MALVERN BANCORP, INC.
Form 10-K
December 19, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)

x	Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the fiscal year ended: September 30, 2013
or	
o	Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from ______ to ______

Commission File Number: 000-54835

MALVERN BANCORP, INC.
(Exact name of Registrant as specified in its charter)

Pennsylvania (State or Other Jurisdiction of Incorporation or Organization)	45-5307782 (I.R.S. Employer Identification Number)
42 E. Lancaster Avenue, Paoli, Pennsylvania (Address of Principal Executive Offices)	19301 (Zip Code)

Registrant’s telephone number, including area code: (610) 644-9400

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

Title of each class	Name of each exchange on which registered
Common Stock, $.01 par value per share	The NASDAQ Stock Market, LLC

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES o NO x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES o NO x

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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if

any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO o

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

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

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	x

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

The aggregate market value of the 6,066,365 shares of the common stock of Malvern Bancorp, Inc. held by non-affiliates, based upon the closing price of $12.19 for the common stock on March 31, 2013, reported by the NASDAQ Stock Market, was approximately $73.9 million. For the purpose of this calculation, shares held by the following persons who may be deemed affiliates have been excluded: directors and executive officers of the registrant (12 persons), 46,705 shares; the registrant's employee stock ownership plan ("ESOP"), 258,217 shares; the Malvern Federal Savings Bank Employees' Savings and Profit Sharing Plan, 75,139 shares; and the Malvern Federal Charitable Foundation, 112,047 shares. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares of the Issuer's common stock, par value $0.01 per share, outstanding as of December 18, 2013 was 6,558,473.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2014 Annual Meeting of Shareholders are incorporated by reference into Part III, Items 10-14 of this Form 10-K.

MALVERN BANCORP, INC.
2013 ANNUAL REPORT ON FORM 10-K

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Forward-Looking Statements

This Annual Report on Form 10-K contains certain forward looking statements (as defined in the Securities Exchange Act of 1934 and the regulations hereunder). Forward looking statements are not historical facts but instead represent only the beliefs, expectations or opinions of Malvern Bancorp, Inc. and its management regarding future events, many of which, by their nature, are inherently uncertain. Forward looking statements may be identified by the use of such words as: "believe," "expect," "anticipate," "intend," "plan," "estimate," or words of similar meaning, or future or condit terms such as "will," "would," "should," "could," "may," "likely," "probably," or "possibly." Forward looking statements inc are not limited to, financial projections and estimates and their underlying assumptions; statements regarding plans, objectives and expectations with respect to future operations, products and services; and statements regarding future performance. Such statements are subject to certain risks, uncertainties and assumptions, many of which are difficult to predict and generally are beyond the control of Malvern Bancorp, Inc. and its management, that could cause actual results to differ materially from those expressed in, or implied or projected by, forward looking statements. The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward looking statements: (1) economic and competitive conditions which could affect the volume of loan originations, deposit flows and real estate values; (2) the levels of non-interest income and expense and the amount of loan losses; (3) competitive pressure among depository institutions increasing significantly; (4) changes in the interest rate environment causing reduced interest margins; (5) general economic conditions, either nationally or in the markets in which Malvern Bancorp, Inc. is or will be doing business, being less favorable than expected;(6) political and social unrest, including acts of war or terrorism; or (7) legislation or changes in regulatory requirements adversely affecting the business in which Malvern Bancorp, Inc. will be engaged. Malvern Bancorp, Inc. undertakes no obligation to update these forward looking statements to reflect events or circumstances that occur after the date on which such statements were made.

PART I.

Item 1. Business.

General

On October 11, 2012, Malvern Bancorp, Inc. (the "Company" or "Malvern Bancorp") completed the "second-step" conversion from the mutual holding company structure to the stock holding company structure pursuant to a Plan of Conversion and Reorganization. Upon completion of the conversion and reorganization, Malvern Federal Mutual Holding Company (the "Mutual Holding Company") and Malvern Federal Bancorp, Inc. (the "Mid-Tier Holding Company") ceased to exist. Malvern Bancorp, Inc., a Pennsylvania company, became the holding company for the Bank and owner of all of the issued and outstanding shares of the common stock of Malvern Federal Saving Bank (the "Bank" or "Malvern Federal Savings"). In connection with the conversion and reorganization, 3,636,875 shares of common stock, par value $0.01 per share, of the Malvern Bancorp, Inc., were sold in a subscription offering to certain depositors of the Bank and other investors for $10 per share, or $36.4 million in the aggregate, and 2,921,598 shares of common stock were issued in exchange for the outstanding shares of common stock of the former Mid-Tier Holding Company held by the "public" shareholders of the Mid-Tier Holding Company (all shareholders except Malvern Federal Mutual Holding Company). Each share of common stock of the Mid-Tier Holding Company was converted into the right to receive 1.0748 shares of common stock of the new Malvern Bancorp, Inc. in the conversion and reorganization. The total shares outstanding upon completion of the stock offering and the exchange were approximately 6,558,473. Treasury stock of the former Mid-Tier Holding Company was cancelled.

The Company is a Pennsylvania chartered corporation which owns all of the issued and outstanding shares of the Bank's common stock, the only shares of equity securities which the Bank has issued. While the Company is authorized to pursue all activities permitted by applicable laws and regulations for savings and loan holding companies, the Company's only business activity to date has been holding all of the outstanding common stock of Malvern Federal Savings. The Company does not own or lease any property, but instead uses the premises, equipment and furniture of the Bank. At the present time, the Company employs only persons who also are officers of Malvern Federal Savings to serve as officers of the Company. The Company also uses the Bank's support staff from time to time. These persons are not separately compensated by the Company.

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The Company is the successor to the Mid-Tier Holding Company and references to Malvern Bancorp or the Company include reference to the Mid-Tier Holding Company where applicable.

Malvern Federal Savings Bank is a federally chartered stock savings bank which was originally organized in 1887 and operates out of its headquarters in Paoli, Pennsylvania and eight full service financial center offices in Chester and Delaware Counties, Pennsylvania. The Bank is primarily engaged in attracting deposits from the general public and using those funds to invest in loans and investment securities. The Bank's principal sources of funds are deposits, repayments of loans and investment securities, maturities of investments and interest-bearing deposits, other funds provided from operations and wholesale funds borrowed from outside sources such as the Federal Home Loan Bank of Pittsburgh (the "FHLB"). These funds are primarily used for the origination of various loan types including single-family residential mortgage loans, commercial real estate mortgage loans, construction and development loans, home equity loans and lines of credit and other consumer loans. The Bank derives its income principally from interest earned on loans, investment securities and, to a lesser extent, from fees received in connection with the origination of loans and for other services. The Bank's primary expenses are interest expense on deposits and borrowings, provisions for loan losses and general operating expenses. Funds for activities are provided primarily by deposits, amortization of loans, loan prepayments and the maturity of loans, securities and other investments and other funds from operations.

Prior to July 2011, the Bank, the Mid-Tier Holding Company and the Mutual Holding Company were regulated by the Office of Thrift Supervision (the "OTS"). As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the OTS was eliminated and, as of July 21, 2011, the regulatory oversight functions and authority of the OTS related to the Bank were transferred to the Office of the Comptroller of the Currency (the "OCC") and the regulatory oversight functions and authority of the OTS related to savings and loan holding companies, such as the Company and, previously, the Mid-Tier Holding Company, were transferred to the Board of Governors of the Federal Reserve System (the "Federal Reserve Board" or the "FRB"). See "–Regulation - General" and "–Regulation - Recently Enacte Regulatory Reform."

The Bank is an active originator of residential home mortgage loans in our market area. Historically, Malvern Federal Savings was a traditional thrift institution which emphasized the origination of loans secured by one-to four-family, or "single-family" residential real estate located in its market area. Over five years ago, we decided to focus on increasing our originations of loans secured by non-residential or commercial real estate loans as well as construction and development loans and home equity loans and lines of credit. Such loans are deemed attractive due to their generally higher yields and shorter anticipated lives compared to single-family residential mortgage loans. However, commercial real estate loans, construction and development loans and home equity loans and lines of credit are all deemed to have a higher risk of default than single-family residential mortgage loans.

In October 2010, the Bank, the Mid-Tier Holding Company and the Mutual Holding Company entered into Supervisory Agreements (the "Supervisory Agreement(s)") with the OTS. As discussed above, the regulatory functions of the OTS have been transferred to the OCC, in the case of the Bank, and the FRB in the case of the Company. Among other things, the terms of the Supervisory Agreements:

- required us to develop a plan to reduce our problem assets;
- required us to develop enhanced policies and procedures for identifying, monitoring and controlling the risk associated with concentrations of commercial real estate loans; and

required that an independent third party undertake reviews of our commercial real estate loans, construction and development loans, multi-family residential mortgage loans and commercial loans not less than once every six months.

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In addition, as a result of the Supervisory Agreements, Malvern Federal Savings is subject to certain additional restrictions, including the following:

- the Bank is required to provide the OCC (and, previously, the OTS) with prior notice of any new director or senior executive officer; and
- the Bank may not enter into, renew, extend or revise any contractual arrangements related to compensation or benefits with any director or officer without receiving prior written non-objection from the OCC (and, previously, the OTS).

Initially, the Supervisory Agreement also prohibited us from making any new commercial real estate loans and/or commercial and industrial loans and required the Bank to limit its growth in any quarter to an amount not exceeding the interest credited on deposits, in each case without the prior written non-objection of the OCC. In April 2013, we were advised that we were no longer subject to such restrictions on commercial real estate lending and commercial and industrial lending and on asset growth, provided that the level of loan growth remains consistent with our business plan filed with the OCC and meets the requirements of the Supervisory Agreement. For additional information, see "-Regulation – The Supervisory Agreements."

In October 2013, we announced the sale of a substantial portion of our problem loans in a bulk transaction to a single investor. The loans had an aggregate book balance of $20.4 million and were sold on October 4, 2013 at a loss of approximately $10.1 million. The subject loans were classified as held for sale at September 30, 2013, after taking charge-offs of $10.2 million in the aggregate to reflect the anticipated sale price of such loans. As a result, our consolidated statement of financial condition at September 30, 2013 includes such $10.4 million in loans as held for sale. Such loans are not considered to be included in our loan portfolio at September 30, 2013. The aggregate book balance of the loans held for sale at September 30, 2013 included approximately $11.2 million of non-accruing loans, $3.4 million of performing troubled debt restructurings ("TDRs") and $5.8 million of classified and other loans. As a result of the loan sale, the Company has significantly improved its credit quality metrics.

The Bank also prepaid $20.0 million in advances from the Federal Home Loan Bank (the "FHLB") of Pittsburgh during the month of September 2013 and incurred a $1.5 million prepayment penalty, which also is reflected in the results for the quarter and fiscal year ended September 30, 2013. The Company determined to prepay the FHLB advances, which had an average cost of 3.84% and maturity dates in mid- to late – 2018, in order to reduce its average cost of funds and improve its net interest spread and net interest margin in future periods. During the fourth quarter of fiscal 2013 we acquired $10.0 million in new FHLB advances with an average cost of 1.06% and maturities of two-to-three years. The prepayment was funded with cash and equivalents currently yielding 0.25%.

Our headquarters is located at 42 East Lancaster Avenue, Paoli, Pennsylvania, and our telephone number is (610) 644-9400. We maintain a website at www.malvernfederal.com and we provide our customers with on-line banking and telephone banking services. The Company's annual reports on Form 10-K, quarterly reports on Form10-Q, current reports on Form 8-K and other documents filed by the Company with the Securities and Exchange Commission ("SEC") are available free of charge on the Company's website under the Investor Relations menu. Such documents are available on the Company's website as soon as reasonably practicable after they have been filed electronically with the SEC. The information presented on our website, currently and in the future, is not considered to be part of this document, or any document, incorporated by reference in this document.

Market Area and Competition

We conduct business from our corporate headquarters in Paoli, Pennsylvania, seven financial center offices located in Chester County, Pennsylvania and one financial center office in Delaware County, Pennsylvania. Our headquarters office is in Paoli, Pennsylvania, approximately 25 miles west of the City of Philadelphia. In addition to Chester County, our lending efforts are focused in neighboring Montgomery County and Delaware County, both of which are also in southeastern Pennsylvania. To a lesser extent, we provide services to other areas in the greater Philadelphia market area.

We face significant competition in originating loans and attracting deposits. This competition stems primarily from commercial banks, other savings banks and savings associations and mortgage-banking companies. Within our market area, we estimate that more than 79 other banks, credit unions and savings institutions are operating. There are several larger commercial banks which have a significant presence in our market area including Wells Fargo Bank, PNC Financial, TD Bank and Susquehanna Bank. We face additional competition for deposits from short-term money market funds and other corporate and government securities funds, mutual funds and from other non-depository financial institutions such as brokerage firms and insurance companies.

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Lending Activities

General. At September 30, 2013, our net loan portfolio totaled $401.9 million or 66.8% of total assets. Historically, our principal lending activity has been the origination of loans collateralized by one- to four-family, also known as "single-family," residential real estate loans located in our market area. In light of the increased levels of our non-performing and problem assets in recent fiscal years, we have taken certain actions to strengthen and enhance our loan underwriting policies and procedures and our loan administration and oversight policies and procedures. We have revised both our consumer loan policy and our commercial loan policy to strengthen certain of our minimum loan-to-value ("LTV") ratios, maximum gross debt ratios and minimum debt coverage ratio policy requirements. We have invested in and implemented software which facilitates our ability to internally review and grade loans in our portfolio and to monitor loan performance. During the fiscal year ended September 30, 2011, we established a Credit Review Department. Initially, the primary focus of the Credit Review Department was the resolution of our non-performing and other problem assets. During the fiscal year ended September 30, 2012, the Credit Review Department was expanded to also serve as an integral component in the loan approval process with the implementation of improved controls for the loan underwriting and annual review processes, primarily for commercial lending. Our Chief Credit Officer, who heads the Credit Review Department, also is the Chairman of the Malvern Federal Savings Bank Loan Committee. In addition, during the September 2013 quarter, the Bank hired an experienced commercial credit loan manager, who is responsible for the implementation, monitoring and control of the approval processes and controls with an emphasis on commercial lending. An additional commercial credit analyst was also hired in July 2013 as added support for commercial lending.

The types of loans that we originate are subject to federal and state law and regulations. Interest rates charged by us on loans are affected principally by the demand for such loans and the supply of money available for lending purposes and the rates offered by our competitors. These factors are, in turn, affected by general and economic conditions, the monetary policy of the federal government, including the Federal Reserve Board, legislative tax policies and governmental budgetary matters.

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Loan Portfolio Composition. The following table shows the composition of our loan portfolio by type of loan at the dates indicated. In addition to total loans in portfolio, which amounted to $404.7 million at September 30, 2013, we held $10.4 million of loans held for sale at such date.

	September 30,									
	2013		2012		2011		2010		2009	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percen
	(Dollars in thousands)									
Residential mortgage	$239,900	59.3 %	$231,803	50.2 %	$229,330	44.7 %	$230,966	41.8 %	$252,308	42.4
Construction and Development:										
Residential and commercial	6,672	1.6	20,500	4.4	26,005	5.0	30,429	5.5	37,508	6.3
Land loans	2,439	0.6	632	0.1	2,722	0.6	2,989	0.6	3,237	0.6
Total construction and development loans	9,111	2.2	21,132	4.5	28,727	5.6	33,418	6.1	40,745	6.9
Commercial:										
Commercial real estate	70,571	17.4	112,199	24.3	131,225	25.5	143,095	25.9	142,863	24.0
Multi-family	1,971	0.5	2,087	0.5	5,507	1.1	6,493	1.2	9,613	1.6
Other	5,573	1.4	7,517	1.6	10,992	2.1	11,398	2.1	15,647	2.6
Total commercial loans	78,115	19.3	121,803	26.4	147,724	28.7	160,986	29.2	168,123	28.2
Consumer:										
Home equity lines of credit	20,431	5.0	20,959	4.5	20,735	4.0	19,927	3.6	19,149	3.2
Second mortgages	54,532	13.5	65,703	14.2	85,881	16.8	105,825	19.1	113,943	19.1
Other	2,648	0.7	762	0.2	788	0.2	1,086	0.2	1,143	0.2
Total consumer loans	77,611	19.2	87,424	18.9	107,404	21.0	126,838	22.9	134,235	22.5
Total loans	404,737	100.0%	462,162	100.0%	513,185	100.0%	552,208	100.0%	595,411	100.0
Deferred loan costs net	2,210		2,420		2,935		3,272		3,872	
Allowance for loan losses	(5,090)		(7,581)		(10,101)		(8,157)		(5,718)	
Loans receivable, net	$401,857		$457,001		$506,019		$547,323		$593,565	

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The following table shows the composition of our loan portfolio by fixed- and adjustable-rate at the dates indicated.

	September 30,									
	2013		2012		2011		2010		2009	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Fixed-Rate Loans:										
Residential mortgage	$229,466	56.7 %	$215,599	46.7 %	$211,405	41.2 %	$201,285	36.4 %	$227,712	38.2 %
Construction and Development:										
Residential and commercial	--	--	3,245	0.7	4,250	0.8	968	0.2	5,382	0.9
Land loans	--	--	--	--	1,376	0.3	1,312	0.3	1,558	0.3
Total fixed-rate construction and development loans	--	--	3,245	0.7	5,626	1.1	2,280	0.5	6,940	1.2
Commercial:										
Commercial real estate	27,731	6.9	38,041	8.2	40,231	7.8	40,833	7.4	56,126	9.4
Multi-family	1,634	0.4	1,671	0.4	932	0.2	950	0.2	3,519	0.6
Other	1,334	0.3	1,442	0.3	1,643	0.3	1,733	0.3	3,798	0.6
Total fixed-rate commercial loans	30,699	7.6	41,154	8.9	42,806	8.3	43,516	7.9	63,443	10.6
Consumer:										
Home equity lines of credit	--	--	--	--	--	--	--	--	--	--
Second mortgages	54,532	13.5	65,671	14.2	85,881	16.8	105,825	19.1	113,943	19.1
Other	481	0.1	470	0.1	552	0.1	822	0.1	867	0.2
Total fixed-rate consumer loans	55,013	13.6	66,141	14.3	86,433	16.9	106,647	19.2	114,810	19.3
Total fixed-rate loans	$315,178	77.9	$326,139	70.6	$346,270	67.5	$353,728	64.0	$412,905	69.3
Adjustable-Rate Loans:										
Residential mortgage	$10,434	2.6 %	$16,204	3.5 %	$17,925	3.5 %	$29,681	5.4 %	$24,596	4.1 %
Construction and Development:										

Residential and commercial	6,672	1.6	17,255	3.7	21,755	4.2	29,461	5.3	32,126	5.4
Land loans	2,439	0.6	632	0.1	1,346	0.3	1,677	0.3	1,679	0.3
Total adjustable-rate construction and development loans	9,111	2.2	17,887	3.8	23,101	4.5	31,138	5.6	33,805	5.7
Commercial:										
Commercial real estate	42,840	10.5	74,158	16.1	90,994	17.7	102,262	18.5	86,737	14.6
Multi-family	337	0.1	416	0.1	4,575	0.9	5,543	1.0	6,094	1.0
Other	4,239	1.1	6,075	1.3	9,349	1.8	9,665	1.8	11,849	2.0
Total adjustable-rate commercial loans	47,416	11.7	80,649	17.5	104,918	20.4	117,470	21.3	104,680	17.6
Consumer:										
Home equity lines of credit	20,431	5.0	20,959	4.5	20,735	4.0	19,927	3.6	19,149	3.2
Second mortgages	--	--	32	--	--	--	--	--	--	--
Other	2,167	0.6	292	0.1	236	0.1	264	0.1	276	0.1
Total adjustable-rate consumer loans	22,598	5.6	21,283	4.6	20,971	4.1	20,191	3.7	19,425	3.3
Total adjustable-rate loans	$89,559	22.1 %	$136,023	29.4 %	$166,915	32.5 %	$198,480	36.0 %	$182,506	30.7 %
Total loans	$404,737	100.0%	$462,162	100.0%	$513,185	100.0%	$552,208	100.0%	$595,411	100.0%

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Loan Maturity. The following table presents the contractual maturity of our loans held in portfolio at September 30, 2013. The table does not include the effect of prepayments or scheduled principal amortization. Loans having no stated repayment schedule or maturity and overdraft loans are reported as being due in one year or less. This table also does not include loans held for sale.

		Construction and Development		Commercial			Consumer			
	Residential Mortgage	Residential and Commercial	Land Loans	Commercial Real Estate	Multi-family	Other	Home Equity Lines of Credit	Second Mortgages	Other	Total
	(In thousands)									
Amounts due in:										
One year or less	$41	$ 5,272	$ 237	$3,563	$-	$897	$-	$ 82	$27	$10,119
After one year through two years	297	1,400	2,202	5,469	891	73	-	145	57	10,534
After two years through three years	1,230	-	-	4,503	31	58	44	344	94	6,304
After three years through five years	6,510	-	-	16,646	76	485	-	1,146	2,047	26,910
After five years through ten years	26,055	-	-	34,015	742	1,779	-	15,593	47	78,231
After ten years through fifteen years	55,075	-	-	4,085	51	1,231	3,796	20,416	4	84,658
Beyond fifteen years	150,692	-	-	2,290	180	1,050	16,591	16,806	372	187,981
Total	$239,900	$ 6,672	$ 2,439	$70,571	$1,971	$5,573	$20,431	$ 54,532	$2,648	$404,737
Interest rate terms on amounts due after one year:										
Fixed rate	$229,425	$ -	$ -	$26,551	$1,634	$1,237	$-	$ 54,450	$456	$313,753
Adjustable rate	10,434	1,400	2,202	40,457	337	3,439	20,431	-	2,165	80,865
Total	$239,859	$ 1,400	$ 2,202	$67,008	$1,971	$4,676	$20,431	$ 54,450	$2,621	$394,618

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Loan Originations, Purchases and Sales. Our lending activities are subject to underwriting standards and loan origination procedures established by our board of directors and management. Loan originations are obtained through a variety of sources, primarily using our four loan originators and new customers obtained from referrals as well as local advertising and promotional efforts. In addition, we rely on a network of approximately eight mortgage brokers with respect to production of new single-family residential mortgage loans, second mortgage loans and home equity lines of credit. We receive applications from such brokers on standardized documents meeting Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac") and Federal National Mortgage Association ("FNMA" or "Fannie Mae") guidelines and, if we determine to acquire loans from such brokers, they are underwritten and approved pursuant to the policies and procedures of Malvern Federal Savings Bank. Depending upon our arrangements with the particular broker, loans obtained from our broker network are classified either as "purchased," when the broker provides the loan funds at closing and closes the loan in its name, or as "originated," when Malvern Federal Savings Bank disburses the loan funds at closing and the documents reflect the Bank as the lender. Single-family residential mortgage loan applications and consumer loan applications are taken at any Malvern Federal Savings Bank branch office. We also accept internet applications submitted to our website. Applications for other loans typically are taken personally by our loan officers or business development officers, although they may be received by a branch office initially and then referred to one of our loan officers or business development officers. All loan applications are processed and underwritten centrally at our main office.

All of our single-family residential mortgage loans are written on standardized documents used by Freddie Mac and Fannie Mae. We also utilize an automated loan processing and underwriting software system for our new single-family residential mortgage loans. Property valuations of loans secured by real estate are undertaken by an independent third-party appraiser approved by our board of directors. We do not originate, and at September 30, 2013, we had no sub-prime loans in our portfolio.

In addition to originating loans, we may consider purchasing participation interests in larger balance loans, typically commercial real estate or construction and development loans, from other financial institutions in our market area. Such participations are reviewed for compliance with our underwriting criteria before they are purchased. We actively monitor the performance of such loans through the receipt of regular reports from the lead lender regarding the loan's performance, physically inspecting the loan security property on a periodic basis, discussing the loan with the lead lender on a regular basis and receiving copies of updated financial statements from the borrower. At September 30, 2013, the largest loan participation interests from other institutions were comprised of loans to four borrowers and their affiliates, which had an aggregate outstanding balance of approximately $1.8 million at such date.

We occasionally sell whole loans or participation interests in loans we originate. We generally have sold participation interests in loans only when a loan would exceed our loans-to-one borrower limits. Our loans-to-one borrower limit, with certain exceptions, generally is 15% of the Bank's unimpaired capital and surplus or $10.4 million at September 30, 2013. At September 30, 2013, our five largest outstanding loans to one borrower and related entities amounted to $4.2 million, $3.4 million, $3.2 million, $3.1 million and $2.3 million, respectively, and all of such loans were performing in accordance with their terms and complied with our loan-to-one borrower limit. In addition, in an effort to improve our interest rate risk exposure, on occasion, we sell long-term (15, 20 or 30 year term) fixed-rate single family residential mortgage loans to Freddie Mac, Fannie Mae and the Federal Home Loan Bank Mortgage Partnership Finance Program, while retaining the loan servicing rights for such loans. We receive a fee for continuing to service such loans when they are sold, and such fees are recorded as non-interest income. As previously indicated, in order to improve our credit quality, we undertook a bulk sale of problem loans in October 2013. The loans designated for sale had an aggregate book balance of $20.4 million at September 30, 2013. Charge-offs of $10.2 million in the aggregate were taken to reflect the anticipated sales price of such loans, and we transferred the loans to held for sale status with an aggregate carrying value of $10.4 million at September 30, 3013. The loans classified as

held for sale are not considered to be in our "portfolio" of loans at September 30, 2013. The bulk loan sale was completed on October 4, 2013 (although $2.5 million of the purchase price was held in escrow for a 30 day period to address unknown items or loans which the purchaser had the ability to return to us during the escrow period. Subsequent to September 30, 2013, the purchaser of the loans in the bulk sale transaction exercised its right to return one loan to us, a participation interest in a non-accruing commercial construction loan which had a $1.1 million book balance at September 30, 2013. This loan will be returned to portfolio as of December 31, 2013 at no additional loss. Due to a $596,000 principal payment received on the returned loan subsequent to September 30, 2013, the current book balance of the loan is approximately $484,000. The bulk sale of the loans has been completed and no additional loans are expected to be returned to us as the time period for any returns of additional loans or any other adjustments from the amount held back has now expired.

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The following table shows our loan origination, purchase and repayment activities for the periods indicated.

	Year Ended September 30,		
	2013	2012	2011
	(In thousands)		
Total gross loans at beginning of period	$462,162	$513,185	$552,208
Transfer to loans held for sale(1)	(10,367)	-	-
Originations by type:			
Residential mortgage	85,427	39,213	35,378
Construction and Development(2):			
Residential and commercial	5,549	4,961	3,890
Land loans	2,202	-	36
Commercial:			
Commercial real estate	723	3,831	3,146
Multi-family	335	221	494
Other	952	1,322	3,426
Consumer:			
Home equity lines of credit(2)	10,451	10,813	11,289
Second mortgages	6,846	1,426	6,719
Other	2,559	684	608
Total originations	115,044	62,471	64,986
Principal Repayments:			
Residential mortgage	66,416	49,872	54,691
Construction and Development:			
Residential and commercial	14,052	10,425	7,750
Land loans	394	1,923	235
Commercial:			
Commercial real estate	32,141	21,112	7,387
Multi-family	400	3,146	1,335
Other	2,460	4,779	3,542
Consumer:			
Home equity lines of credit	10,571	10,917	10,034
Second mortgages	18,659	25,653	28,848
Other	655	709	882
Total principal repayments	145,748	128,536	114,704
Net loan originations and principal repayments	(30,704)	(66,065)	(49,718)
Purchases:			
Residential mortgage(3)	27,724	25,914	27,683
Construction and Development:			
Residential and commercial	312	-	125
Commercial:			
Commercial real estate	618	-	-
Consumer:			
Home equity lines of credit	113	361	-
Second mortgages	2,293	4,626	4,560
Total purchased	31,060	30,901	32,368
Sales:			

Residential mortgage	(27,763)	(10,671)	-
Construction and Development:			
Residential and commercial	(1,707)		
Other adjustments, net(4)	(17,944)	(5,188)	(21,673)
Net increase (decrease)	(57,425)	(51,023)	(39,023)
Total gross loans in portfolio at end of period	$404,737	$462,162	$513,185

(1) Reflects fair market value of loans transferred to held for sale status at September 30, 2013 in connection with our bulk sale of loans.

(2) Origination amounts for construction and development loans and line of credit loans reflect disbursements of loan proceeds during the period, although loans may have been originated in a prior period.

(3) Includes purchases of loans from our network of loan brokers.

(4) Reflects non-cash items related to transfers of loans to other real estate owned, recoveries and charge-offs.

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The loans receivable portfolio is segmented into residential loans, construction and development loans, commercial loans and consumer loans. The residential loan segment has one class, one- to four-family first lien residential mortgage loans. The construction and development loan segment consists of the following classes: residential and commercial and land loans. Residential construction loans are made for the acquisition of and/or construction on a lot or lots on which a residential dwelling is to be built. Commercial construction loans are made for the purpose of acquiring, developing and constructing a commercial use structure. The commercial loan segment consists of the following classes: commercial real estate loans, multi-family real estate loans, and other commercial loans, which are also generally known as commercial and industrial loans or commercial business loans. The consumer loan segment consists of the following classes: home equity lines of credit, second mortgage loans and other consumer loans, primarily unsecured consumer lines of credit.

Residential Lending. Residential mortgage originations are secured primarily by properties located in the Company's primary market area and surrounding areas. At September 30, 2013, $239.9 million, or 59.3%, of our total loans in portfolio consisted of single-family residential mortgage loans.

Our single-family residential mortgage loans generally are underwritten on terms and documentation conforming to guidelines issued by Freddie Mac and Fannie Mae. Applications for one- to four-family residential mortgage loans are taken by our loan origination officers and are accepted at any of our banking offices and are then referred to the lending department at our main office in order to process the loan, which consists primarily of obtaining all documents required by Freddie Mac and Fannie Mae underwriting standards, and completing the underwriting, which includes making a determination whether the loan meets our underwriting standards such that the Bank can extend a loan commitment to the customer. We generally have retained for portfolio a substantial portion of the single-family residential mortgage loans that we originate. We currently originate fixed-rate, fully amortizing mortgage loans with maturities of 10 to 30 years. We also offer adjustable rate mortgage ("ARM") loans where the interest rate either adjusts on an annual basis or is fixed for the initial one, three or five years and then adjusts annually. However, due to local market conditions, we have not originated a significant amount of ARM loans in recent years. At September 30, 2013, $10.4 million, or 4.4%, of our one- to four-family residential loans consisted of ARM loans. Occasionally, we also offer "balloon" loans which are amortized on a 30 year schedule but become due at the fifth or seventh anniversary, bi-weekly mortgage loans and, until August 2008, for borrowers with credit scores exceeding 700, no income/no asset ("NINA") loans. Our NINA loans amounted to $1.4 million in the aggregate at September 30, 2013. None of our NINA loan were impaired or on non-accrual status at September 30, 2013.

We underwrite one- to four-family residential mortgage loans with loan-to-value ratios of up to 95%, provided that the borrower obtains private mortgage insurance on loans that exceed 80% of the appraised value or sales price, whichever is less, of the secured property. We also require that title insurance, hazard insurance and, if appropriate, flood insurance be maintained on all properties securing real estate loans. We require that a licensed appraiser from our list of approved appraisers perform and submit to us an appraisal on all properties secured by a first mortgage on one- to four-family first mortgage loans. Our mortgage loans generally include due-on-sale clauses which provide us with the contractual right to deem the loan immediately due and payable in the event the borrower transfers ownership of the property. Due-on-sale clauses are an important means of adjusting the yields of fixed-rate mortgage loans in portfolio and we generally exercise our rights under these clauses.

Construction and Development Loans. The amount of our outstanding construction and development loans in portfolio decreased to $9.1 million or 2.2% of total loans at September 30, 2013 from $21.1 million or 4.5% of total loans as of September 30, 2012. In addition to normal amortization and payoffs, the reduction of the outstanding balance of our construction loans in portfolio at September 30, 2013 compared to September 30, 2012 primarily reflects the net transfer of $4.3 million, after charge-offs of $4.1 million, of construction loans to held for sale status at September 30,

2013. In October 2009, we ceased originating any new construction and development loans, with certain limited exceptions. However, during fiscal 2014, we expect to resume originating construction loans to builders and developers in our market area, on a relatively modest basis consistent with our business plan filed with the OCC. Our only new construction loans which we have made since we entered into the Supervisory Agreements in October 2010 have consisted of single-family residential construction loans which, by their terms, convert to permanent, long-term mortgage loans upon completion of construction ("construction/perm." loans). We had 12 of such construction/perm loans in portfolio with an aggregate outstanding balance of $3.6 million at September 30, 2013. During the initial or construction phase, these construction/perm loans require payment of interest only, which generally is tied to prime rate, as the home is being constructed. Upon the earlier of the completion of construction or one year, these loans automatically convert to long-term (generally 30 years), amortizing, fixed-rate single-family mortgage loans. We generally limit construction loans to builders and developers with whom we had an established relationship, or who were otherwise known to officers of the Bank.

Our construction and development loans currently in the portfolio typically have variable rates of interest tied to the prime rate which improves the interest rate sensitivity of our loan portfolio. At September 30, 2013, all of our construction loans had variable rates of interest and 69.3% of such loans had two years or less in their remaining terms to maturity at such date.

Our current portfolio of construction loans generally have a maximum term to maturity of one year (for individual, owner-occupied dwellings), and loan-to-value ratios less than 80%. Residential construction loans to developers are made on either a pre-sold or speculative (unsold) basis. Limits are placed on the number of units that can be built on a speculative basis based upon the reputation and financial position of the builder, his/her present obligations, the location of the property and prior sales in the development and the surrounding area. Generally, a limit of two unsold homes (one model home and one speculative home) is placed per project.

Prior to committing to a construction loan, we require that an independent appraiser prepare an appraisal of the property. Each project also is reviewed and inspected at its inception and prior to every disbursement of loan proceeds. Disbursements are made after inspections based upon a percentage of project completion and monthly payment of interest is required on all construction loans.

Our construction loans also include loans for the acquisition and development of land for sale (i.e. roads, sewer and water lines). We typically made these loans only in conjunction with a commitment for a construction loan for the units to be built on the site. These loans are secured by a lien on the property and were limited to a loan-to-value ratio not exceeding 75% of the appraised value at the time of origination. The loans have a variable rate of interest and require monthly payments of interest. The principal of the loan is repaid as units are sold and released. We limited loans of this type to our market area and to developers with whom we had established relationships. In most cases, we also obtained personal guarantees from the borrowers.

Our loan portfolio included three loans secured by unimproved real estate and lots (“land loan”), with an outstanding balance of $2.4 million, constituting 0.6% of total loans, at September 30, 2013.

Construction and development loans generally are considered to involve a higher level of risk than one-to four-family residential lending, due to the concentration of principal in a limited number of loans and borrowers and the effect of economic conditions on developers, builders and projects. At September 30, 2013, the amounts outstanding on our five largest residential construction loans in portfolio were approximately $641,000, $539,000, $532,000, $480,000 and $471,000, respectively. At September 30, 2013, we only had one commercial construction or development loan in portfolio for approximately $1.5 million. The average size of our construction loans was approximately $380,000 at September 30, 2013. Additional risk is also associated with construction lending because of the inherent difficulty in estimating both a property’s value at completion and the estimated cost (including interest) to complete a project. The nature of these loans is such that they are more difficult to evaluate and monitor. In addition, speculative construction loans to a builder are not pre-sold and thus pose a greater potential risk than construction loans to individuals on their personal residences.

In order to mitigate some of the risks inherent to construction lending, we inspect properties under construction, review construction progress prior to advancing funds, work with builders with whom we have established relationships, require annual updating of tax returns and other financial data of developers and obtain personal guarantees from the principals. At September 30, 2013, $220,000, or 4.3%, of our allowance for loan losses was attributed to construction and development loans. We had no non-performing construction and development loans in portfolio at September 30, 2013 compared to $3.8 million at September 30, 2012. During the fiscal year ended September 30, 2013, we charged off a total of $5.9 million in construction and development loans of which $4.1

million is related to the transfer of $4.3 million to held for sale status at September 30, 2013. See “Asset Quality – Non-Performing Loans and Real Estate Owned.” In addition to our non-performing construction and development loans, at September 30, 2013 and 2012, we had $446,000 and $1.1 million, respectively, in construction and development loans that were performing troubled debt restructurings.

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Commercial Lending. In August 2010, the Company generally ceased originating or acquiring new commercial real estate, multi-family real estate mortgage loans, or commercial business loans. The Supervisory Agreement, which became effective in October 2010, prohibited the Bank from originating or purchasing any new commercial real estate loans or commercial and industrial loans except for refinancing, extending or modifying existing loans where no new funds are advanced and except with the prior written non-objection of the OCC.

As a result of the OCC's determination in April 2013 to remove the restrictions on commercial lending as well as enhancements made to our commercial loan policies, approval and underwriting processes, as well as the addition of experienced personnel in the Credit Review department, we intend to resume commercial real estate and business lending during fiscal 2014, subject to the levels of growth reflected in our business plan submitted to the OCC.

At September 30, 2013, our loans in portfolio secured by commercial real estate amounted to $70.6 million and constituted 17.4% of our total loans at such date. During the year ended September 30, 2013, the commercial real estate loan portfolio decreased by an aggregate of $41.6 million, or 37.1% due primarily to our ceasing, with certain exceptions, originations of new commercial real estate loans and the sale of commercial real estate problem loans. In addition to loan payoffs and normal amortization, the reduction of our commercial loan portfolio during fiscal 2013 reflects aggregate charge-offs of $6.3 million of commercial real estate loans, the transfer of $10.5 million (after charge-offs) of commercial real estate loans to held for sale status and the transfer of $1.1 million in commercial real estate loans to other real estate owned ("REO") during the fiscal year ended September 30, 2013.

Our commercial real estate loan portfolio consists primarily of loans secured by office buildings, retail and industrial use buildings, strip shopping centers, mixed-use and other properties used for commercial purposes located in its market area. Loans in our commercial real estate portfolio tend to be in an amount less than $3.0 million, but some exceed that amount. At September 30, 2013, the average amount outstanding on our commercial real estate loans in portfolio was $183,000. The five largest commercial real estate loans in portfolio outstanding were $4.2 million, $3.2 million, $3.1 million, $3.1 million and $1.9 million at September 30, 2013. During the year ended September 30, 2013, the average yield on our commercial real estate loans was 5.0% compared to 4.1% for our single-family residential mortgage loans. Commercial real estate loans are much more likely to have adjustable interest rates than single-family residential mortgage loans, which adds to the interest rate sensitivity of commercial real estate loans and makes them attractive. At September 30, 2013, approximately 60.7% of our commercial real estate loans in portfolio had adjustable interest rates compared to 4.4% of our single-family residential mortgage loans with adjustable rates at such date.

Although terms for commercial real estate and multi-family loans vary, our underwriting standards generally allow for terms up to 10 years with the interest rate being reset in the fifth year and with monthly amortization not greater than 25 years and loan-to-value ratios of not more than 75%. Interest rates are either fixed or adjustable, based upon the prime rate plus a margin, and fees ranging from 0.5% to 1.50% are charged to the borrower at the origination of the loan. Prepayment fees are charged on most loans in the event of early repayment. Generally, we obtain personal guarantees of the principals as additional collateral for commercial real estate and multi-family real estate loans.

At September 30, 2013, our loan portfolio included six loans with an aggregate book value of $2.0 million secured by multi-family (more than four units) properties, constituting 0.5% of our total loans at such date. These loans are for properties located in Chester County and Delaware County, Pennsylvania, respectively. As of September 30, 2013, we had no non-accruing multi-family loans.

Commercial and multi-family real estate loans generally present a higher level of risk than loans secured by one- to four-family residences. This greater risk is due to several factors, including the concentration of principal in a limited

number of loans and borrowers, the effect of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by commercial and multi-family real estate is typically dependent upon the successful operation of the related real estate project. If the cash flow from the project is reduced (for example, if leases are not obtained or renewed, a bankruptcy court modifies a lease term, or a major tenant is unable to fulfill its lease obligations), the borrower's ability to repay the loan may be impaired. As of September 30, 2013, none of our commercial real estate mortgage loans held in portfolio were on non-accrual status but an aggregate of $377,000 of our commercial real estate loans at such date were classified for regulatory reporting purposes as substandard. See "Asset Quality – Asset Classification." As of September 30, 2013, $1.7 million, or 33.9% of our allowance for loan losses was allocated to commercial real estate mortgage loans. In addition, at September 30, 2013 we held $1.9 million of real estate owned which was acquired from foreclosures on, or our acceptance of a deed-in-lieu of foreclosure, on commercial real estate loans. See "Asset Quality – Non-Performing Assets and Real Estate Owned." None of our commercial real estate loans held in portfolio were deemed performing troubled debt restructurings at September 30, 2013 as compared to $6.0 million at September 30, 2012.

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At September 30, 2013, we had $5.6 million in commercial business loans (1.4% of gross loans outstanding) in portfolio. Our commercial business loans generally have been made to small to mid-sized businesses located in our market area. The commercial business loans in our portfolio assist us in our asset/liability management since they generally provide shorter maturities and/or adjustable rates of interest in addition to generally having higher rates of return which are designed to compensate for the additional credit risk associated with these loans. The commercial business loans which we have originated may be either a revolving line of credit or for a fixed term of generally 10 years or less. Interest rates are adjustable, indexed to a published prime rate of interest, or fixed. Generally, equipment, machinery, real property or other corporate assets secure such loans. Personal guarantees from the business principals are generally obtained as additional collateral. At September 30, 2013, the average balance of our commercial business loans was $70,000.

Generally, commercial business loans are characterized as having higher risks associated with them than single-family residential mortgage loans. As of September 30, 2013, we had no non-accruing commercial business loans in portfolio. At such date, $59,000 or 1.2% of the allowance for loan losses was allocated to commercial business loans.

In our underwriting procedures, consideration is given to the stability of the property's cash flow history, future operating projections, current and projected occupancy levels, location and physical condition. Generally, our practice in recent periods is to impose a debt service ratio (the ratio of net cash flows from operations before the payment of debt service to debt service) of not less than 125%. We also evaluate the credit and financial condition of the borrower, and if applicable, the guarantor. Appraisal reports prepared by independent appraisers are obtained on each loan to substantiate the property's market value, and are reviewed by us prior to the closing of the loan.

Consumer Lending. In our efforts to provide a full range of financial services to our customers, we offer various types of consumer loans. Our consumer loans amounted to $77.6 million or 19.2% of our total loan portfolio at September 30, 2013. The largest components of our consumer loans are loans secured by second mortgages, consisting primarily of home equity loans, which amounted to $54.5 million at September 30, 2013, and home equity lines of credit, which amounted to $20.4 million at such date. Our consumer loans also include automobile loans, unsecured personal loans and loans secured by deposits. Consumer loans are originated primarily through existing and walk-in customers and direct advertising and, with respect to second mortgages and home equity lines of credit, through our broker network.

Our home equity lines of credit are variable rate loans tied to the prime rate. Our second mortgages may have fixed or variable rates, although they generally have had fixed rates in recent periods. Our second mortgages have a maximum term to maturity of 20 years. Both our second mortgages and our home equity lines of credit generally are secured by the borrower's primary residence. However, our security generally consists of a second lien on the property. Our lending policy provides that our home equity loans have loan-to-value ratios of 85% or less when combined with any Malvern Federal Savings Bank's first mortgage. Our lending policy also provides that our home equity loans have loan-to-value ratios of 75% or less when combined with any first mortgage with any other financial institution. The maximum loan-to-value ratio on our home equity lines of credit is 75%, when Malvern Federal Savings has the first mortgage. However, the maximum loan-to-value ratio on our home equity lines of credit is reduced to 70%, when the Bank does not have the first mortgage. At September 30, 2013, the unused portion of our home equity lines of credit was $13.9 million.

Consumer loans generally have higher interest rates and shorter terms than residential loans; however, they have additional credit risk due to the type of collateral securing the loan or in some case the absence of collateral. In the year ended September 30, 2013, we charged-off $1.1 million of consumer loans. We are continuing to evaluate and monitor the credit conditions of our consumer loan borrowers and the real estate values of the properties securing our second mortgage loans as part of our on-going efforts to assess the overall credit quality of the portfolio in connection

with our review of the allowance for loan losses. As of September 30, 2013, we had an aggregate of $606,000 of non-accruing second mortgage loans and home equity lines of credit, representing an improvement of $156,000 over the amount of non-accruing second mortgage loans and home equity lines of credit at September 30, 2012. At September 30, 2013, $762,000 of our consumer loans were classified as substandard and we had no doubtful consumer loans. At September 30, 2013, an aggregate of $1.6 million of our allowance for loan losses was allocated to second mortgages and home equity lines of credit.

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Loan Approval Procedures and Authority. Our board of directors establishes the Bank's lending policies and procedures. Our Lending Policy Manual is reviewed on at least an annual basis by our management team in order to propose modifications as a result of market conditions, regulatory changes and other factors. All loan modifications must be approved by our board of directors.

All loans in excess of $417,000 and all loans which are approved as an exception to our standard loan underwriting policies and procedures must be approved by the Bank's Board of Directors after such loans are recommended for approval by the Property and Loan Committee of the Board of Directors. Our Chief Lending Officer is authorized to approve residential mortgage loans up to $417,000. Commercial loans in amounts up to $200,000 must be approved by the Director of Commercial Banking, plus the Senior Commercial Loan Portfolio Manager. Commercial loans in excess of $200,000 must be approved by two designated officers plus the Chief Lending Officer and the Commercial Loan Committee. The consumer loans in excess of $100,000 but not exceeding $200,000 must be approved by a designated consumer loan officer and our Chief Lending Officer. Consumer loans under $100,000 can be approved by one designated loan officer.

Asset Quality

General. One of our key goals in fiscal 2013 was to continue to improve asset quality. Accordingly, as previously discussed we entered into the previously described agreement to sell a substantial portion of our problem loans in a bulk sale transaction. As a result of the bulk sale transaction, which was completed in October 2013, we transferred non-accruing loans with an aggregate book balance of $11.2 million (before charge-offs of $5.5 million) and performing TDRs with an aggregate book balance of $3.4 million (before charge-offs of $1.4 million) to held for sale status as of September 30, 2013.

When a borrower fails to make a scheduled payment, we attempt to cure the deficiency by making personal contact with the borrower. Initial contacts are made as soon as five days after the date the payment is due, and late notices are sent approximately 16 days after the date the payment is due. In most cases, deficiencies are promptly resolved. If the delinquency continues, late charges are assessed and additional efforts are made to collect the deficiency. All loans which are delinquent 30 days or more are reported to the board of directors of Malvern Federal Savings on a monthly basis.

On loans where the collection of principal or interest payments is doubtful, the accrual of interest income ceases ("non-accrual" loans). It is our policy to discontinue accruing additional interest and reverse any interest accrued on any loan which is 90 days or more past due. On occasion, this action may be taken earlier if the financial condition of the borrower raises significant concern with regard to his/her ability to service the debt in accordance with the terms of the loan agreement. Interest income is not accrued on these loans until the borrower's financial condition and payment record demonstrate an ability to service the debt.

Real estate which is acquired as a result of foreclosure is classified as real estate owned until sold. Real estate owned is recorded at the lower of cost or fair value less estimated selling costs. Costs associated with acquiring and improving a foreclosed property is usually capitalized to the extent that the carrying value does not exceed fair value less estimated selling costs. Holding costs are charged to expense. Gains and losses on the sale of real estate owned are charged to operations, as incurred.

We account for our impaired loans under accounting principles generally accepted in the United States of America ("U.S. GAAP"). An impaired loan generally is one for which it is probable, based on current information, that the lender will not collect all the amounts due under the contractual terms of the loan. Large groups of smaller balance,

homogeneous loans are collectively evaluated for impairment. Loans collectively evaluated for impairment include smaller balance residential real estate loans and consumer loans. These loans are evaluated as a group because they have similar characteristics and performance experience. Larger commercial and construction loans are individually evaluated for impairment. Our impaired loans in portfolio amounted to $3.2 million and $13.2 million at September 30, 2013 and 2012, respectively.

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Asset Classification. Federal regulations and our policies require that we utilize an internal asset classification system as a means of reporting problem and potential problem assets. We have incorporated an internal asset classification system, substantially consistent with Federal banking regulations, as a part of our credit monitoring system. Federal banking regulations set forth a classification scheme for problem and potential problem assets 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 insured 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. Assets which do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated "special mention."

When an insured institution classifies one or more assets, or portions thereof, as "substandard" or "doubtful," it is required that a general valuation allowance for loan losses be established for loan losses in an amount deemed prudent by management. General valuation allowances represent loss allowances which have been established to recognize the inherent losses associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies one or more assets, or portions thereof, as "loss," it is required either to establish a specific allowance for losses equal to 100% of the amount of the asset so classified or to charge off such amount.

A savings institution's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by Federal bank regulators which can order the establishment of additional general or specific loss allowances. The Federal banking agencies, have adopted an interagency policy statement on the allowance for loan and lease losses. The policy statement provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of allowances and guidance for banking agency examiners to use in determining the adequacy of general valuation guidelines. Generally, the policy statement recommends that institutions have effective systems and controls to identify, monitor and address asset quality problems; that management analyze all significant factors that affect the collectibility of the portfolio in a reasonable manner; and that management establish acceptable allowance evaluation processes that meet the objectives set forth in the policy statement. Our management believes that, based on information currently available, the Company's allowance for loan losses is maintained at a level which covers all known and inherent losses that are both probable and reasonably estimable at each reporting date. However, actual losses are dependent upon future events and, as such; further additions to the level of allowances for loan losses may become necessary.

We review and classify assets on a monthly basis and the board of directors is provided with monthly reports on our classified assets. We classify assets in accordance with the management guidelines described above. Assets in our portfolio classified as "substandard" amounted to $8.5 million, including $4.0 million of other real estate owned, at September 30, 2013 compared to $40.2 million, in the aggregate, including $4.6 million of other real estate owned, at September 30, 2012. We had no assets classified doubtful at September 30, 2013 compared to $351,000 at September 30, 2012. Assets designated as ?special mention? totaled $3.8 million at September 30, 2013 compared to $7.7 million at September 30, 2012. We attribute the improvement in the aggregate amount of our classified assets and assets designated special mention primarily to $14.3 million in charge-offs and the transfer of classified and criticized loans with an aggregate book balance of $19.6 million (before charge-offs) to held-for-sale as well as our enhanced loan

monitoring, collection and charge-off efforts combined with the reductions in the size of our loan portfolio and our holdings of other real estate owned. We had no loans classified as loss at September 30, 2013 or 2012.

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Delinquent Loans. The following table shows the delinquencies in our loan portfolio as of the dates indicated. The table does not include loans held for sale at September 30, 2013.

	At September 30, 2013 Loans Delinquent For:											
	31-89 Days				90 Days and Over				Total Delinquent Loans			
	Number	Amount	Percent of Total Delinquent Loans 31-89 Days		Number	Amount	Percent of Total Delinquent Loans 90 Day and Over		Number	Amount	Percent of Total Delinquent Loans Greater Than 30 Days	
	(Dollars in thousands)											
Residential mortgage	8	$1,021	41.8	%	11	$1,295	68.1	%	19	$2,316	53.3	%
Commercial:												
Commercial real estate	2	155	6.3		-	-	-		2	155	3.6	
Consumer:												
Home equity lines of credit	-	-	-		2	34	1.8		2	34	0.8	
Second mortgages	18	1,262	51.7		12	572	30.1		30	1,834	42.2	
Other	3	5	0.2		-	-	-		3	5	0.1	
Total	31	$2,443	100.0	%	25	$1,901	100.0	%	56	$4,344	100.0	%

	At September 30, 2012 Loans Delinquent For:											
	31-89 Days				90 Days and Over				Total Delinquent Loans			
	Number	Amount	Percent of Total Delinquent Loans 31-89 Days		Number	Amount	Percent of Total Delinquent Loans 90 Day and Over		Number	Amount	Percent of Total Delinquent Loans Greater Than 30 Days	
	(Dollars in thousands)											
Residential mortgage	7	$1,402	30.9	%	14	$3,540	36.3	%	21	$4,942	34.6	%
Construction and Development:												
Residential and commercial	-	-	-		7	3,788	38.8		7	3,788	26.5	
Commercial:												
Commercial real estate	2	1,778	39.1		2	1,458	15.0		4	3,236	22.6	
Other	-	-	-		1	201	2.1		1	201	1.4	
Consumer:												
Home equity lines of credit	2	220	4.8		1	23	0.2		3	243	1.7	
Second mortgages	17	1,140	25.1		9	739	7.6		26	1,879	13.2	
Other	4	4	0.1		-	-	-		4	4	-	
Total	32	$4,544	100.0	%	34	$9,749	100.0	%	66	$14,293	100.0	%

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The table below sets forth information on our classified assets and assets designated special mention held in portfolio at the dates indicated. The table does not include loans held for sale at September 30, 2013.

	September 30,		
	2013	2012	2011
	(In thousands)		
Classified assets:			
Substandard(1)	$8,482	$40,226	$39,860
Doubtful	-	351	1,095
Loss	-	-	-
Total classified assets	8,482	40,577	40,955
Special mention assets	3,816	7,657	12,685
Total classified and special mention assets	$12,298	$48,234	$53,640

(1) Includes other real estate owned of $4.0 million, $4.6 million and $8.3 million, at September 30, 2013, 2012 and 2011, respectively.

Our total classified assets plus assets designated as special mention (assets designated special mention are assets which do not currently expose the institution to risk sufficient to warrant classification as substandard, doubtful or loss but which are deemed to have certain weaknesses) held in portfolio amounted to $12.3 million at September 30, 2013 compared to $48.2 million at September 30, 2012. Our total classified assets were $8.5 million at September 30, 2013 compared to $40.6 million at September 30, 2012. This substantial decrease was primarily driven by the transfer of certain loans to held for sale status at September 30, 2013. Other items included in the decrease are short sales, charge-offs and transfer of loans to REO which subsequently have been sold during fiscal-end 2013. The bulk loan sale included $9.8 million (after charge-offs of $9.2 in the aggregate) of loans classified substandard and $265,000 (after charge-offs of $313,000 in the aggregate) of loans deemed to be special mention.

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Non-Performing Loans and Real Estate Owned. The following table sets forth non-performing assets and performing troubled debt restructurings held in our portfolio which are neither non-accruing nor more than 90 days past due and still accruing in our portfolio at the dates indicated. Loans are generally placed on non-accrual status when they are 90 days or more past due as to principal or interest or when the collection of principal and/or interest becomes doubtful. There were no loans past due 90 days or more and still accruing interest for the periods shown. Troubled debt restructurings are loans which are modified in a manner constituting a concession to the borrower, such as forgiving a portion of interest or principal making loans at a rate materially less than that of market rates, when the borrower is experiencing financial difficulty. The table does not include loans held for sale at September 30, 2013. At September 30, 2013, our loans held for sale included $11.2 million in non-accruing loans and $3.4 million in performing TDRs.

	September 30,				
	2013	2012	2011	2010	2009
	(Dollars in thousands)				
Non-accruing loans:					
Residential mortgage	$1,295	$3,540	$2,866	$8,354	$3,809
Construction and Development:					
Residential and commercial	-	3,788	6,617	1,393	7,086
Commercial:					
Commercial real estate	-	1,458	1,765	4,476	785
Multi-family	-	-	-	1,093	-
Other	-	201	229	-	35
Consumer:					
Home equity lines of credit	34	23	61	457	407
Second mortgages	572	739	1,377	4,085	2,072
Other	-	-	-	3	1
Total non-accruing loans	1,901	9,749	12,915	19,861	14,195
Accruing loans delinquent more than 90 days past due	-	-	-	-	-
Real estate owned and other foreclosed assets:					
Residential mortgage	725	1,262	3,872	1,538	1,568
Construction and Development:					
Residential and commercial	675	-	-	1,085	196
Commercial:					
Commercial real estate	1,929	2,405	4,415	2,602	4,006
Multi-family	81	486	-	70	-
Other	174	-	34	20	20
Consumer:					
Second mortgages	378	441	-	-	85
Total	3,962	4,594	8,321	5,315	5,875
Total non-performing assets	$5,863	$14,343	$21,236	$25,176	$20,070
Performing troubled debt-restructurings:					