835 in 2004 and $2,779 in 2003	521,331	398,401
Accrued interest receivable	3,254	2,334
Premises and equipment, net	12,499	11,903
Foreclosed assets	326	1,007
Federal Home Loan Bank stock	7,385	5,660
Mortgage servicing rights, net	868	973
Bank-owned life insurance	6,842	6,580
Deferred tax asset	1,119	641
Other assets	854	1,351
Total assets	$ 603,131	468,198
Liabilities and Stockholders Equity		
Liabilities:		
Noninterest-bearing demand deposits	$ 21,305	6,352
Interest-bearing demand deposits	48,792	15,566
Money-market deposits	76,236	76,047
Savings deposits	6,237	8,714
Time deposits	251,546	207,951
Total deposits	404,116	314,630
Federal Home Loan Bank advances	143,700	107,700
Other borrowings	885	5,217
Junior subordinated debentures	5,155	5,155
Capital lease obligation	3,049	3,334
Accrued interest payable	811	527
Official checks	1,045	1,612
Other liabilities	4,983	3,566
Total liabilities	563,744	441,741
Commitments and contingencies (Notes 5, 10 and 17)		

Stockholders equity:		
Common stock, $.01 par value, 15,000,000 shares authorized; 8,061,813 and 6,661,807 shares issued in 2004 and 2003, respectively	81	67
Additional paid-in capital	32,059	22,069
Retained earnings	8,089	5,629
Unallocated ESOP shares (119,375 and 135,592 shares)	(862)	(979)
Accumulated other comprehensive income (loss)	20	(329)
Total stockholders equity	39,387	26,457
Total liabilities and stockholders equity	$ 603,131	468,198

See Accompanying Notes to Consolidated Financial Statements.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Consolidated Statements of Earnings

($ in thousands, except per share amounts)

	Year Ended December 31,		
	2004	**2003**	**2002**
Interest income:			
Loans	$ 23,016	19,591	18,349
Securities	1,290	1,112	735
Other	285	218	368
Total interest income	24,591	20,921	19,452
Interest expense:			
Deposits	7,559	7,083	8,520
Other	3,292	2,667	2,451
Total interest expense	10,851	9,750	10,971
Net interest income	13,740	11,171	8,481
Provision for loan losses	1,180	650	445
Net interest income after provision for loan losses	12,560	10,521	8,036
Other income:			
Service charges and fees	406	348	360
Gain on sale of loans held for sale	519	604	449
Gain on sale of securities available for sale	64	363	229
Rental income	262	408	385
Increase in cash surrender value of life insurance policies	262	206	127
Other	896	429	850
Total other income	2,409	2,358	2,400
Other-than-temporary impairment	(1,055)		
Other expense:			
Salary and employee benefits	4,892	4,531	3,948
Occupancy expense	1,502	1,483	1,148
Professional services	575	466	401
Data processing	637	572	420
Marketing and advertising	314	209	164
Other	1,414	1,565	1,258

Total other expense	9,334	8,826	7,339
Earnings before income taxes	4,580	4,053	3,097
Income taxes	1,491	1,276	1,038
Net earnings	$ 3,089	2,777	2,059
Earnings per share:			
Basic	$ 0.44	0.42	0.34
Diluted	$ 0.43	0.42	0.34

See Accompanying Notes to Consolidated Financial Statements

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Consolidated Statements of Stockholders Equity

Years Ended December 31, 2004, 2003 and 2002

($ in thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Unallocated ESOP Shares	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at December 31, 2001	5,409,449	$ 54	17,492	1,121		(136)	18,531
Comprehensive income:							
Net earnings				2,059			2,059
Change in net unrealized loss on securities available for sale, net of tax of $87						151	151
Comprehensive income							2,210
Issuance of common stock, net of issuance cost of $39	1,181,889	12	4,259				4,271
Accretion of stock options for stock compensation programs			27				27
Balance at December 31, 2002	6,591,338	$ 66	21,778	3,180		15	25,039
Comprehensive income:							
Net earnings				2,777			2,777
Change in net unrealized gain on securities available for sale, net of tax benefit of $191						(344)	(344)
Comprehensive income							2,433
Issuance of common stock, stock options exercised	70,469	1	281				282
Purchase of common shares for the ESOP (135,592 shares)					(979)		(979)
Dividends paid, $.05 per share				(328)			(328)
Accretion of stock options for stock compensation programs			10				10
Balance at December 31, 2003	6,661,807	$ 67	22,069	5,629	(979)	(329)	26,457

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Consolidated Statements of Stockholders Equity, Continued

Years Ended December 31, 2004, 2003 and 2002

($ in thousands)

	Common Stock		Additional Paid-In	Retained	Unallocated ESOP	Accumulated Other Comprehensive	Total Stockholders
	Shares	Amount	Capital	Earnings	Shares	Income (Loss)	Equity
Balance at December 31, 2003	6,661,807	$ 67	22,069	5,629	(979)	(329)	26,457
Comprehensive income:							
Net earnings				3,089			3,089
Change in net unrealized loss on securities available for sale, net of tax of $195						349	349
Comprehensive income							3,438
Proceeds from sale of common Stock, net of offering costs of $531	1,400,000	14	9,955				9,969
Issuance of common stock, stock options exercised	6						
ESOP shares allocated (16,217 shares)			35		117		152
Dividends paid, $.09 per share				(629)			(629)
Balance at December 31, 2004	8,061,813	$ 81	32,059	8,089	(862)	20	39,387

See Accompanying Notes to Consolidated Financial Statements.

FEDERAL TRUST CORPORATION AND SUBSIDIARY

Consolidated Statements of Cash Flows

(In thousands)

	Year Ended December 31,		
	2004	**2003**	**2002**
Cash flows from operating activities:			
Net earnings	$ 3,089	2,777	2,059
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	664	577	458
Net amortization of premiums and discounts on securities	347	326	167
Amortization of mortgage servicing rights	385	542	531
Valuation allowance on mortgage servicing rights	30	70	
Net amortization of loan origination fees, costs, premiums and discounts	1,108	1,770	1,158
Provision for loan losses	1,180	650	445
Other-than-temporary impairment	1,055		
Loans originated for resale	(10,036)	(20,337)	(16,926)
Proceeds from sales of loans held for sale	29,151	40,164	28,521
Gain on sale of loans held for sale	(519)	(604)	(449)
Deferred income tax benefit	(673)	(338)	(85)
Gain on sale of securities available for sale	(64)	(363)	(229)
Loss on sale of foreclosed assets		41	4
Increase in cash surrender value of life insurance policies	(262)	(206)	(127)
Accretion of stock option expense		10	27
Allocate ESOP shares	152		
Cash provided by (used in) resulting from changes in:			
Accrued interest receivable	(920)	(148)	(138)
Other assets	497	(920)	254
Accrued interest payable	284	78	129
Official checks	(567)	(166)	(791)
Other liabilities	1,233	(1,320)	388
Net cash provided by operating activities	26,134	22,603	15,396
Cash flows from investing activities:			
Principal repayments, net of loans originated	33,291	63,991	36,156
Purchase of loans	(178,482)	(176,828)	(97,897)
Purchase of securities available for sale	(24,404)	(36,607)	(26,800)
Proceeds from principal repayments, calls and sales of securities available for sale	16,053	24,014	22,838
Net proceeds from the sale of foreclosed assets	1,748	941	796
(Purchase) redemption of Federal Home Loan Bank stock	(1,725)	(2,800)	215
Purchase of premises and equipment	(1,260)	(2,623)	(2,747)
Purchase of bank-owned life insurance		(3,400)	
Net cash used in investing activities	(154,779)	(133,312)	(67,439)
Cash flows from financing activities:			

Net increase in deposits	89,486	36,099	53,131
Net increase in Federal Home Loan Bank advances	36,000	53,500	4,200
Net (decrease) increase in other borrowings	(4,332)	4,302	(1,200)
Principal repayments under capital lease obligation	(285)	(305)	(313)
Proceeds from issuance of junior subordinated debentures		5,155	
Net increase (decrease) in advance payments by borrowers for taxes and insurance	184	(117)	(479)
Dividends paid	(629)	(328)	
Purchase of common shares for the ESOP		(979)	
Net proceeds from the sale of common stock	9,969	282	3,971
Net cash provided by financing activities	130,393	97,609	59,310
Net increase (decrease) in cash and cash equivalents	1,748	(13,100)	7,267
Cash and cash equivalents at beginning of year	5,733	18,833	11,566
Cash and cash equivalents at end of year	$ 7,481	5,733	18,833

(Continued)

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Consolidated Statements of Cash Flows, Continued

(In thousands)

	Year Ended December 31,		
	2004	**2003**	**2002**
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest	$ 10,567	9,672	10,842
Income taxes	$ 2,115	1,914	943
Noncash transactions:			
Foreclosed assets acquired in settlement of loans	$ 1,067	1,131	1,069
Accumulated other comprehensive income (loss), net change in unrealized gain (loss) on securities available for sale, net of tax	$ 349	(344)	151
Other-than-temporary impairment on securities available for sale	$ 1,055		
Premises and equipment under capital lease obligation	$	1,500	
Securitization of loans held for sale	$		3,310
Transfer of loans in portfolio to loans held for sale	$ 19,855	18,361	15,550
Common stock issued in connection with land lease	$		300
Transfer of foreclosed assets to premises and equipment	$		125
Mortgage servicing rights recognized upon sale of loans held for sale	$ 310	260	202

See Accompanying Notes to Consolidated Financial Statements.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements

At December 31, 2004 and 2003 and for Each of the Three Years

in the Period Ended December 31, 2004

(1) Organization and Summary of Significant Accounting Policies

Organization. Federal Trust Corporation (Federal Trust) is the sole shareholder of Federal Trust Bank (the Bank). Federal Trust operates as a unitary savings and loan holding company. Federal Trust s business activities primarily include the operation of the Bank. The Bank is federally-chartered as a stock savings bank. The Bank s deposits are insured up to the applicable limits by the Federal Deposit Insurance Corporation. The Bank provides a wide range of banking services to individual and corporate customers through its six offices located in Orange, Seminole and Volusia Counties, Florida.

FTB Financial, Inc., a wholly-owned subsidiary of the Bank, provided investment services to customers of the Bank. FTB Financial, Inc. ceased operations in September 2003 and is currently inactive.

Basis of Financial Statement Presentation. The consolidated financial statements include the accounts of Federal Trust, the Bank and the Bank s subsidiary (together, the Company). All significant intercompany accounts and transactions have been eliminated in consolidation.

The accounting and reporting policies of the Company conform to U.S. generally accepted accounting principles and prevailing practices within the banking industry. The following summarizes the more significant of these policies and practices.

Use of Estimates. The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amount of revenues and expenses during the reporting period. The most significant estimates made by management that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and foreclosed assets. Actual results could differ from these estimates.

Cash and Cash Equivalents. For the purposes of reporting cash flows, cash and cash equivalents includes cash and due from banks and interest-earning deposits with maturities of three months or less.

The Bank is required by law or regulation to maintain cash reserves in the form of vault cash or in a noninterest-earning account with the Federal Reserve Bank or other qualified banks, based on its transaction deposit accounts. These reserve balances at December 31, 2004 and 2003 were approximately $2,299,000 and $472,000, respectively.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(1) Organization and Summary of Significant Accounting Policies, Continued

Securities. The Company may classify its securities as either trading, held to maturity or available for sale. Trading securities are held principally for resale and recorded at their fair values. Unrealized gains and losses on trading securities are included immediately in earnings. Held-to-maturity securities are those which the Company has the positive intent and ability to hold to maturity and are reported at amortized cost. Available-for-sale securities consist of securities not classified as trading securities nor as held-to-maturity securities. Unrealized holding gains and losses, net of tax, on available-for-sale securities are excluded from earnings and reported in other comprehensive income. A security is considered impaired if its fair value is less than its cost. If the impairment is considered to be other-than-temporary, an impairment loss is recognized in earnings equal to the difference between the security s cost and its fair value. During the year ended December 31, 2004, the Company recorded an other-than-temporary loss of approximately $1,055,000 (see note 2). Gains and losses on the sale of available-for-sale securities are recorded on the trade date and determined using the specific-identification method. Premiums and discounts on securities available for sale are recognized in interest income using the interest method over the period to maturity.

Loans. Loans that management has the intent and the Company has the ability to hold until maturity or payoff, are reported at their outstanding unpaid principal balance, adjusted for premiums or discounts on loans purchased, charge-offs and recoveries, the allowance for loan losses and deferred fees and costs on originated loans.

Loan origination fees are deferred and certain direct loan origination costs are capitalized. Both are recognized in earnings over the contractual life of the loans, adjusted for estimated prepayments based on the Company s historical prepayment experience. If the loan is prepaid, the remaining unamortized fees and costs are charged to earnings. Amortization is ceased on nonaccrual loans.

Loans are placed on nonaccrual status when the loan becomes more than 90 days past due as to interest or principal, unless the loan is both well collateralized and in the process of collection, or when the full, timely collection of interest or principal becomes uncertain. When a loan is placed on nonaccrual status, the accrued and unpaid interest receivable is written off and the loan is accounted for on the cash or cost recovery method thereafter, until qualifying for return to accrual status.

The Company considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due, both principal and interest, according to the contractual terms of the loan agreement. When a loan is impaired, the Company may measure impairment based on (a) the present value of the expected future cash flows of the impaired loan discounted at the loan s original effective interest rate, (b) the observable market price of the impaired loan, or (c) the fair value of the collateral of a collateral-dependent loan. The Company selects the measurement method on a loan-by-loan basis, except for collateral-dependent loans for which foreclosure is probable, are measured at the fair value of the collateral. In a troubled debt restructuring involving a restructured loan, the Company measures impairment by discounting the total expected future cash flows at the loan s original effective rate of interest.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(1) Organization and Summary of Significant Accounting Policies, Continued

Loans Held for Sale. Loans originated that are intended to be sold in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to earnings. The Company had approximately $1,628,000 and $679,000 of loans held for sale at December 31, 2004 and 2003, respectively, which are included in loans on the accompanying consolidated balance sheets and the fair value of these loans exceeded book value in the aggregate. Loan origination fees are deferred and direct loan origination costs are capitalized until the related loan is sold, at which time the net fees are included in the gain on sale of loans held for sale in the consolidated statements of earnings.

Allowance for Loan Losses. The Company follows a consistent procedural discipline and accounts for loan loss contingencies in accordance with Statement of Financial Accounting Standards No.5, *Accounting for Contingencies* (Statement 5). The following is a description of how each portion of the allowance for loan losses is determined.

The Company segregates the loan portfolio for loan loss purposes into the following broad segments: commercial real estate; residential real estate; commercial business; and consumer loans. The Company provides for a general allowance for losses inherent in the portfolio by the above categories, which consists of two components. First, general loss percentages are calculated based upon historical analyses. Second, a supplemental portion of the allowance is calculated for inherent losses which probably exist as of the evaluation date even though they might not have been identified by the more objective processes used for the portion of the allowance described above. This is due to the risk of error and/or inherent imprecision in the process. This supplemental portion of the allowance is particularly subjective and requires judgments based on qualitative factors which do not lend themselves to exact mathematical calculations such as; trends in delinquencies and nonaccruals; migration trends in the portfolio; trends in volume, terms, and portfolio mix; new credit products and/or changes in the geographic distribution of those products; changes in lending policies and procedures; loan review reports; changes in the outlook for local, regional and national economic conditions and concentrations of credit risk.

Specific allowances are provided in the event that the specific collateral analysis on each classified loan indicates that the probable loss upon liquidation of collateral would be in excess of the general percentage allocation. The provision for loan losses is debited or credited in order to state the allowance for loan losses to the required level.

Regulatory examiners may require the Company to recognize additions to the allowance based upon their judgments about the information available to them at the time of their examination. Management believes that the allowance for loan losses is adequate at December 31, 2004.

Mortgage Servicing Rights. Mortgage servicing rights are recognized as separate assets when rights are acquired through sale of financial assets. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the net present value of estimated future net servicing income.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(1) Organization and Summary of Significant Accounting Policies, Continued

Mortgage Servicing Rights, Continued. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earning rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Capitalized servicing rights are reported as an asset and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized costs. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance account for an individual tranche, to the extent that all or a portion of the impairment no longer exists for a particular tranche based on the fair value, a reduction of the allowance may be recorded as an increase to income. At December 31, 2004 and 2003, the Company had valuation allowances of $100,000 and $70,000, respectively.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income.

Foreclosed Assets. Assets acquired in the settlement of loans are initially recorded at the lower of cost (principal balance of the former loan plus costs of obtaining title and possession) or estimated fair value at the date of acquisition. Subsequently, such assets acquired are carried at the lower of cost or fair value less estimated costs to sell. Costs relating to development and improvement of foreclosed assets are capitalized, whereas costs relating to holding the foreclosed assets are charged to earnings.

Premises and Equipment. Land is stated at cost. Premises and equipment and leasehold improvements are stated at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Amortization of leasehold improvements is computed using the straight-line method over the lesser of the estimated useful lives or the respective lease terms, including renewal options expected to be exercised. Major renovations and betterments of property are capitalized; maintenance, repairs, and minor renovations and betterments are expensed in the period incurred. Upon retirement or other disposition of the assets, the asset cost and related accumulated depreciation or amortization are removed from the accounts, and gains or losses are included in earnings.

Stock Compensation Plans. Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148 *Accounting for Stock-Based Compensation Transition and Disclosure,* (collectively, SFAS No. 123), encourages all entities to adopt a fair value based method of accounting for employee stock compensation plans, whereby compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. However, it also allows an entity to continue to measure compensation cost for those plans using the intrinsic value based method of accounting prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25), whereby compensation cost is the excess, if any, of the quoted market price of the stock at the grant date (or other measurement date) over the amount an employee must pay to acquire the stock. The Company accounts for their stock option plans under the recognition and measurement principles of APB No. 25.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(1) Organization and Summary of Significant Accounting Policies, Continued

Stock Compensation Plans, Continued. The following table illustrates the assumptions used in calculating the grant-date fair value and the effect on net earnings and basic and diluted earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation. For purposes of proforma disclosure, the estimated fair value is included in expense in the period vesting occurs ($ in thousands, except per share amounts):

	Year Ended December 31,		
	2004	**2003**	**2002**
Assumptions:			
Weighted-average risk-free rate of return	4.68%	4.42%	4.46%
Annualized dividend yield	1.05%	80%	
Expected life of options granted	10 years	10 years	10 years
Expected stock volatility	20%	30%	25%

	Year Ended December 31,		
	2004	**2003**	**2002**
Grant-date fair value of options issued during the year	$ 8	495	65
Weighted-average grant-date fair value per option of options issued during the year	$ 2.68	3.01	1.86
Net earnings, as reported	$ 3,089	2,777	2,059
Deduct: Total stock-based employee compensation determined under the fair value based method for all awards, net of related tax benefit	(181)	(159)	(69)
Proforma net earnings	$ 2,908	2,618	1,990
Basic earnings per share:			
As reported	$ .44	.42	.34
Proforma	$ .41	.40	.33
Diluted earnings per share:			
As reported	$ .43	.42	.34

Proforma	$ 40	.39	.33

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(1) Organization and Summary of Significant Accounting Policies, Continued

Comprehensive Income. Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net earnings. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the consolidated balance sheets, such items, along with net earnings, are components of comprehensive income.

The components of other comprehensive income and related tax effects are as follows (in thousands):

	Year Ended December 31,		
	2004	**2003**	**2002**
Unrealized holding (losses) gains on securities available for sale	$ (447)	(172)	467
Reclassification adjustment for gains realized in earnings	(64)	(363)	(229)
Reclassification adjustment for other than temporary impairment realized	1,055		
Net change in unrealized amount	544	(535)	238
Income taxes (benefit)	195	(191)	87
Net amount	$ 349	(344)	151

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(1) Organization and Summary of Significant Accounting Policies, Continued

Earnings Per Share of Common Stock. The Company follows the provisions of Financial Accounting Standards No. 128, *Earnings Per Share* (SFAS No. 128). SFAS No. 128 provides accounting and reporting standards for calculating earnings per share. Basic earnings per share of common stock have been computed by dividing the net earnings for the year by the weighted-average number of shares outstanding. Shares of common stock purchased by the Company s Employee Stock Ownership Plan (ESOP) are considered outstanding when the shares are allocated to participants. Diluted earnings per share is computed by dividing net earnings by the weighted-average number of shares outstanding including the dilutive effect of stock options computed using the treasury stock method. The following table presents the calculation of basic and diluted earnings per share of common stock (in thousands, except per share amounts):

	Year Ended December 31,		
	2004	**2003**	**2002**
Weighted-average shares outstanding before adjustment for unallocated ESOP shares	7,213	6,592	5,991
Adjustment to reflect the effect of unallocated ESOP shares	(131)	(43)	
Weighted-average shares outstanding for basic earnings per share	7,082	6,549	5,991
Basic earnings per share	$ .44	.42	.34
Total weighted-average shares outstanding for basic earnings per share computation	7,082	6,549	5,991
Additional dilutive shares using the average market value for the period utilizing the treasury stock method regarding stock options	180	113	12
Weighted-average shares and equivalents outstanding for diluted earnings per share	7,262	6,662	6,003
Diluted earnings per share	$ .43	.42	.34

Income Taxes. Federal Trust, the Bank and the Bank s subsidiary file a consolidated income tax return. Income taxes are allocated between Federal Trust, the Bank and the Bank s subsidiary as though separate income tax returns were filed.

The Company accounts for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment date. Valuation allowances are provided against assets which are not likely to be realized.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(1) Organization and Summary of Significant Accounting Policies, Continued

Off-Balance Sheet Financial Instruments. In the ordinary course of business, the Company has entered into off-balance-sheet financial instruments consisting of commitments to extend credit, unused lines of credit, standby letters of credit and undisbursed construction loans in process. Such financial instruments are recorded in the consolidated financial statements when they are funded.

Recent Pronouncements. In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment.* This Statement requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments, which includes stock options, based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. Public entities will adopt this Statement using a modified version of prospective application. Under this application, this Statement will apply to new awards and to awards modified, repurchased, or cancelled after the required effective date and to awards not yet vested that exist as of the effective date. This Statement is effective as of the beginning of the interim period that begins on July 1, 2005. Management has not yet determined what effect this Statement will have on the Company s 2005 consolidated financial statements.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets An Amendment of APB Opinion No. 29.* This Statement addresses the measurement of exchanges of nonmonetary assets and is effective for fiscal periods beginning after June 15, 2005. Management believes the overall effect of this Statement will be immaterial to the Company s consolidated financial statements.

In December 2003, the American Institute of Certified Public Accountants issued Statement of Position 03-3, *Accounting for Certain Loans and Debt Securities Acquired in a Transfer* (SOP 03-3). SOP 03-3 addresses accounting for differences between contractual cash flows expected to be collected and an investor s initial investment in loans or debt securities acquired in a transfer if those differences are attributable, at least in part, to credit quality. SOP 03-3 also prohibits carrying over or creation of valuation allowances in the initial accounting of all loans acquired in a transfer that are within the scope of SOP 03-3. The prohibition of the valuation allowance carryover applies to the purchase of an individual loan, a pool of loans, a group of loans, and loans acquired in a purchase business combination. SOP 03-3 is effective for loans acquired in fiscal years beginning after December 15, 2004. The Company does not anticipate that the adoption of SOP 03-3 will have a material impact on its financial condition or results of operations.

In March 2004, the Emerging Issues Task Force reached a consensus on Issue 03-1, *Meaning of Other-Than-Temporary Impairment* (Issue 03-1). The Task Force reached a consensus on an other-than-temporary impairment model for debt and equity securities accounted for under Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* and cost method investments, and required certain additional financial statement disclosures. The implementation of the *Other-Than-Temporary Impairment* component of this consensus has been postponed. Based on the guidance provided in Issue 03-1, the Company recognized an impairment of approximately $1,055,000 at December 31, 2004. See footnote 2 for further information on the other-than-temporary impairment at the end of 2004.

Reclassification. Certain amounts in the 2003 and 2002 consolidated financial statements have been reclassified to conform with the 2004 presentation.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(2) Securities Available for Sale

All securities have been classified as available for sale by management. The amortized cost and estimated fair values of securities available for sale are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2004:				
Mortgage-backed securities	$ 24,118	95	(61)	24,152
Municipal bonds	1,046	15	(5)	1,056
Corporate equity securities	8,988	98	(14)	9,072
U.S. government agency securities	2,992		(15)	2,977
Corporate Bonds	3,995		(80)	3,915
	$ 41,139	208	(175)	41,172
At December 31, 2003:				
Mortgage-backed securities	15,804	41	(90)	15,755
Municipal bonds	6,043	54	(109)	5,988
Corporate equity securities	10,295	83	(469)	9,909
U.S. government agency securities	1,984		(21)	1,963
	$ 34,126	178	(689)	33,615

The amortized cost and estimated fair values of securities available for sale at December 31, 2004, by contractual maturity are below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

	Amortized Cost	Fair Value
Due after one year up to five years	$ 1,995	1,944
Due after five years up to ten years	4,992	4,948
Due after ten years	1,046	1,056
Mortgage-backed securities	24,118	24,152
Corporate equity securities	8,988	9,072

	$ 41,139	41,172

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(2) Securities Available for Sale, Continued

The following summarizes sales of securities (in thousands):

	Year Ended December 31,		
	2004	**2003**	**2002**
Proceeds from sales	$ 9,352	13,753	15,879
Gross gains from sales	114	363	256
Gross losses from sales	(50)		(27)
Net gain	$ 64	363	229

Information pertaining to securities with gross unrealized losses at December 31, 2004, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows (in thousands):

	Less Than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**
Mortgage-backed securities	$ (60)	9,107	(1)	268
Municipal bonds			(5)	318
Corporate equity securities	(11)	3,489	(3)	997
U.S. government agency securities	(15)	2,977		
Corporate Bonds	(80)	3,915		
	$ (166)	19,488	(9)	1,583

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

During 2004, the Company recorded an other-than-temporary impairment write-down of approximately $1,055,000. The charge related to the Company s $9.5 million investment in Freddie Mac and Fannie Mae adjustable rate preferred stock. These investment grade securities declined in value in 2004 due to the recent events at Freddie Mac and Fannie Mae coupled with the record low interest rates which caused the dividend payment rate to decline from the original rates at the time of issuance.

At December 31, 2004, the Company has eight mortgage-backed securities, two municipal bonds, two corporate equity securities, two U.S. government agency securities and two corporate bonds with unrealized losses. Management believes these unrealized losses relate to changes in interest rates and not credit quality. Management also believes the Company has the ability to hold these securities until maturity or for the foreseeable future and therefore no declines are deemed to be other-than-temporary.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(3) Loans

The components of loans are summarized as follows (in thousands):

	At December 31,	
	2004	**2003**
Residential lending:		
Mortgages [1]	$ 374,581	302,083
Lot loans	41,369	20,816
Construction	5,405	780
Total Residential lending	421,355	323,679
Commercial lending:		
Real Estate Secured	56,267	47,918
Land, Development and Construction	38,091	16,524
Commercial loans	13,257	11,639
Total Commercial lending	107,615	76,081
Consumer loans	657	864
Total loans	529,627	400,624
Add (deduct):		
Allowance for loan losses	(3,835)	(2,779)
Net premiums, discounts, deferred fees and costs	3,524	3,346
Undisbursed portion of loans in process	(7,985)	(2,790)
Loans, net	$ 521,331	398,401

(1) Includes approximately $1,628,000 and $679,000 of loans held for sale at December 31, 2004 and 2003, respectively.

The following is a summary of information regarding nonaccrual and impaired loans (in thousands):

	At December 31,	
	2004	2003
Nonaccrual loans	$ 2,600	6,396
Accruing loans past due ninety days or more	$	
Recorded investment in impaired loans for which there is a related allowance for loan losses	$ 2,648	8,249
Recorded investment in impaired loans for which there is no related allowance for loan losses	$	
Allowance for loan losses related to impaired loans	$ 290	1,110

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(3) Loans, Continued

	Interest Income Recognized and Received on Impaired Loans	Average Net Recorded Investment in Impaired Loans
For the Year Ended December 31:		
2004	$ 122	4,181
2003	$ 111	6,343
2002	$ 134	4,896

The activity in the allowance for loan losses is as follows (in thousands):

	For the Year Ended December 31,		
	2004	2003	2002
Balance at beginning of year	$ 2,779	2,110	1,765
Provision for loan losses	1,180	650	445
Charge-offs	(154)	(31)	(258)
Recoveries	30	50	158
Balance at end of year	$ 3,835	2,779	2,110

(4) Loan Servicing

Loans serviced for other entities are not included in the accompanying consolidated balance sheets. The unpaid principal balances of these loans were approximately $80.8 million and $92.7 million at December 31, 2004 and 2003, respectively. Loan servicing income (expense), net of amortization of mortgage servicing rights, was approximately $21,000, $(123,000) and $97,000 for the years ended December 31, 2004, 2003 and 2002, respectively and is included in other noninterest income on the consolidated statements of earnings.

The balance of capitalized servicing rights, net of valuation allowances, at December 31, 2004 and 2003, was approximately $868,000 and $973,000, respectively. The fair value of these rights was approximately $868,000 and $973,000, respectively. The fair value of servicing rights at December 31, 2004 was determined using discount rates ranging from 8% to 12.5% and prepayment speeds ranging from 10% to 55%, depending upon the stratification of the specific right.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(4) Loan Servicing, Continued

The following summarizes mortgage servicing rights capitalized and amortized, along with the aggregate activity in related valuation allowances (in thousands):

	Year Ended December 31,		
	2004	2003	2002
Mortgage servicing rights capitalized	$ 310	260	202
Mortgage servicing rights amortized	$ 385	542	531
Valuation allowances during year	$ 30	70	
Valuation allowances at year-end	$ 100	70	

The Company also owns loans serviced by other entities. These loans totaled approximately $293.6 million and $202.8 million at December 31, 2004 and 2003, respectively.

(5) Premises and Equipment

Premises and equipment consisted of the following (in thousands):

	At December 31,	
	2004	2003
Land	$ 1,986	1,973
Bank premises under capital lease	3,490	3,490
Buildings and improvements	4,118	4,808
Leasehold improvements	2,569	637
Furniture, fixtures and equipment	3,059	3,014
Construction in progress	18	124
Total	15,240	14,046
Less accumulated depreciation and amortization	(2,741)	(2,143)

Premises and equipment, net	$ 12,499	11,903

Accumulated depreciation of approximately $173,000 and $124,000 at December 31, 2004 and 2003, respectively related to bank premises under capital lease.

During February 2002, the Company entered into a land lease for a branch facility in Casselberry, Florida. As part of the lease, the Company paid cash of $200,000 and issued 83,333 shares of common stock. The Company expended approximately $788,000 in construction costs and the branch opened in December 2002.

During 2003, the Company completed the construction of another branch facility in Orange City, Florida that opened in September 2003. The Company also opened a branch facility with a short-term lease in Deltona, Florida in June 2003. The Company owns land near this leased branch and expended approximately $822,000 in construction costs for a permanent facility, which was opened in June 2004. After the new Deltona branch opened, the Company subleased the space utilized by the temporary branch site.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(5) Premises and Equipment, Continued

During 2001, the Company entered into a lease agreement for its administrative office building, which qualifies as a capital lease. The lease term for the building is fifteen years with fixed annual lease payments and an option to purchase the building for $1 at the end of the term. Future minimum lease payments under this capital lease are as follows (in thousands):

Year Ending December 31,	Amount
2005	$ 439
2006	439
2007	439
2008	439
2009	439
Thereafter	2,932
Total minimum lease payments	5,127
Less: amount representing interest	(2,078)
Present value of minimum lease payments	$ 3,049

The Company leases two branch offices, office space in a commercial shopping center that was previously occupied by a branch location and is now subleased to another tenant, and a ground lease which will be the location for a future branch expected to open in 2005 under operating leases. The terms of these leases are for up to twenty years and the leases contain escalation clauses and renewal options. Rent expense under operating leases was approximately $264,000, $242,000 and $238,000 for the years ended December 31, 2004, 2003 and 2002, respectively. Future minimum payments under operating leases are as follows (in thousands):

Year Ending December 31,	Amount
2005	$ 328
2006	324
2007	317
2008	329
2009 and thereafter	1,935
	$3,233

The Company leases space to third parties in its administration building. The Company pays a fee to a third party to manage the property. The Company also subleases space at one of its branch offices and has subleased the entire space used for the temporary branch facility in Deltona. The Company recognized approximately $262,000, $408,000 and $385,000 in rental income during the years ended December 31, 2004, 2003 and 2002, respectively.

The Company owns a parcel of land in Port Orange, Florida and has leased a site in Lake Mary, Florida. Management expects to begin construction of new branch facilities on both sites in the first half of 2005.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(6) Deposits

At December 31, 2004 and 2003, time deposits of $100,000 or more were approximately $152.2 million and $113.5 million, respectively. At December 31, 2004 the scheduled maturities of time deposits were as follows (in thousands):

Year Ending December 31,	Amount
2005	$ 186,028
2006	59,918
2007	5,016
2008	305
2009 and thereafter	279
	$ 251,546

Interest expense on deposits is as follows (in thousands):

	Year Ended December 31,		
	2004	2003	2002
Interest-bearing demand deposits	$ 598	268	113
Money-market accounts	1,421	1,496	1,494
Savings accounts	110	163	139
Time deposits, net of penalties	5,430	5,156	6,774
Total interest expense on deposits	$ 7,559	7,083	8,520

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(7) Federal Home Loan Bank Advances

A summary of advances from the Federal Home Loan Bank of Atlanta (FHLB) are as follows ($ in thousands):

Maturing During the Year Ending December 31,	Interest Rate	At December 31, 2004	2003	2002
2004	1.15[1]	$	$ 25,500	$
2005	2.00	25,000	25,000	
2005	2.44[1]	15,000		
2005	1.70	5,000		
2005	1.56	5,000		
2005	2.84	10,000		
2006	1.24[2]		5,000	
2006	0.58[1][2]		5,000	
2006	3.13	5,000		
2007	5.22	2,200	2,200	2,200
2007	2.01[5]	15,000		
2007	1.26[2]		5,000	5,000
2008	1.98[2]	5,000	5,000	
2008	1.12[2]		5,000	
2008	1.01[2]		5,000	
2009	2.05[3]	5,000		
2009	3.11[4]	10,000		
2011	3.73		25,000	25,000
2014	2.93[6]	5,000		
2014	3.03[7]	11,500		
2014	3.22[8]	25,000		
		$ 143,700	$ 107,700	$ 32,200

(1) Daily advance or adjustable rate.
(2) FHLB has the option to call every three months.
(3) FHLB has the option to call every three months beginning in February 2006.
(4) FHLB has the option to call every three months beginning in July 2006.
(5) FHLB has a one-time call option in June 2005.
(6) FHLB has the option to call every three months beginning in December 2006.
(7) FHLB has the option to call every three months beginning in September 2007.
(8) FHLB has the option to call every three months beginning in December 2007.

The security agreement with FHLB includes a blanket floating lien requiring the Company to maintain qualifying first mortgage loans, discounted at 75% of the unpaid principal balances, as pledged collateral in an amount equal to at least 100% of the total advances outstanding. The FHLB also requires the purchase of FHLB common stock in proportion to the amount of advances outstanding. The FHLB stock is also pledged as collateral for these advances.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(8) Other Borrowings

During 2003, the Company entered into a loan agreement with another correspondent bank. Under this agreement, the Company can borrow up to $6,000,000 under a revolving line of credit (LOC) for general operations and up to $2,000,000 on a separate nonrevolving line of credit (ESOP LOC) for common stock purchases relating to the Company s Employee Stock Ownership Plan. Both lines are secured by all the Bank s common stock and both have interest rates of prime minus 12.5 basis points as long as the Company maintains certain loan-to-Company book value percentages. The loan agreement also has certain covenants that the Company is required to meet. The following summarizes the balances and other information pertaining to these loans ($ in thousands):

	Outstanding Balance at December 31, 2004	Outstanding Balance at December 31, 2003	Available Balance at December 31, 2004	Interest Rate at December 31, 2004	Interest Due	Principal Due
LOC	$	4,212	6,000	5.125%	Quarterly	Beginning in June 2005 principal amortizes over 10 year schedule-due June 2015
ESOP LOC	885	1,005	1,115	5.125%	Quarterly	Annual principal repayments of 10% of outstanding balance increasing 5% per year, due in full in June 2009
Total	$ 885	5,217	7,115			

Total interest expense on other borrowings for the years ended December 31, 2004, 2003 and 2002, was approximately $124,000, $137,000 and $84,000, respectively.

(9) Junior Subordinated Debentures

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

On September 17, 2003, Statutory Trust I sold adjustable-rate Trust Preferred Securities due September 17, 2033 in the aggregate principal amount of $5,000,000 (the Trust Preferred Securities) in a pooled trust preferred securities offering. The interest rate on the Trust Preferred Securities adjusts quarterly, to a rate equal to the then current three-month London Interchange Bank Offering Rate (LIBOR), plus 295 basis points (5.45% at December 31, 2004). In addition, Federal Trust contributed capital of $155,000 to Statutory Trust I for the purchase of the common securities of Statutory Trust I. The proceeds from these sales were paid to Federal Trust in exchange for $5,155,000 of its adjustable-rate Junior Subordinated Debentures (the Debentures) due September 17, 2033. The Debentures have the same terms as the Trust Preferred Securities. The sole asset of Statutory Trust I, the obligor on the Trust Preferred Securities, is the Debentures.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(9) Junior Subordinated Debentures, Continued

Federal Trust has guaranteed Statutory Trust I s payment of distributions on, payments on any redemptions of, and any liquidation distribution with respect to, the Trust Preferred Securities. Cash distributions on both the Trust Preferred Securities and the Debentures are payable quarterly in arrears on March 17, June 17, September 17 and December 17 of each year.

The Trust Preferred Securities are subject to mandatory redemption: (i) in whole, but not in part, upon repayment of the Debentures at stated maturity or, at the option of Federal Trust, their earlier redemption in whole upon the occurrence of certain changes in the tax treatment or capital treatment of the Trust Preferred Securities, or a change in the law such that Statutory Trust I would be considered an Investment Company; and (ii) in whole or in part at any time on or after September 17, 2008 contemporaneously with the optional redemption by Federal Trust of the Debentures in whole or in part. The Debentures are redeemable prior to maturity at the option of Federal Trust: (i) on or after September 17, 2008, in whole at any time or in part from time to time; or (ii) in whole, but not in part, at any time within 90 days following the occurrence and continuation of certain changes in the tax treatment or capital treatment of the Trust Preferred Securities, or a change in law such that Statutory Trust I would be considered an Investment Company, required to be registered under the Investment Company Act of 1940.

(10) Fair Value of Financial Instruments

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company s various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument or may not necessarily represent the underlying fair value of the Company. The following methods and assumptions were used by the Company in estimating fair values of financial instruments:

Cash and Cash Equivalents - The carrying amount of cash and cash equivalents represents fair value.

Securities Available for Sale - The fair value of securities available for sale are based on quoted market prices. If quoted market prices are not available, fair values are based on quoted market values of comparable instruments.

Federal Home Loan Bank Stock - The stock is not publicly traded and the estimated fair value is based on its redemption value of $100 per share.

Loans - For variable rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for residential, commercial real estate, commercial and consumer loans other than variable rate loans are estimated using discounted cash flow analysis, using the Office of Thrift Supervision (OTS) pricing model. Fair values of impaired loans are estimated using discounted cash flow analysis or underlying collateral values, where applicable.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(10) Fair Value of Financial Instruments, Continued

Mortgage Servicing Rights - The fair value of mortgage servicing rights is based on a valuation performed by an independent third-party using certain assumptions relating to the Company s servicing portfolio.

Deposits - The fair values disclosed for noninterest-bearing demand, interest-bearing demand, money-market and savings deposits are, by definition, equal to the amount payable on demand (that is their carrying amounts). Fair values for time deposits are estimated using the OTS pricing model.

Federal Home Loan Bank Advances - Fair value for Federal Home Loan Bank advances are estimated using the OTS pricing model.

Other Borrowings and Junior Subordinated Debentures - Fair values of these borrowings are estimated using discounted cash flow analysis based on the Company s current borrowing rates for similar types of borrowing arrangements.

Accrued Interest - The carrying amounts of accrued interest receivable and accrued interest payable approximates fair value.

Off-Balance Sheet Instruments - Fair values for off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standing.

The carrying amounts and estimated fair values of the Company s financial instruments are as follows (in thousands):

	At December 31,			
	2004		2003	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				

Cash and cash equivalents	$ 7,481	7,481	5,733	5,733
Securities available for sale	41,172	41,172	33,615	33,615
Loans, net	521,331	524,517	398,401	408,560
Federal Home Loan Bank stock	7,385	7,385	5,660	5,660
Accrued interest receivable	3,254	3,254	2,334	2,334
Mortgage servicing rights	868	868	973	973
Financial liabilities:				
Deposits	404,116	404,789	314,630	316,627
Federal Home Loan Bank advances	143,700	143,219	107,700	108,605
Other borrowings	885	885	5,217	5,217
Junior subordinated debentures	5,155	5,155	5,155	5,155
Accrued interest payable	811	811	527	527

Off-Balance Sheet financial instruments

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(11) Off-Balance Sheet Financial Instruments

The Company has outstanding at any time a significant number of commitments to extend credit. These arrangements are subject to strict credit control assessments and each customer s credit worthiness is evaluated on a case-by-case basis. A summary of the contractual amounts of off-balance sheet commitments which approximate fair value is as follows (in thousands):

	At December 31	
	2004	**2003**
Unused lines of credit	$ 11,408	5,341
Commitment to extend credit	$ 7,526	4,675
Standby letters of credit	$ 2,738	494
Undisbursed portion of construction loans in process	$ 7,985	2,790

Because many commitments expire without being funded in whole or part, the contract amounts are not estimates of future cash flows.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer s credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Company upon extension of credit is based on management s credit evaluation of the counterparty.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters-of-credit are primarily issued to support public and private borrowing arrangements. Essentially, all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. At December 31, 2004, the Company had commitments of approximately $2.7 million in standby letters of credit of which approximately 91% were to two commercial loan customers that were secured by real estate on related land acquisition and development loans to these customers.

Loan commitments written have off-balance-sheet credit risk because only original fees are recognized in the balance sheet until the commitments are fulfilled or expire. Credit risk represents the accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted. The credit risk amounts are equal to the contractual amounts, assuming that the amounts are fully advanced, and that collateral or other security is of no value.

The Company s policy is to require customers to provide collateral prior to the disbursement of approved loans. The amount of collateral obtained, if it is deemed necessary by the Company upon extension of credit, is based on management s credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, real estate and income producing commercial properties.

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(12) Income Taxes

Allocation of Federal and state income taxes between current and deferred portions is as follows (in thousands):

	Current	Deferred	Total
Year Ended December 31, 2004:			
Federal	$ 1,844	(575)	1,269
State	320	(98)	222
Total	$ 2,164	(673)	1,491
Year Ended December 31, 2003:			
Federal	1,390	(289)	1,101
State	224	(49)	175
Total	$ 1,614	(338)	1,276
Year Ended December 31, 2002:			
Federal	955	(73)	882
State	168	(12)	156
Total	$ 1,123	(85)	1,038

The effective tax rate was different than the statutory Federal income tax rate. A summary and the reasons for the difference are as follows ($ in thousands):

	Year Ended December 31,					
	2004		2003		2002	
	Amount	% of Pretax Earnings	Amount	% of Pretax Earnings	Amount	% of Pretax Earnings
Tax provision at statutory rate	$ 1,557	34.0%	$ 1,378	34.0%	$ 1,053	34.0%
Increase (decrease) in tax resulting from:						

State income taxes, net of federal income tax benefit	147	3.2	116	2.9	103	3.3
Tax-exempt income	(156)	(3.4)	(175)	(4.3)	(78)	(2.5)
Officers life insurance, meals and entertainment and other permanent items	(57)	(1.2)%	(43)	(1.1)	(40)	(1.3)
	$ 1,491	32.6%	$ 1,276	31.5%	$ 1,038	33.5%

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(12) Income Taxes, Continued

The tax effects of temporary differences between the tax basis of assets and liabilities and their financial reporting amounts which give rise to significant portions of deferred tax assets and liabilities, are as follows (in thousands):

	At December 31,	
	2004	2003
Deferred tax assets:		
Allowance for loan losses	$ 1,281	866
Deferred compensation	283	212
Impaired loan interest	140	97
Impaired securities	397	
Unrealized loss on securities available for sale		182
Other	33	64
Total deferred tax assets	2,134	1,421
Deferred tax liabilities:		
Depreciation	(428)	(402)
Mortgage servicing rights	(207)	(233)
Deferred loan fees and costs, net	(343)	(126)
FHLB stock	(24)	(19)
Unrealized gain on securities available for sale	(13)	
Total deferred tax liabilities	(1,015)	(780)
Net deferred tax assets	$ 1,119	641

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(13) Regulatory Capital

The Bank is subject to certain restrictions on the amount of dividends that it may declare and distribute to the Holding Company without prior regulatory approval.

The Bank is also subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank s and the Company s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank s assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and percentages (set forth in the table below) of total and Tier I capital (as defined in the regulations) to total and risk-weighted assets (as defined in the regulations). Management believes, as of December 31, 2004, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2004, the most recent notification from the Office of Thrift Supervision categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain total risk-based, Tier I risk-based and Tier I leverage percentages as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution s category. The following table summarizes the capital thresholds for each prompt corrective action capital category. An institution s capital category is based on whether it meets the threshold for all three capital ratios within the category. The Bank s actual capital amounts and percentages are also presented in the table ($ in thousands).

	Actual		**For Capital Adequacy Purposes**		**To Be Well Capitalized Under Prompt Corrective Action Provisions**	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**
At December 31, 2004:						
Total capital (to risk-weighted assets)	$ 45,648	11.5%	$ 31,687	8.0%	$ 39,609	10.0%
Tier I capital (to risk-weighted assets)	41,813	10.6	15,844	4.0	23,765	6.0
Tier I capital (to average adjusted assets)	41,813	7.0	23,924	4.0	29,905	5.0
At December 31, 2003:						
Total capital (to risk-weighted assets)	33,877	11.6	23,391	8.0	29,238	10.0
Tier I capital (to risk-weighted assets)	31,149	10.7	11,695	4.0	17,543	6.0

Tier I capital (to average adjusted assets)	31,149	6.8	18,385	4.0	22,981	5.0

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(14) Stock Option Plans

The Company has two stock options plans. The Key Employee Stock Compensation Program, as amended (the Employee Plan) is authorized to issue up to 10% of the issued shares up to a maximum of 1,000,000 shares through the exercise of incentive stock options, compensatory stock options, stock appreciation rights or performance shares. All awards granted under the Employee Plan have been incentive stock options. These options have ten year lives and vest ratably over various terms up to five years. At December 31, 2004, the Company had 355,330 options available for future grants under the Employee Plan.

The Directors Stock Option Plan, as amended (the Director Plan) is authorized to issue up to 140,000 shares. All options granted under the Director Plan have ten year lives, vest immediately and are not exercisable for a period of six months after the grant date. During 2003, all of the remaining options in the Director Plan were granted.

During 1998, 350,000 options were granted under both plans at an exercise price less than the then market price. This amount was being expensed over the related vesting periods of options still outstanding. These options were fully vested during the second quarter of 2003, consequently there was no compensation costs relating to these options recorded after this date. Compensation costs relating to these options was approximately $10,000 and $27,000 for the years ended December 31, 2003 and 2002, respectively.

A summary of stock option transactions follows ($ in thousands, except per share data):

	Number of Options	Range of Per Share Option Price	Aggregate Option Price
Options Granted Under the Employee Plan:			
Outstanding at December 31, 2001	305,000	$ 4.00	$ 1,220
Options granted	17,446	4.00	70
Outstanding at December 31, 2002	322,446	4.00	1,290
Options granted	127,436	5.09-7.62	933
Options exercised	(70,469)	4.00	(282)
Options forfeited	(1,995)	4.00	(8)
Outstanding at December 31, 2003	377,418	4.00-7.62	1,933
Options granted	3,000	7.62	23
Options exercised	(6)	4.00	
Options forfeited	(36)	4.00	

Outstanding at December 31, 2004	380,376	$ 4.00-7.62	$ 1,956
Options Granted Under the Director Plan:			
Outstanding at December 31, 2001	75,000	$ 4.00	$ 300
Options granted	28,061	4.00	112
Outstanding at December 31, 2002	103,061	4.00	412
Options granted	36,939	7.62	282
Outstanding at December 31, 2003 and 2004	140,000	$ 4.00-7.62	$ 694

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FEDERAL TRUST CORPORATION AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(14) Stock Option Plans, Continued

The weighted-average remaining contractual life of all options outstanding at December 31, 2004 and 2003 was 5.9 years and 6.9 years, respectively.

The options are exercisable as follows:

Year Ending December 31,	Number of Options	Weighted-Average Exercise Price
Currently exercisable	373,062	$ 4.59
2005	46,076	5.88
2006	46,076	5.88
2007	29,075	6.99
2008	26,087	7.33
	520,376	$ 5.09