MALVERN FEDERAL BANCORP INC
Form 10-K
December 20, 2011

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, 2011

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: 001-34051

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

United States (State or Other Jurisdiction of Incorporation or Organization)	38-3783478 (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 2,245,347 shares of the Registrant's common stock held by non-affiliates, based upon the closing price of $8.72 for the common stock on March 31, 2011, reported by the NASDAQ Stock Market, was approximately $19.6 million. Shares of common stock held by the registrant's parent, Malvern Federal Mutual Holding Company and its executive officers, directors and certain benefit plans have been excluded since such persons may be deemed to be affiliates. 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 19, 2011 was 6,102,500.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2012 Annual Meeting of Shareholders are incorporated by reference into Part III, Items 10-14 of this Form 10-K.

MALVERN FEDERAL BANCORP, INC.
2011 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 Federal 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 futu conditional terms such as “will,” “would,” “should,” “could,” “may,” “likely,” “probably,” or “possibly.” Forward looking s include, but are not limited to, financial projections and estimates and their underlying assumptions; statements regarding plans, objectives and expectations with respect to future operations, products and services; and statements regarding future performance. Such statements are subject to certain risks, uncertainties and assumption, many of which are difficult to predict and generally are beyond the control of Malvern Federal 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 Federal 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 Federal Bancorp, Inc. will be engaged. Malvern Federal 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.

As used in this report, unless the context otherwise requires, the terms “we,” “our,” “us,” or “the Company” refer to Malver Federal Bancorp, Inc., a Federal corporation, and the term the “Bank” refers to Malvern Federal Savings Bank, a federally chartered savings bank and wholly owned subsidiary of the Company. In addition, unless the context otherwise requires, references to the operations of the Company include the operations of the Bank.

PART I

Item 1. Business.

General

In 2008, Malvern Federal Savings Bank (“Malvern Federal Savings” or the “Bank”) completed its reorganization to the mutual holding company form of organization and formed Malvern Federal Bancorp, Inc. (the “Company”) to serve as the stock holding company for the Bank. In connection with the reorganization, the Company sold 2,645,575 shares of its common stock to certain members of the Bank and the public at a purchase price of $10.00 per share. In addition, the Company issued 3,383,875 shares, or 55% of the outstanding shares, of its common stock to Malvern Federal Mutual Holding Company, a federally chartered mutual holding company (the “Mutual Holding Company”), and contributed 123,050 shares (with a value of $1.2 million), or 2.0% of the then outstanding shares, to the Malvern Federal Charitable Foundation, a newly created Delaware charitable foundation.

The Company is a federally chartered corporation which owns all of the issued and outstanding shares of the Bank’s common stock, the only 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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Malvern Federal Savings is a federally chartered community-oriented savings bank which was originally organized in 1887 and is headquartered in Paoli, Pennsylvania. The Bank currently conducts its business from its headquarters and eight additional financial centers.

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 ("FHLB") of Pittsburgh. 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. Malvern Federal Savings' 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.

Until recently, the Bank, the 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 the Holding Company and Mutual Holding Company, which are savings and loan holding companies, 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 Enacted 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 with an emphasis on originating various residential loan products to hold in its portfolio. Approximately eight years ago, we determined to shift the emphasis on the loan products we offer and increased our efforts to originate commercial real estate loans, construction and development loans and consumer loans. We determined to originate greater amounts of commercial real estate loans, construction and development loans and consumer loans because we believed we could compete effectively as a niche lender in our market area for such loans given management's knowledge of, and its extensive network of contacts in, the small to mid-sized businesses community in southeastern Pennsylvania. In addition, commercial real estate loans, construction and development loans and consumer loans are deemed attractive due to their generally higher yields and shorter anticipated lives compared to single-family residential mortgage loans. Given the increase in the level of our non-performing assets, in light of the increased risk represented by commercial real estate loans and construction and developments loans and due to regulatory constraints imposed by the OTS during fiscal 2010, we generally ceased originating any new commercial real estate loans and construction and development loans.

In October 2010, the Company, the Bank 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 and the Mutual Holding Company. The agreements provide, among other things, that within specified time frames:

the Bank was required to submit an updated, comprehensive business plan to the OTS that, among other things, addressed the Bank's strategy to improve core earnings, maintain appropriate levels of liquidity and achieve profitability on a consistent basis. The Bank must submit quarterly reports to the OCC (and, previously, the OTS) regarding the Bank's compliance with the plan. We submitted an updated business plan to the OTS in accordance with the terms of the Supervisory Agreement and continue to submit the quarterly reports to the OCC as required;

the Bank must ensure that its financial reports to the OCC (and, previously, the OTS) are accurately prepared and timely filed in accordance with applicable law, regulations and regulatory guidance;

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the Bank was required to submit a written internal asset review and classification program to the OTS that, among other things, ensures the accurate and timely identification and classification of the Bank's classified and criticized assets, and requires asset reviews for commercial real estate, construction and land development, multi-family and commercial loans by an independent third-party loan review consultant not less than every six months. We submitted an internal asset review and classification program to the OTS in accordance with the terms of the Supervisory Agreement and are continuing to obtain the third-party loan reviews as required;

the Bank was required to submit to the OTS a detailed, written plan with targeted levels of the Bank's problem assets (as defined), describing the Bank's strategies to reduce the levels of its problem assets to the targeted levels and the development of specific workout plans for problem assets in the amount of $500,000 or more and it must submit quarterly asset reports to the OCC (and, previously, the OTS) regarding, among other things, its compliance with such plans. The original plan addressing the levels of the Bank's problem assets was submitted to the OTS in accordance with the terms of the Supervisory Agreement and we are continuing to submit the quarterly reports as required;

the Bank was required to revise its policies, procedures and methodologies relating to the allowance for loan and lease losses ("ALLL") to be in compliance with all applicable laws, regulations and regulatory guidance, and it must provide for a quarterly independent third-party review and validation of its ALLL. The Bank has revised its policies, procedures and methodologies relating to ALLL and submitted them to the OTS in accordance with the terms of the Supervisory Agreement and we are continuing to obtain the third-party ALLL reviews as required;

the Bank was required to submit to the OTS a written program of its policies and procedures for identifying, monitoring and controlling risks associated with concentrations of commercial real estate credit which, among other things, establishes comprehensive concentration limits, provides for specific review procedures and reporting requirements to identify, monitor and control risks associated with concentrations of credit and contain a written action plan, with specific time frames, for bringing the Bank into compliance with its concentration of credit limits. The policies and procedures for identifying, monitoring and controlling risks associated with concentrations of commercial real estate credit were submitted to the OTS in accordance with the terms of the Supervisory Agreement;

the Bank may not make, invest in, or purchase any new commercial real estate loans and/or commercial and industrial loans without the prior written non-objection of the OCC (and, previously, the OTS), other than with respect to any refinancing, extension or modification of an existing commercial real estate or commercial and industrial loan where no new funds are advanced;

the Bank was required to develop and implement an information technology policy. The information technology policy has been developed and is being implemented in accordance with the terms of the Supervisory Agreement;

the Company and the Mutual Holding Company are prohibited from declaring or paying dividends or making any other capital distributions (as defined) without receiving the prior written approval of the FRB (and, previously, the OTS); and

the Company and the Mutual Holding Company are required to ensure the Bank's compliance with its Supervisory Agreement.

As a result of the Supervisory Agreement with Malvern Federal Savings, the Bank is subject to certain additional restrictions pursuant to regulations of the OTS, including the following:

The Bank must limit its asset growth in any quarter to an amount which does not exceed the net interest credited on deposit liabilities during the quarter, unless otherwise permitted by the OCC (and, previously, the OTS);

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The Bank is required to provide the OCC (and, previously, the OTS) with prior notice of any new director or senior executive officer;

The Bank is restricted from making any "golden parachute payments," as defined;

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);

The Bank may not declare or pay any dividends or make other capital distributions without the prior written approval of the OCC (and, previously, the OTS);

The Bank's ability to engage in transactions with affiliates, as defined, is restricted; and

The Bank may not engage in the use of brokered deposits without the prior written non-objection of the OCC (and, previously, the OTS).

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 headquarters and eight financial centers located throughout Chester and Delaware Counties, 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 76 other banks, credit unions and savings institutions are operating. 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.

Lending Activities

General. At September 30, 2011, our net loan portfolio totaled $506.0 million or 75.9% 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. During fiscal 2010, we discontinued, with certain exceptions, the origination of any new commercial real estate loans and construction and development loans, but we continue to be an originator of consumer loan products. Our consumer loans consist primarily of home equity loans, second mortgage loans and lines of credit. Pursuant to the terms of the Supervisory Agreement, we may not make,

invest in or purchase any new commercial real estate loans and/or commercial and industrial loans without the prior written non-objection of the OCC, other than with respect to any refinancing, extension or modification of an existing commercial real estate or commercial and industrial loan where no new funds are advanced.

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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.

	September 30,									
	2011		2010		2009		2008		2007	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Residential mortgage(1)	$229,330	44.7 %	$230,966	41.8 %	$252,308	42.4 %	$248,118	43.3 %	$193,460	40.4 %
Construction and Development:										
Residential and commercial	26,005	5.0	30,429	5.5	37,508	6.3	45,451	7.9	58,870	12.4
Land loans	2,722	0.6	2,989	0.6	3,237	0.6	4,530	0.8	6,665	1.4
Total construction and development loans	28,727	5.6	33,418	6.1	40,745	6.9	49,981	8.7	65,535	13.8
Commercial:										
Commercial real estate	131,225	25.5	143,095	25.9	142,863	24.0	138,522	24.2	108,500	22.7
Multi-family	5,507	1.1	6,493	1.2	9,613	1.6	1,906	0.3	2,257	0.5
Other	10,992	2.1	11,398	2.1	15,647	2.6	17,260	3.0	15,767	3.3
Total commercial loans	147,724	28.7	160,986	29.2	168,123	28.2	157,688	27.5	126,524	26.5
Consumer:										
Home equity lines of credit	20,735	4.0	19,927	3.6	19,149	3.2	12,393	2.2	11,811	2.5
Second mortgages	85,881	16.8	105,825	19.1	113,943	19.1	103,741	18.1	78,733	16.5
Other	788	0.2	1,086	0.2	1,143	0.2	1,304	0.2	1,525	0.3
Total consumer loans	107,404	21.0	126,838	22.9	134,235	22.5	117,438	20.5	92,069	19.3
Total loans	513,185	100.0%	552,208	100.0%	595,411	100.0%	573,225	100.0%	477,588	100.0%
Deferred loan costs, net	2,935		3,272		3,872		3,816		2,404	
Allowance for loan losses	(10,101)		(8,157)		(5,718)		(5,505)		(4,541)	
Loans receivable, net	$506,019		$547,323		$593,565		$571,536		$475,451	

(1) Includes $9.3 million of loans held for sale at September 30, 2007.

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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,									
	2011		2010		2009		2008		2007	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Fixed-Rate Loans:										
Residential mortgage(1)	$211,405	41.2 %	$201,285	36.4 %	$227,712	38.2 %	$218,214	38.1 %	$163,463	34.2 %
Construction and Development:										
Residential and commercial	4,250	0.8	968	0.2	5,382	0.9	4,505	0.8	8,626	1.8
Land loans	1,376	0.3	1,312	0.3	1,558	0.3	1,575	0.2	1,591	0.3
Total fixed-rate construction and development loans	5,626	1.1	2,280	0.5	6,940	1.2	6,080	1.0	10,217	2.1
Commercial:										
Commercial real estate	40,231	7.8	40,833	7.4	56,126	9.4	52,406	9.1	35,053	7.4
Multi-family	932	0.2	950	0.2	3,519	0.6	--	--	--	--
Other	1,643	0.3	1,733	0.3	3,798	0.6	4,441	0.8	3,847	0.8
Total fixed-rate commercial loans	42,806	8.3	43,516	7.9	63,443	10.6	56,847	9.9	38,900	8.2
Consumer:										
Home equity lines of credit	--	--	--	--	--	--	--	--	--	--
Second mortgages	85,881	16.8	105,825	19.1	113,943	19.1	103,741	18.1	78,706	16.5
Other	552	0.1	822	0.1	867	0.2	960	0.2	1,097	0.2
Total fixed-rate consumer loans	86,433	16.9	106,647	19.2	114,810	19.3	104,701	18.3	79,803	16.7
Total fixed-rate loans	$346,270	67.5	$353,728	64.0	$412,905	69.3	$385,842	67.3	$292,383	61.2
Adjustable-Rate Loans:										
Residential mortgage	$17,925	3.5 %	$29,681	5.4 %	$24,596	4.1 %	$29,904	5.2 %	$29,998	6.3 %
Construction and Development:										
Residential and commercial	21,755	4.2	29,461	5.3	32,126	5.4	40,946	7.1	50,244	10.5
Land loans	1,346	0.3	1,677	0.3	1,679	0.3	2,955	0.5	5,074	1.1
	23,101	4.5	38,138	5.6	33,805	5.7	43,901	7.6	55,318	11.6

Total adjustable-rate construction and development loans										
Commercial:										
Commercial real estate	90,994	17.7	102,262	18.5	86,737	14.6	86,116	15.0	73,448	15.4
Multi-family	4,575	0.9	5,543	1.0	6,094	1.0	1,906	0.4	2,257	0.5
Other	9,349	1.8	9,665	1.8	11,849	2.0	12,819	2.2	11,920	2.5
Total adjustable-rate commercial loans	104,918	20.4	117,470	21.3	104,680	17.6	100,841	17.6	87,625	18.4
Consumer:										
Home equity lines of credit	20,735	4.0	19,927	3.6	19,149	3.2	12,393	2.2	11,811	2.4
Second mortgages	--	--	--	--	--	--	--	--	26	--
Other	236	0.1	264	0.1	276	0.1	344	0.1	427	0.1
Total adjustable-rate consumer loans	20,971	4.1	20,191	3.7	19,425	3.3	12,737	2.3	12,264	2.5
Total adjustable-rate loans	$166,915	32.5 %	$198,480	36.0 %	$182,506	30.7 %	$187,383	32.7 %	$185,205	38.8 %
Total loans(1)	$513,185	100.0%	$552,208	100.0%	$595,411	100.0%	$573,225	100.0%	$477,588	100.0%

(1) Includes $9.3 million of fixed-rate, single-family residential loans held for sale at September 30, 2007.

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Loan Maturity. The following table presents the contractual maturity of our loans at September 30, 2011. The table does not include the effect of prepayments or scheduled principals amortization. Loans having no stated repayment schedule or maturity and overdraft loans are reported as being due in one year or less.

		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
				(Dollars in thousands)						
Amounts due in:										
One year or less	$190	$ 14,713	$ 1,662	$7,089	$ -	$1,118	$300	$ 105	$26	$25,203
After one year through two years	669	-	-	3,209	200	332	-	378	132	4,920
After two years through three years	1,212	-	-	5,338	-	1,568	-	584	203	8,905
After three years through five years	4,276	3,754	928	25,416	932	141	72	1,831	179	37,529
After five years through ten years	30,511	6,693	132	70,045	3,813	3,753	-	14,121	-	129,068
After ten years through fifteen years	33,146	-	-	8,606	-	2,139	5,189	27,357	6	76,443
Beyond fifteen years	159,326	845	-	11,522	562	1,941	15,174	41,505	242	231,117
Total	$229,330	$ 26,005	$ 2,722	$131,225	$ 5,507	$10,992	$20,735	$ 85,881	$788	$513,185
Interest rate terms on amounts due after one year:										
Fixed rate	$211,214	$ 4,251	$ 530	$39,056	$ 932	$1,636	$-	$ 85,776	$526	$343,921
	17,926	7,041	530	85,080	4,575	8,238	20,435	-	236	144,061

Adjustable rate										
Total	$229,140	$ 11,292	$ 1,060	$124,136	$ 5,507	$9,874	$20,435	$ 85,776	$762	$487,982

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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 existing customers as well as new customers obtained from referrals and local advertising and promotional efforts. In addition, we rely on a network of approximately ten 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, 2011 we had no, sub-prime loans in our portfolio.

In addition to originating loans, we occasionally purchase 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, 2011, the largest loan participation interests from other institutions were comprised of seven loans to three borrowers and their affiliates, which had an outstanding balance of approximately $9.9 million. Of those seven loans, four construction and development loans to three borrowers and their affiliates, which had an aggregate outstanding balance on our books of $5.2 million at September 30, 2011, were impaired and on non-accrual status at such date. See "Asset Quality – Non-Performing Loans and Real Estate Owned."

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In addition, we also 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. At September 30, 2011, our five largest outstanding loans to one borrower and related entities amounted to $9.0 million, $8.5 million, $8.4 million, $6.9 million and $5.6 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 (20 or 30 year term) fixed-rate single family residential mortgage loans to Freddie Mac and Fannie Mae 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.

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.

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

	Year Ended September 30,		
	2011	2010	2009
	(Dollars in thousands)		
Total gross loans at beginning of period	$552,208	$595,411	$573,225
Originations by type:			
Residential mortgage	35,378	26,422	37,842
Construction and Development:			
Residential and commercial	3,890	7,250	16,015
Land loans	36	40	318
Commercial:			
Commercial real estate	3,146	28,354	32,494
Multi-family	494	45	10,431
Other	3,426	3,836	5,105
Consumer:			
Home equity lines of credit	11,289	10,965	19,309
Second mortgages	6,719	6,952	6,103
Other	608	1,139	884
Total originations	64,986	85,003	128,501
Principal Repayments:			
Residential mortgage	54,691	53,338	59,838
Construction and Development:			
Residential and commercial	7,750	13,244	23,763
Land loans	235	287	1,612
Commercial:			
Commercial real estate	7,387	25,519	24,167
Multi-family	1,335	3,095	2,727
Other	3,542	8,063	6,696
Consumer:			
Home equity lines of credit	10,034	10,313	12,595
Second mortgages	28,848	25,935	27,250
Other	882	1,196	1,044
Total principal repayments	114,704	140,990	159,692
Net loan originations and principal repayments	(49,718)	(55,987)	(31,191)
Purchases:			
Residential mortgage(1)	27,683	10,130	28,293
Construction and Development:			
Residential and commercial	125	-	-
Consumer:			
Home equity lines of credit	-	131	58
Second mortgages	4,560	11,098	31,964
Total purchased	32,368	21,359	60,315
Sales:			
Residential mortgage	-	-	-
Construction and Development:			
Residential and commercial	-	-	-
Other adjustments, net(2)	(21,673)	(8,575)	(6,938)
Net increase (decrease)	(39,023)	(43,203)	22,186

Total gross loans at end of period	$513,185	$552,208	$595,411

(1) Includes purchases of loans from our network of loan brokers.
(2) Reflects non-cash items related to transfers of loans to other real estate owned, recoveries and charge-offs.

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Residential Lending. Residential mortgage originations are secured primarily by properties located in the Company's primary market area and surrounding areas. At September 30, 2011, $229.3 million, or 44.7%, of our total loans 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 Business Development Officer 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 15 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, 2011, $17.9 million, or 7.8%, of our one- to four-family residential loans consisted of ARM loans. 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 $2.4 million in the aggregate at September 30, 2011. One NINA loan with an outstanding balance of $506,000 at September 30, 2011, was impaired and on non-accrual status at such date.

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. During fiscal 2010, we generally ceased originating any new construction and development loans. Previously, we originated construction loans for residential and, to a lesser extent, commercial uses within its market area. We generally limited construction loans to builders and developers with whom we had an established relationship, or who were otherwise known to officers of the Bank. The amount of our outstanding construction and development loans decreased to $28.7 million or 5.6% of total loans at September 30, 2011 from $33.4 million or 6.1% of total loans as of September 30, 2010. 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, 2011, approximately 80.4% of our construction loans had variable rates of interest and 57.0% 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 required that an independent appraiser prepare an appraisal of the property. Each project also was 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. Monthly payment of interest is required on all construction loans and we often established interest reserves on construction loans to developers, which helped ensure interest payments are received during the construction period.

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We also made construction 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 80% 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 $2.7 million loans secured by unimproved real estate and lots ("land loans"), constituting 0.6% of total loans at September 30, 2011. As previously indicated, we generally have ceased making any new land loans. Our three largest land loans, with outstanding balances of $762,000, $635,000 and $530,000, respectively, at September 30, 2011, comprised 70.8% of our land loans at such date. These loans are to local developers for the purpose of acquiring raw land in Chester County, Pennsylvania, subdividing and improving such land and then selling the developed lots to nationally known homebuilders. These loans have performed in accordance with their terms since their originations in 2005 and 2004, respectively. We had no non-performing land loans at September 30, 2011. Two land loans in the aggregate amount of $1.2 million were classified as substandard at September 30, 2011.

Our construction and development loans also include loans made to consumers for the construction of their individual homes underwritten on a construction/permanent basis. During the initial or construction phase, these 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.

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, 2011, the amounts outstanding on our five largest residential construction loans were approximately $1.4 million, $1.1 million, $1.1 million, $706,000 and $639,000. At September 30, 2011, the amounts outstanding on our five largest commercial construction or development loans were $3.5 million, $3.3 million, $3.0 million, $2.0 million and $1.1 million. The average size of our construction loans was approximately $619,000 at September 30, 2011. 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, 2011, $1.7 million, or 16.6%, of our allowance for loan losses was attributed to construction and development loans. Our non-performing construction and development loans amounted to $6.6 million at September 30, 2011 compared to $1.4 million at September 30, 2010. During the fiscal year ended September 30, 2011, we charged off a total of $1.3 million in construction and development loans including an $800,000 partial charge-off on a $3.0 million participation interest in two construction and development loans for the construction of 64 units of a proposed 198 unit age-restricted condominium community located in Delaware County. The remaining carrying value on such participation interest at September 30, 2011 was $1.9 million. In addition, we took a $400,000 partial charge-off on a $2.4 million participation interest in a construction and development loan for the development of commercial and mixed use facilities on approximately 40 acres located in Mount Laurel, New Jersey reducing our carrying value to $2.0 million at September 30, 2011. See "Asset Quality – Non-Performing Assets and Real Estate Owned." In addition to our non-performing construction and development loans, at September 30,

2011 and 2010, we had $1.2 million in construction and development loans that were performing troubled debt restructurings.

Commercial Lending. During fiscal 2010, the Company generally ceased originating new commercial real estate, multi-family real estate mortgage loans, or commercial business loans and we are no longer purchasing whole loans or participation interests in commercial loans from other financial institutions. The Supervisory Agreement, which became effective in October 2010, prohibits 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.

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, or 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.

At September 30, 2011, our loans secured by commercial real estate amounted to $131.2 million and constituted 25.5% of our total loans at such date. During the year ended September 30, 2011, the commercial real estate loan portfolio decreased by $11.9 million, or 8.3% due primarily to our ceasing, with certain exceptions, originations of new commercial real estate loans. As previously indicated, the Supervisory Agreement executed in October 2010 prevents us from making, investing in or purchasing any new multi-family residential loans, commercial real estate loans and/or commercial and industrial loans without the prior written non-objection of the OCC (or, prior to July 21, 2011, the OTS), other than with respect to any refinancing, extension or modification of an existing loan where no new funds are advanced. In addition to loan payoffs and normal amortization, the reduction of our commercial loan portfolio during fiscal 2011 reflects charge-offs of $2.5 million of commercial real estate loans and the transfer of $6.5 million in commercial real estate loans to other real estate owned ("REO") during the fiscal year ended September 30, 2011.

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 will occasionally exceed that amount. At September 30, 2011, the average amount outstanding on our commercial real estate loans was $442,000. The five largest commercial real estate loans outstanding were $7.6 million, $5.5 million, $4.5 million, $4.5 million and $4.3 million at September 30, 2011. During the year ended September 30, 2011, the average yield on our commercial real estate loans was 5.8% compared to 5.3% 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, 2011, approximately 69.3% of our commercial real estate loans had adjustable interest rates compared to 7.8% 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 loan 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, 2011, our loan portfolio included $5.5 million of multi-family (more than four units) loans, constituting 1.1% of our total loans at such date. The two largest multi-family loans, with outstanding balances of $1.9 million and $932,000, respectively, at September 30, 2011, comprised 51.4% of our multi-family loans at such date. These loans are for properties located in Chester County and Delaware County, Pennsylvania, respectively. As of September 30, 2011 we had no non-accruing multi-family loans. All the multi-family loans have performed in accordance with their terms, although one additional multi-family loan, with an outstanding balance of $597,000, was classified as substandard as of September 30, 2011.

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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, 2011, $1.8 million or 1.4% of our commercial real estate mortgage loans were on non-accrual status and an aggregate of $16.3 million of our commercial real estate loans at such date were classified for regulatory reporting purposes with $16.1 million classified substandard and $225,000 classified doubtful. See "Asset Quality – Asset Classification." As of September 30, 2011, $4.2 million, or 41.4% of our allowance for loan losses was allocated to commercial real estate mortgage loans. In addition, at September 30, 2011 we held $4.4 million of commercial real estate as real estate owned. See "Asset Quality – Non-Performing Assets and Real Estate Owned." During the fiscal year ended September 30, 2011, we charged off an aggregate of $2.5 million in commercial real estate loans. In addition to our non-performing commercial real estate loans and commercial real estate owned, we had $7.9 million and $7.7 million of commercial real estate loans deemed performing troubled debt restructurings at September 30, 2011 and 2010, respectively.

At September 30, 2011, we had $11.0 million in commercial business loans (2.1% of gross loans outstanding). Our commercial business loans generally are 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 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, 2011, the average balance of our commercial business loans was $204,000. As previously indicated, the Supervisory Agreement prevents us from making, investing in or purchasing any new commercial business loans (which are referred to as commercial and industrial loans in such agreement) without the prior written non-objection of the OTS (now, the OCC), other than with respect to any refinancing, extension or modification of an existing loan where no new funds are advanced.

Generally, commercial business loans are characterized as having higher risks associated with them than single-family residential mortgage loans. As of September 30, 2011, we had two non-accruing commercial business loans with an aggregate balance of $229,000. At such date, $317,000 or 3.1% of the allowance for loan losses was allocated to commercial business loans. During the past five fiscal years, we have charged off an aggregate of $282,000 of commercial business loans.

Prior to our cessation of new originations of commercial real estate, multi-family residential and commercial business loans, various aspects of a commercial real estate, multi-family loan and commercial business loan transactions were evaluated in an effort to mitigate the additional risk in these types of loans. In our underwriting procedures, consideration was 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 was 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 would 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.

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Consumer Lending Activities. 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 $107.4 million or 21.0% of our total loan portfolio at September 30, 2011. The largest components of our consumer loans are loans secured by second mortgages, consisting primarily of home equity loans, which amounted to $85.9 million at September 30, 2011, and home equity lines of credit, which amounted to $20.7 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 80% 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 80%. We offer home equity lines on a revolving line of credit basis, with interest tied to the prime rate. At September 30, 2011, the unused portion of our home equity lines of credit was $23.7 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, 2011, we charged-off $3.9 million of consumer loans. As a result of the recent declines in the market value of real estate and the deterioration in the overall economy, 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, 2011, we had an aggregate of $1.4 million of non-accruing second mortgage loans and home equity lines of credit, representing a decrease of $3.1 million over the amount of non-accruing second mortgage loans and home equity lines of credit at September 30, 2010. At September 30, 2011, $2.2 million of our consumer loans were classified as substandard and we had no doubtful consumer loans. At September 30, 2011, an aggregate of $2.4 million of our allowance for loan losses was allocated to second mortgages and home equity lines of credit.

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 $200,000 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 $200,000. Commercial loans in amounts up to $200,000 must be approved by two designated commercial loan officers and 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 objectives is to improve asset quality. Given the stagnant economy and its effects on our market area, the increased levels of our classified and non-performing assets and the provisions of the Supervisory Agreement, we have become much more proactive in our loan monitoring, collection and workout processes in dealing with delinquent or problem loans.

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 commercial real estate loans, 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 amounted to $14.9 million and $16.0 million at September 30, 2011 and 2010, respectively.

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.

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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. For regulatory reporting purposes assets classified as "substandard" were $39.8 million, including $8.3 million of other real estate owned, and $38.2 million, at September 30, 2011 and 2010, respectively. We had $1.1 million in assets classified doubtful at September 30, 2011 compared to $3.3 million at September 30, 2010. Assets designated as "special mention" totaled $12.7 million at September 30, 2011 compared to $16.7 million at September 30, 2010. We attribute the improvement in the aggregate amount of our classified assets and assets designated special mention at September 30, 2011 compared to September 30, 2010 primarily to our enhanced loan monitoring, collection and charge-off efforts combined with the reduced size of our loan portfolio. Our efforts appear to have had some positive effect against the continuing impact of the lackluster economy on our borrowers, the increase in unemployment in the local economy and declining valuations in the collateral securing loans. We had no loans classified as loss at September 30, 2011 or 2010.

The Supervisory Agreement required us to develop and implement a written internal asset review and classification program to, among other things, require accurate and timely identification and reporting of all classified assets and to require an independent third party loan review consultant to review our commercial real estate, construction, multi-family and commercial loans not less than every six months.

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Delinquent Loans. The following table shows the delinquencies in our loan portfolio as of the dates indicated.

	At September 30, 2011 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	6	$759	28.0	%	13	$2,866	22.2	%	19	$3,625	23.2	%
Construction and Development:												
Residential and commercial	-	-	-		7	6,617	51.2		7	6,617	42.4	
Commercial:												
Commercial real Estate	1	195	7.2		3	1,765	13.7		4	1,960	12.5	
Other	1	22	0.8		2	229	1.8		3	251	1.6	
Consumer:												
Home equity lines of credit	1	16	0.6		2	61	0.5		3	77	0.5	
Second mortgages	24	1,701	62.8		17	1,377	10.6		41	3,078	19.7	
Other	2	16	0.6		-	-	-		2	16	0.1	
Total	35	$2,709	100.0	%	44	$12,915	100.0	%	79	$15,624	100.0	%

	At September 30, 2010 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	12	$1,678	38.9	%	20	$8,354	42.1	%	32	$10,032	41.5	%
Construction and Development:												
Residential and commercial	-	-	-		1	1,393	7.0		1	1,393	5.8	
Commercial:												
Commercial real Estate	1	776	18.0		8	4,476	22.5		9	5,252	21.7	
Multi-family	-	-	-		1	1,093	5.5		1	1,093	4.5	
Other	1	209	4.8		-	-	-		1	209	0.9	
Consumer:												