MALVERN BANCORP, INC.
Form 10-K
December 23, 2015

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, 2015

or

¨ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from ______ to ______

Commission File Number: 000-54835

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

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

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 ¨

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 ¨	Accelerated filer	x
Non-accelerated filer ¨	Smaller reporting company	¨

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates was approximately $78.0 million, based on the last sale price on NASDAQ Stock Market for the last business day of the Registrant's most recently completed second fiscal quarter.

The number of shares of the Issuer's common stock, par value $0.01 per share, outstanding as of December 23, 2015 was 6,558,473.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2015 Annual Meeting of Shareholders are incorporated by reference into Part III, Items 10-14 of this Form 10-K.

MALVERN BANCORP, INC.

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Information included in or incorporated by reference in this Annual Report on Form 10-K, other filings with the Securities and Exchange Commission, the Company's press releases or other public statements, contain or may contain forward looking statements. Please refer to a discussion of the Corporation's forward looking statements and associated risks in ''Item 1 — Business — Historical Development of Business'' and ''Item 1A — Risk factors'' in this Annual Report on Form 10-K.

PART I.

This report, in Item 1, Item 7 and elsewhere, includes forward-looking statements within the meaning of Sections 27A of the Securities Act of 1933, as amended, and 21E of the Securities Exchange Act of 1934, as amended, that involve inherent risks and uncertainties. This report contains certain forward-looking statements with respect to the financial condition, results of operations, plans, objectives, future performance and business of Malvern Bancorp, Inc. and its subsidiaries, including statements preceded by, followed by or that include words or phrases such as ‘‘believes,’’ ‘‘expects,’’ ‘‘anticipates,’’ ‘‘plans,’’ ‘‘trend,’’ ‘‘objective,’’ ‘‘continue,’’ ‘‘remain,’’ ‘‘pattern’’ or similar expressions or future or conditional verbs such as ‘‘will,’’ ‘‘would,’’ ‘‘should,’’ ‘‘could,’’ ‘‘might,’’ ‘‘can,’’ ‘‘may’’ or similar expressions. There are a number of important factors that could cause future results to differ materially from historical performance and these forward-looking statements. Factors that might cause such a difference include, but are not limited to: (1) competitive pressures among depository institutions may increase significantly; (2) changes in the interest rate environment may reduce interest margins; (3) prepayment speeds, loan origination and sale volumes, charge-offs and loan loss provisions may vary substantially from period to period; (4) general economic conditions may be less favorable than expected; (5) political developments, wars or other hostilities may disrupt or increase volatility in securities markets or other economic conditions; (6) legislative or regulatory changes or actions may adversely affect the businesses in which Malvern Bancorp, Inc. is engaged; (7) changes and trends in the securities markets may adversely impact Malvern Bancorp, Inc.; (8) a delayed or incomplete resolution of regulatory issues could adversely impact our planning; (9) difficulties in integrating any businesses that we may acquire, which may increase our expenses and delay the achievement of any benefits that we may expect from such acquisitions; (10) the impact of reputation risk created by the developments discussed above on such matters as business generation and retention, funding and liquidity could be significant; and (11) the outcome of regulatory and legal investigations and proceedings may not be anticipated. Further information on other factors that could affect the financial results of Malvern Bancorp, Inc. are included in Item 1A of this Annual Report on Form 10-K and in Malvern Bancorp’s other filings with the Securities and Exchange Commission. These documents are available free of charge at the Commission’s website at http://www.sec.gov and/or from Malvern Bancorp, Inc. Malvern Bancorp, Inc. assumes no obligation to update forward-looking statements at any time.

Item 1. Business

Historical Development of Business

Malvern Bancorp, Inc., a Pennsylvania corporation (the “Company” or “Malvern Bancorp”), is the holding company for Malvern Federal Savings Bank ("Malvern Federal Savings" or the "Bank") and owns all of the issued and outstanding shares of the common stock of the Bank. In connection with the “second-step” conversion and reorganization which we completed in October 2012, 3,636,875 shares of common stock, par value $0.01 per share, of Malvern Bancorp 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 federally chartered mid-tier holding company, Malvern Federal Bancorp, Inc. (the

"Mid-Tier Holding Company"), held by the "public" shareholders of the Mid-Tier Holding Company (all shareholders except Malvern Federal Mutual Holding Company).

The Bank has one subsidiary, Strategic Asset Management Group, Inc. ("SAMG"), a Pennsylvania corporation and insurance brokerage engaged in sales of property and casualty insurance, commercial insurance and life and health insurance. During September 2014, the Bank and Malvern Bancorp dissolved two former investment subsidiaries, Malvern Federal Holdings, Inc. and Malvern Federal Investments, Inc., which were Delaware corporations which previously held and managed certain investment securities.

Malvern Federal Savings Bank is a federally chartered savings bank which was originally organized in 1887. The Bank conducts business from its main office located in Paoli, Pennsylvania and its seven full service financial center offices located in Chester and Delaware Counties, Pennsylvania. The Bank's principal business consists of attracting deposits from businesses and the general public primarily in Chester County, Pennsylvania and investing those deposits, together with borrowings and funds generated from operations, in one- to four-family residential real estate loans, construction and development loans, commercial and multi-family real estate loans, commercial business loans, home equity loans and lines of credit and other consumer loans, as well as investing in investment securities. 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. We are also serving client needs in the greater Philadelphia market area. On August 19, 2015, we expanded our base of operations with the opening of a loan production office in New Jersey. The Bank's revenues are derived principally from interest on loans and investment securities, loan commitment and customer service fees and our mortgage banking operation. Our primary sources of funds are deposits, borrowings and principal and interest payments on loans and securities, as well as the sale of residential loans in the secondary market. The Bank's primary expenses are interest expense on deposits and borrowings, provisions for loan losses and general operating expenses.

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 Office of Thrift Supervision (the “OTS”). As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), effective as of July 21, 2011, the OTS was abolished, 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 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 “FRB”).

In October 2013, we completed 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 at a loss of approximately $10.1 million. This transaction dramatically reduced our non-performing asset balances and significantly improved our credit quality metrics. As a result of the sale, the Company significantly reduced its exposure to sectors that experienced economic weakness and significant declines in collateral valuations and has substantially reduced the amount of non-accruing loans completing the transformation of the Bank.

SEC Reports and Corporate Governance

The Company makes its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and amendments thereto available on its website at *www.malvernfederal.com* without charge as soon as reasonably practicable after filing or furnishing them to the SEC. Also available on the website are the Company’s corporate code of ethics that applies to all of the Company’s employees, including principal officers and directors, and charters for the Audit Committee, Compensation Committee and Nominating Committee.

Additionally, the Company will provide without charge, a copy of its Annual Report on Form 10-K to any shareholder by mail. Requests should be sent to Malvern Bancorp, Inc., Attention: Shareholder Relations, 42 East Lancaster Avenue, Paoli, Pennsylvania, 19301 and our telephone number is (610) 644-9400.

Market Area and Competition

The banking business is highly competitive. We face substantial immediate competition and potential future competition both in attracting deposits and in originating loans. We compete with numerous commercial banks, savings banks and savings and loan associations, many of which have assets, capital and lending limits larger than those that we have. Other competitors include money market mutual funds, mortgage bankers, insurance companies, stock brokerage firms, regulated small loan companies, credit unions and issuers of commercial paper and other securities.

Our larger competitors have greater financial resources to finance wide-ranging advertising campaigns.

Additionally, we endeavor to compete for business by providing high quality, personal service to customers, customer access to our decision-makers and competitive interest rates and fees. We seek to hire and retain quality employees who desire greater responsibility than may be available working for a larger employer. Additionally, the local real estate and other business activities of our Directors help us develop business relationships by increasing our profile in our communities.

Product and Services

We derive substantially all of our income from our net interest income (i.e., the difference between the interest we receive on our loans and securities and the interest we pay on deposits and other borrowings). We offer a broad range of deposit and loan products. In addition, to attract the business of consumer and business customers, we also provide a broad array of other banking services. Products and services provided include personal and business checking accounts, retirement accounts, money market accounts, time and savings accounts, credit cards, wire transfers, access to automated teller services, internet banking, ACH origination, telephone banking, and mobile banking by phone. In addition, we offer safe deposit boxes. The Bank also offers remote deposit capture banking for business customers, providing the ability to electronically scan and transmit checks for deposit, reducing time and cost. In addition the Bank offers mobile remote deposit capture banking for both retail and business customers, providing the convenience to deposit on the go.

Checking account products consist of both retail and business demand deposit products. Retail products include free checking and, for businesses, both interest-bearing accounts, which require a minimum balance, and non-interest bearing accounts. NOW accounts consist of both retail and business interest-bearing transaction accounts that have minimum balance requirements. Money market accounts consist of products that provide a market rate of interest to depositors but have limited check writing capabilities. Our savings accounts consist of statement type accounts. Time deposits consist of certificates of deposit, including those held in IRA accounts. CDARS/ICS Reciprocal deposits are offered based with the Bank’s participation in Promontory Interfinancial Network, LLC. Customers who are FDIC insurance sensitive are able to place large dollar deposits with the Company and the Company uses CDARS to place those funds into certificates of deposit issued by other banks in the Network. This occurs in increments of less than the FDIC insurance limits so that both the principal and interest are eligible for complete FDIC insurance coverage. The FDIC currently considers these funds as brokered deposits.

The Bank, with it’s partnership with Bell Rock Capital, offers through its private banking and wealth management division personalized wealth management and advisory service to high net worth individuals and families. Services provided include liquidity management, investment services, custody, wealth planning, trust and fiduciary services, insurance and 401k services.

Deposits serve as the primary source of funding for our interest-earning assets, but also generate non-interest revenue through insufficient funds fees, stop payment fees, safe deposit rental fees, card income, including ATM fees and credit and debit card interchange, gift card fees, and other miscellaneous fees. In addition, the Bank generates additional non-interest revenue associated with residential loan origination and sale, loan servicing, late fees and merchant services.

We offer personal and commercial business loans on a secured and unsecured basis, revolving lines of credit, commercial mortgage loans, and residential mortgages on both primary and secondary residences, home equity loans, bridge loans and other personal purpose loans. However, we are not and have not historically been a participant in the sub-prime lending market.

Commercial loans are loans made for business purposes and are primarily secured by collateral such as cash balances with the Bank, marketable securities held by or under the control of the Bank, business assets including accounts receivable, inventory and equipment, and liens on commercial and residential real estate.

Commercial construction loans are loans to finance the construction of commercial or residential properties secured by first liens on such properties. Commercial real estate loans include loans secured by first liens on completed commercial properties, including multi- family properties, to purchase or refinance such properties. Residential mortgages include loans secured by first liens on residential real estate, and are generally made to existing customers of the Bank to purchase or refinance primary and secondary residences. Home equity loans and lines of credit include loans secured by first or second liens on residential real estate for primary or secondary residences.

Consumer loans are made to individuals who qualify for auto loans, cash reserve, credit cards and installment loans.

The Bank's lending policies generally provide for lending inside of our primary trade area. However, the Bank will make loans to persons outside of our primary trade area when we deem it prudent to do so. In an effort to promote a high degree of asset quality, the Bank focuses primarily upon offering secured loans. However, the Bank does make short-term unsecured loans to borrowers with high net worth and income profiles. The Bank generally requires loan customers to maintain deposit accounts with the Bank. In addition, the Bank generally provides for a minimum required rate of interest in its variable rate loans. We believe that having senior management on-site allows for an enhanced local presence and rapid decision-making that attracts borrowers**.** The Bank's legal lending limit to any one borrower is 15% of the Banks's capital base (defined as tangible equity plus the allowance for loan losses) for most loans ($10.4 million) and 25% of the capital base for loans secured by readily marketable collateral ($17.3 million). At September 30, 2015, the Bank's largest committed relationship totaled $10.0 million.

Our business model includes using industry best practices for community banks, including personalized service, state-of-the-art technology and extended hours. We believe that this will generate deposit accounts with somewhat larger average balances than we might attract otherwise. We also use pricing techniques in our efforts to attract banking relationships having larger than average balances.

Supervision and Regulation

The banking industry is highly regulated. Earnings of the Company are affected by state and federal laws and regulations and by policies of various regulatory authorities. Changes in applicable law or in the policies of various regulatory authorities could affect materially the business and prospects of the Company and the Bank. The following discussion of supervision and regulation is qualified in its entirety by reference to the statutory and regulatory provisions discussed.

On October 7, 2014, the Bank entered into a formal written agreement (the “Formal Agreement”) with the OCC. The Formal Agreement provides, among other things, that within specified time frames, the Bank will:

- establish a Compliance Committee of its Board of directors to monitor and coordinate the Bank’s adherence to the Formal Agreement and to prepare periodic reports describing the Bank’s progress in complying with the Formal Agreement;

- ensure that it has competent management in place, undertake periodic reviews of the Bank’s management, implement a program to enhance and improve the skills the Bank’s management team, where necessary, act to fill any vacancies among the Bank’s senior executive officers within prescribed timeframes and in accordance with regulations of the OCC;

- revise its written strategic plan and submit such revised plan to the OCC for review, with such strategic plan establishing objectives for the Bank’s overall risk profile, earnings performance, growth, balance sheet mix, off-balance sheet activities, liability structure, capital and liquidity adequacy, and tolerance for interest rate risk, together with strategies to achieve the Bank’s objectives;

- revise its capital plan consistent with its revised strategic plan, and submit such revised capital plan to the OCC, with such revised capital plan providing specific plans for the Bank’s maintenance of adequate capital, determining the Bank’s capital needs in relation to material risks and the Bank’s strategic direction, identifying and establishing a strategy to maintain capital adequacy and strengthen capital if necessary, and providing for specific plans detailing how the Bank will comply with the restrictions and requirements included in the Formal Agreement which impact the Bank’s capital;

- declare or pay a dividend or make a capital distribution only if the Bank is, and will continue to be in compliance with its capital plan and its minimum capital ratios, and only after receipt of written non-objection by the OCC; and

- take all necessary steps to correct each violation of law, rule or regulation cited in the most recent report of examination by the OCC.

Management of the Bank has implemented policies and procedures to ensure compliance with the provisions of the Formal Agreement. Management believes that, as of September 30, 2015, the Bank was in compliance with all requirements of the Formal Agreement.

The Formal Agreement supersedes and replaces the Supervisory Agreement (the “Supervisory Agreement”) that the Bank previously entered into with the Office of Thrift Supervision (the “OTS”) in October 2010. The Supervisory Agreement placed numerous operating restrictions and reporting requirements on the Bank. Among other things, the Supervisory Agreement prohibited us from making any new commercial real estate loans and/or commercial and industrial loans and limited our growth in any quarter to the amount of net interest credited on our deposits, in each case without the prior written non-objection of the OTS or OCC. In April 2013, we were advised that we were no longer subject to such restrictions on commercial real estate lending, commercial and industrial lending and asset growth, provided that the level of loan growth remained consistent with our business plan filed with the OCC.

As a result of the Formal Agreement with the OCC, the Bank is subject to certain additional restrictions pursuant to Federal banking regulations, including the following:

- Malvern Federal Savings Bank is required to provide the OCC with prior notice of any new director or senior executive officer; and

- Malvern Federal Savings Bank is restricted from making any “golden parachute payments,” as defined.

In December 2013, the Company’s board of directors adopted a resolution (the “Supervisory Resolution”), as recommended by the Federal Reserve Bank of Philadelphia (the “Reserve Bank”) which, among other things, requires the Company to serve as a source of strength to the Bank, prohibits the Company from declaring or paying dividends unless it receives the prior written approval of the Reserve Bank, prohibits the Company from receiving any dividends from the Bank without the prior written approval of the Reserve Bank, and requires the Company to provide various reports and a plan to strengthen oversight.

Dodd-Frank Act

On July 21, 2010, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The Dodd-Frank Act has significantly changed the bank regulatory structure and significantly impacted the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies have been given significant discretion in drafting the implementing rules and regulations, and consequently, many of the details and future impact of the Dodd-Frank Act may not be known for many months or years. The discussion below generally discusses the material provisions of the Dodd-Frank Act applicable to the Company and the Bank and is not complete or meant to be an exhaustive discussion.

The following aspects of the financial reform and consumer protection act are related to the operations of the Bank:

- The Office of Thrift Supervision has been merged into the OCC and the authority of the other remaining bank regulatory agencies restructured. The federal thrift charter has been preserved under the jurisdiction of the OCC.

- A new independent consumer financial protection bureau was established within the Federal Reserve Board, empowered to exercise broad regulatory, supervisory and enforcement authority with respect to both new and existing consumer financial protection laws. Smaller financial institutions, like the Bank, are subject to the supervision and enforcement of their primary federal banking regulator with respect to the federal consumer financial protection laws.

- Tier 1 capital treatment for "hybrid" capital items like trust preferred securities was eliminated subject to various grandfathering and transition rules.

- The prohibition on payment of interest on demand deposits was repealed.

- State consumer financial law is preempted only if it would have a discriminatory effect on a federal savings association, prevents or significantly interferes with the exercise by a federal savings association of its powers or is preempted by any other federal law. The OCC must make a preemption determination on a case-by-case basis with respect to a particular state law or other state law with substantively equivalent terms.

- Deposit insurance has been permanently increased to $250,000.

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- Deposit insurance assessment base calculation equals the depository institution's total assets minus the sum of its average tangible equity during the assessment period.

- The minimum reserve ratio of the Deposit Insurance Fund increased to 1.35 percent of estimated annual insured deposits or assessment base; however, the FDIC was directed to "offset the effect" of the increased reserve ratio for insured depository institutions with total consolidated assets of less than $10 billion.

The following aspects of the financial reform and consumer protection act are related to the operations of the Company:

- Authority over savings and loan holding companies transferred to the Board of Governors of the Federal Reserve System (the "Federal Reserve Board" or the "FRB").

- The Home Owners' Loan Act was amended to provide that leverage capital requirements and risk based capital requirements applicable to depository institutions and bank holding companies was extended to thrift holding companies.

- The Federal Deposit Insurance Act was amended to direct federal regulators to require depository institution holding companies to serve as a source of strength for their depository institution subsidiaries.

- Public companies are required to provide their shareholders with a non-binding vote: (i) at least once every three years on the compensation paid to executive officers, and (ii) at least once every six years on whether they should have a "say on pay" vote every one, two or three years.

- A separate, non-binding shareholder vote is required regarding golden parachutes for named executive officers when a shareholder vote takes place on mergers, acquisitions, dispositions or other transactions that would trigger the parachute payments.

- Securities exchanges are required to prohibit brokers from using their own discretion to vote shares not beneficially owned by them for certain "significant" matters, which include votes on the election of directors, executive compensation matters, and any other matter determined to be significant.

- Stock exchanges, which includes the Nasdaq, will be prohibited from listing the securities of any issuer that does not have a policy providing for (i) disclosure of its policy on incentive compensation payable on the basis of financial information reportable under the securities laws, and (ii) the recovery from current or former executive officers, following an accounting restatement triggered by material noncompliance with securities law reporting requirements, of any incentive compensation paid erroneously during the three-year period preceding the date on which the restatement was required that exceeds the amount that would have been paid on the basis of the restated financial information.

- Disclosure in annual proxy materials will be required concerning the relationship between the executive compensation paid and the financial performance of the issuer.

- Item 402 of Regulation S-K will be amended to require companies to disclose the ratio of the Chief Executive Officer’s annual total compensation to the median annual total compensation of all other employees.

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Regulation of Malvern Bancorp, Inc.

Holding Company Acquisitions. Malvern Bancorp is a savings and loan holding company under the Home Owners' Loan Act, as amended, and is subject to examination and supervision by the Federal Reserve Board. Federal law generally prohibits a savings and loan holding company, without prior FRB approval, from acquiring the ownership or control of any other savings institution or savings and loan holding company, or all, or substantially all, of the assets or more than 5% of the voting shares of the savings institution or savings and loan holding company. These provisions also prohibit, among other things, any director or officer of a savings and loan holding company, or any individual who owns or controls more than 25% of the voting shares of such holding company, from acquiring control of any savings institution not a subsidiary of such savings and loan holding company, unless the acquisition is approved by the FRB.

The FRB may not approve any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, subject to two exceptions: (1) the approval of interstate supervisory acquisitions by savings and loan holding companies; and (2) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

Holding Company Activities. Malvern Bancorp operates as a unitary savings and loan holding company and is permitted to engage only in the activities permitted for financial institution holding companies or for multiple savings and loan holding companies. Multiple savings and loan holding companies are permitted to engage in the following activities: (i) activities permitted for a bank holding company under section 4(c) of the Bank Holding Company Act (unless the Federal Reserve Board prohibits or limits such 4(c) activities); (ii) furnishing or performing management services for a subsidiary savings association; (iii) conducting any insurance agency or escrow business; (iv) holding, managing, or liquidating assets owned by or acquired from a subsidiary savings association; (v) holding or managing properties used or occupied by a subsidiary savings association; (vi) acting as trustee under deeds of trust; or (vii) activities authorized by regulation as of March 5, 1987, to be engaged in by multiple savings and loan holding companies.

Under the recently enacted legislation, savings and loan holding companies became subject to statutory capital requirements. However, in May 2015, amendments to the Federal Reserve Board’s small bank holding company policy statement (the “SBHC Policy”) became effective. The amendments made the SBHC Policy applicable to savings and loan holding companies such as Malvern Bancorp and increased the asset threshold to qualify to be subject to the provisions of the SBHC Policy from $500 million to $1 billion. Savings and loan holding companies that have total assets of $1 billion or less are subject to the SBHC Policy and are not required to comply with the regulatory capital requirements set forth in the table below. Such treatment continues until Malvern Bancorp’s total assets exceed $1 billion or the Federal Reserve Board deems it to no longer be a small savings and loan holding company. However, if Malvern Bancorp had been subject to the requirements, it would have been in compliance with them as of September 30, 2015.

Certain of the savings and loan holding company capital requirements promulgated by the FRB in 2013 became effective as of January 1, 2015. Those requirements establish the following four minimum capital ratios that savings and loan holding companies not subject to the SBHC Policy must comply with as of that date:

Capital Ratio	Regulatory Minimum	
Common Equity Tier 1 Capital	4.5	%
Tier 1 Leverage Capital	4.0	%
Tier 1 Risk-Based Capital	6.0	%
Total Risk-Based Capital	8.0	%

The leverage capital requirement is calculated as a percentage of total assets and the other three capital requirements are calculated as a percentage of risk-weighted assets. For a more detailed discussion of the 2015 capital rules, see “Recent Regulatory Capital Rules” under “Regulations of Malvern Federal Savings Bank” below.

While there are no specific restrictions on the payment of dividends or other capital distributions for savings and loan holding companies, federal regulations do prescribe such restrictions on subsidiary savings institutions, as described below. Malvern Federal Savings Bank is required to notify the Federal Reserve Board 30 days before declaring any dividend. In addition, the financial impact of a holding company on its subsidiary institution is a matter that is evaluated by the Federal Reserve Board and the agency has authority to order cessation of activities or divestiture of subsidiaries deemed to pose a threat to the safety and soundness of the institution.

All savings associations subsidiaries of savings and loan holding companies are required to meet a qualified thrift lender, or QTL, test to avoid certain restrictions on their operations. If the subsidiary savings institution fails to meet the QTL, as discussed below, then the savings and loan holding company must register with the Federal Reserve Board as a bank holding company, unless the savings institution requalifies as a QTL within one year thereafter.

Federal Securities Laws. As the successor to Malvern Federal Bancorp, Inc., Malvern Bancorp has registered its common stock with the Securities and Exchange Commission under Section 12(b) of the Securities Exchange Act of 1934. Malvern Bancorp is subject to the proxy and tender offer rules, insider trading reporting requirements and restrictions, and certain other requirements under the Securities Exchange Act of 1934. Pursuant to the FRB regulations and our Plan of Conversion and Reorganization, we have agreed to maintain such registration for a minimum of three years following completion of the second-step conversion.

The Sarbanes-Oxley Act. As a public company, Malvern Bancorp is subject to the Sarbanes-Oxley Act of 2002 which addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. As directed by the Sarbanes-Oxley Act, our principal executive officer and principal financial officer are required to certify that our quarterly and annual reports do not contain any untrue statement of a material fact. The rules adopted by the Securities and Exchange Commission under the Sarbanes-Oxley Act have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our internal control over financial reporting; they have made certain disclosures to our auditors and the audit committee of the Board of Directors about our internal control over financial reporting; and they have included information in our quarterly and annual reports about their evaluation and whether there have been changes in our internal control over financial reporting or in other factors that could materially affect internal control over financial reporting.

Volcker Rule Regulations

Regulations adopted by the federal banking agencies to implement the provisions of the Dodd Frank Act commonly referred to as the Volcker Rule became effective on April 1, 2014 with full compliance being phased in over a period ending on July 21, 2015. The regulations contain prohibitions and restrictions on the ability of financial institutions holding companies and their affiliates to engage in proprietary trading and to hold certain interests in, or to have certain relationships with, various types of investment funds, including hedge funds and private equity funds. The Company is in compliance with the various provisions of the Volcker Rule regulations.

Regulation of Malvern Federal Savings Bank

General. Malvern Federal Savings Bank is subject to the regulation of the OCC, as its primary federal regulator and the FDIC, as the insurer of its deposit accounts, and, to a limited extent, the Federal Reserve Board. As the primary federal regulator of Malvern Federal Savings Bank, the OCC has extensive authority over the operations of federally chartered savings institutions. As part of this authority, Malvern Federal Savings Bank is required to file periodic reports with the OCC and is subject to periodic examinations by the OCC and the FDIC. The investment and lending authorities of savings institutions are prescribed by federal laws and regulations, and such institutions are prohibited from engaging in any activities not permitted by such laws and regulations. Such regulation and supervision is primarily intended for the protection of depositors and the Deposit Insurance Fund, administered by the FDIC.

The OCC's enforcement authority over all savings institutions includes, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to initiate injunctive actions. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with the OCC.

Insurance of Accounts. The deposits of Malvern Federal Savings Bank are insured to the maximum extent permitted by the Deposit Insurance Fund and are backed by the full faith and credit of the U.S. Government. As insurer, the FDIC is authorized to conduct examinations of, and to require reporting by, insured institutions. It also may prohibit any insured institution from engaging in any activity determined by regulation or order to pose a serious threat to the FDIC. The FDIC also has the authority to initiate enforcement actions against savings institutions, after giving the OCC an opportunity to take such action.

The Federal Deposit Insurance Corporation's risk-based premium system provides for quarterly assessments. Each insured institution is placed in one of four risk categories depending on supervisory and capital considerations. Within its risk category, an institution is assigned to an initial base assessment rate which is then adjusted to determine its final assessment rate based on its brokered deposits, secured liabilities and unsecured debt. To implement the Dodd Frank Act, the Federal Deposit Insurance Corporation amended its deposit insurance regulations (1) to change the assessment base for insurance from domestic deposits to average assets minus average tangible equity and (2) to lower overall assessment rates. The revised assessments rates are between 2.5 to 9 basis points for banks in the lowest risk category and between 30 to 45 basis points for banks in the highest risk category.

In addition, all institutions with deposits insured by the FDIC are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation, a mixed-ownership government corporation established to recapitalize the predecessor to the Deposit Insurance Fund. These assessments will continue until the Financing Corporation bonds mature in 2019.

The FDIC may terminate the deposit insurance of any insured depository institution, including the Bank, if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance, if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the FDIC. Management is not aware of any existing circumstances which could result in termination of the Bank's deposit insurance.

As noted above, the Dodd Frank Act raises the minimum reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% and requires the FDIC to offset the effect of this increase on insured institutions with assets of less than $10 billion (small institutions). The FDIC has proposed a rule to accomplish this by imposing a surcharge on larger institutions commencing when the reserve ratio reaches 1.15% and ending when it reaches 1.35%. This surcharge period is expected to begin in 2016 and end by December 31, 2018. Small institutions will receive credits for the portion of their regular assessments that contributed to growth in the reserve ratio between 1.15% and 1.35%. The credits will apply to reduce regular assessments by 2.0 basis points for quarters when the reserve ratio is at least 1.40%.

Regulatory Capital Requirements. Federally insured savings institutions are required to maintain minimum levels of regulatory capital. The OCC has established capital standards consisting of a “tangible capital requirement,” a “leverage capital requirement” and “a risk-based capital requirement.” The OCC also is authorized to impose capital requirements in excess of these standards on individual institutions on a case-by-case basis. As described below, the OCC has imposed such individual minimum capital ratios (“IMCR”) on the Bank.

Current OCC capital standards require savings institutions to satisfy the following capital requirements:

- tangible capital requirement – “tangible” capital equal to at least 1.5% of adjusted total assets;
- Common equity Tier 1 capital requirement – generally consists of retained earnings and common stock instruments equal to at least 4.5% of “risk weighted” assets;
- leverage capital requirement – “core” capital equal to at least 3.0% of adjusted total assets for the most highly rated institutions;
- an additional “cushion” of at least 100 basis points of core capital for all but the most highly rated savings associations effectively increasing their minimum Tier 1 leverage ratio to 4.0% or more; and
- risk-based capital requirement – “total” capital (a combination of core and “supplementary” capital) equal to at least 8.0% of “risk-weighted” assets.

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Core capital generally consists of common stockholders' equity (including retained earnings). Tangible capital generally equals core capital minus intangible assets, with only a limited exception for purchased mortgage servicing rights. Malvern Federal Savings Bank had no intangible assets at September 30, 2015. Both core and tangible capital are further reduced by an amount equal to a savings institution's debt and equity investments in subsidiaries engaged in activities not permissible to national banks (other than subsidiaries engaged in activities undertaken as agent for customers or in mortgage banking activities and subsidiary depository institutions or their holding companies). These adjustments do not affect Malvern Federal Savings Bank's regulatory capital.

In determining compliance with the risk-based capital requirement, a savings institution is allowed to include both core capital and supplementary capital in its total capital, provided that the amount of supplementary capital included does not exceed the savings institution's core capital. Supplementary capital generally consists of general allowances for loan losses up to a maximum of 1.25% of risk-weighted assets, together with certain other items. In determining the required amount of risk-based capital, total assets, including certain off-balance sheet items, are multiplied by a risk weight based on the risks inherent in the type of assets. The risk weights range from 0% for cash and securities issued by the U.S. Government or unconditionally backed by the full faith and credit of the U.S. Government to 100% for loans (other than qualifying residential loans weighted at 80%) and repossessed assets.

Savings institutions must value securities available for sale at amortized cost for regulatory capital purposes. This means that in computing regulatory capital, savings institutions should add back any unrealized losses and deduct any unrealized gains, net of income taxes, on debt securities reported as a separate component of GAAP capital.

The OCC has imposed IMCRs on the Bank which require it to maintain regulatory capital of not less than the following:

- tier 1 capital of 8.5% or adjusted total assets;

- tier 1 risk-based capital to risk-weighted assets of 10.5%; and

- total risk-based capital to risk-weighted assets of 12.5%.

At September 30, 2015, Malvern Federal Savings Bank exceeded all of its regulatory capital requirements. At such date, the Bank’s tier 1 capital, tier 1 risked-based capital and total risk-based capital ratios were 10.80%, 15.90% and 16.99%, respectively.

Any savings institution that fails any of the capital requirements is subject to possible enforcement actions by the OCC or the FDIC. Such actions could include a capital directive, a cease and desist order, civil money penalties, the establishment of restrictions on the institution's operations, termination of federal deposit insurance and the appointment of a conservator or receiver. The OCC's capital regulation provides that such actions, through enforcement proceedings or otherwise, could require one or more of a variety of corrective actions.

Recent Regulatory Capital Regulations. In July of 2013 the respective U.S. federal banking agencies issued final rules implementing Basel III and the Dodd-Frank Act capital requirements to be fully phased in on a global basis on January 1, 2019. The new regulations establish a new tangible common equity capital requirement, increase the minimum requirement for the current Tier 1 risk-weighted asset (“RWA”) ratio, phase out certain kinds of intangibles treated as capital and certain types of instruments and change the risk weightings of certain assets used to determine required capital ratios. The new common equity Tier 1 capital component requires capital of the highest quality – predominantly composed of retained earnings and common stock instruments. For community banks such as Malvern Federal Savings Bank, a common equity Tier 1 capital ratio 4.5% became effective on January 1, 2015. The new capital rules also increased the current minimum Tier 1 capital ratio from 4.0% to 6.0% beginning on January 1, 2015. In addition, in order to make capital distributions and pay discretionary bonuses to executive officers without restriction, an institution must also maintain greater than 2.5% in common equity attributable to a capital conservation buffer to be phased in from January 1, 2016 until January 1, 2019. The new rules also increased the risk weights for several categories of assets, including an increase from 100% to 150% for certain acquisition, development and construction loans and more than 90-day past due exposures. The new capital rules maintain the general structure of the prompt corrective action rules, but incorporate the new common equity Tier 1 capital requirement and the increased Tier 1 RWA requirement into the prompt corrective action framework.

Prompt Corrective Action. The following table shows the amount of capital associated with the different capital categories set forth in the prompt corrective action regulations.

Capital Category	Total Risk-Based Capital	Tier 1 Risk-Based Capital	Common Equity Tier 1 Capital	Tier 1 Leverage Capital
Well capitalized	10% or more	8% or more	6.5% or more	5% or more
Adequately capitalized	8% or more	6% or more	4.5% or more	4% or more
Undercapitalized	Less than 8%	Less than 6%	Less than 4.5%	Less than 4%
Significantly undercapitalized	Less than 6%	Less than 4%	Less than 3%	Less than 3%

In addition, an institution is "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. Under specified circumstances, a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized institution or an undercapitalized institution to comply with supervisory actions as if it were in the next lower category (except that the FDIC may not reclassify a significantly undercapitalized institution as critically undercapitalized).

An institution generally must file a written capital restoration plan which meets specified requirements within 45 days of the date that the institution receives notice or is deemed to have notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. A federal banking agency must provide the institution with written notice of approval or disapproval within 60 days after receiving a capital restoration plan, subject to extensions by the agency. An institution which is required to submit a capital restoration plan must concurrently submit a performance guaranty by each company that controls the institution. In addition, undercapitalized institutions are subject to various regulatory restrictions, and the appropriate federal banking agency also may take any number of discretionary supervisory actions.

At September 30, 2015, Malvern Federal Savings Bank was not subject to the above mentioned restrictions.

The table below sets forth Malvern Federal Savings Bank's capital position relative to the OCC's regulatory capital requirements at September 30, 2015. Malvern Bancorp is not subject to the regulatory capital ratios imposed by the Dodd-Frank Act on savings and loan holding companies because it was deemed to be a small savings and loan holding company as of September 30, 2015.

	Actual	Required for Capital Adequacy	To Be Well Capitalized Under Prompt	Excess Over Well-Capitalized Provision

			Purposes		Corrective Action Provisions			
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)							
Tier 1 leverage capital (to adjusted tangible assets)	$69,030	10.80%	$25,573	4.00%	$31,966	5.00 %	$37,064	5.80 %
Common equity Tier 1 (to risk-weighted assets)	$69,030	15.90	$19,538	4.50	$28,222	6.50	$40,408	9.40
Tier 1 risk-based capital (to risk-weighted assets)	$69,030	15.90	$26,051	6.00	$34,734	8.00	$34,296	7.90
Total risk-based capital (to risk-weighted assets)	$73,759	16.99	$34,734	8.00	$43,418	10.00	$30,341	6.99

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Capital Distributions. OCC regulations govern capital distributions by savings institutions, which include cash dividends, stock repurchases and other transactions charged to the capital account of a savings institution to make capital distributions. A savings institution must file an application for OCC approval of the capital distribution if either (1) the total capital distributions for the applicable calendar year exceed the sum of the institution's net income for that year to date plus the institution's retained net income for the preceding two years, (2) the institution would not be at least adequately capitalized following the distribution, (3) the distribution would violate any applicable statute, regulation, agreement or OCC-imposed condition, or (4) the institution is not eligible for expedited treatment of its filings. If an application is not required to be filed, savings institutions which are a subsidiary of a savings and loan holding company (as well as certain other institutions) must still file a notice with the OCC at least 30 days before the board of directors declares a dividend or approves a capital distribution if either (1) the institution would not be well capitalized following the distribution; (2) the proposed distribution would reduce the amount or retire any part of our common or preferred stock or (3) the savings institution is a subsidiary of a savings and loan holding company and the proposed dividend is not a cash dividend. If a savings institution, such as Malvern Federal Savings Bank, that is the subsidiary of a savings and loan holding company, has filed a notice with the Federal Reserve Board for a cash dividend and is not required to file an application or notice with the OCC for any of the reasons described above, then the savings institution is only required to provide an informational copy to the OCC of the notice filed with the Federal Reserve Board.

The Company adopted a resolution in December 2013 that provides, among other things, that the Company will not declare or pay any dividends to shareholders and that it will not receive any dividends from the Bank without the prior written approval of the Federal Reserve Bank of Philadelphia.

An institution that either before or after a proposed capital distribution fails to meet its then applicable minimum capital requirement or that has been notified that it needs more than normal supervision may not make any capital distributions without the prior written approval of the OCC. In addition, the OCC may prohibit a proposed capital distribution, which would otherwise be permitted by OCC regulations, if the OCC determines that such distribution would constitute an unsafe or unsound practice.

Under federal rules, an insured depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it is already undercapitalized. In addition, federal regulators have the authority to restrict or prohibit the payment of dividends for safety and soundness reasons. The FDIC also prohibits an insured depository institution from paying dividends on its capital stock or interest on its capital notes or debentures (if such interest is required to be paid only out of net profits) or distributing any of its capital assets while it remains in default in the payment of any assessment due the FDIC. Malvern Federal Savings Bank is currently not in default in any assessment payment to the FDIC.

Qualified Thrift Lender Test. All savings institutions are required to meet a qualified thrift lender, or QTL, test to avoid certain restrictions on their operations. A savings institution can comply with the QTL test by either qualifying as a domestic building and loan association as defined in the Internal Revenue Code or meeting the QTL test of the OCC.

Currently, the OCC's QTL test requires that 65% of an institution's "portfolio assets" (as defined) consist of certain housing and consumer-related assets on a monthly average basis in nine out of every 12 months. To be a qualified thrift lender under the IRS test, the savings institution must meet a "business operations test" and a "60 percent assets test," each defined in the Internal Revenue Code.

If the savings institution fails to maintain its QTL status, the holding company's activities are restricted. In addition, it must discontinue any non-permissible business within three years. Nonetheless, any company that controls a savings institution that is not a qualified thrift lender must register as a bank holding company within one year of the savings institution's failure to meet the QTL test.

Statutory penalty provisions prohibit an institution that fails to remain a QTL from the following:

- Making any new investments or engaging in any new activity not allowed for both a national bank and a savings association;
- Establishing any new branch office unless allowable for a national bank; and
- Paying dividends unless allowable for a national bank.

Three years from the date a savings association should have become or ceases to be a QTL, by failing to meet either QTL test, the institution must comply with the following restriction:

- Dispose of any investment or not engage in any activity unless the investment or activity is allowed for both a national bank and a savings association.

Under the Dodd-Frank Act, a savings institution not in compliance with the QTL test is also subject to an enforcement action for violation of the Home Owners’ Loan Act, as amended.

At September 30, 2015, Malvern Federal Savings Bank met the requirements to be deemed a QTL.

Limitations on Transactions with Affiliates. Transactions between savings associations and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act as made applicable to savings associations by Section 11 of the Home Owners' Loan Act. An affiliate of a savings association includes any company or entity which controls the savings institution or that is controlled by a company that controls the savings association. In a holding company context, the holding company of a savings association (such as Malvern Bancorp) and any companies which are controlled by such holding company are affiliates of the savings association. Generally, Section 23A limits the extent to which the savings association or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of such association's capital stock and surplus, and contains an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. Section 23B applies to "covered transactions" as well as certain other transactions and requires that all transactions be on terms substantially the same, or at least as favorable, to the savings association as those provided to a non-affiliate. The term "covered transaction" includes the making of loans to, purchase of assets from and issuance of a guarantee to an affiliate and similar transactions. Section 23B transactions also include the provision of services and the sale of assets by a savings association to an affiliate. In addition to the restrictions imposed by Sections 23A and 23B, Section 11 of the Home Owners' Loan Act prohibits a savings association from (i) making a loan or other extension of credit to an affiliate, except for any affiliate which engages only in certain activities which are permissible for bank holding companies, or (ii) purchasing or investing in any stocks, bonds, debentures, notes or similar obligations of any affiliate, except for affiliates which are subsidiaries of the savings association.

In addition, Sections 22(g) and (h) of the Federal Reserve Act as made applicable to savings associations by Section 11 of the Home Owners' Loan Act, place restrictions on loans to executive officers, directors and principal shareholders of the savings association and its affiliates. Under Section 22(h), loans to a director, an executive officer and to a greater than 10% shareholder of a savings association, and certain affiliated interests of either, may not exceed, together with all other outstanding loans to such person and affiliated interests, the savings association's loans to one borrower limit (generally equal to 15% of the association's unimpaired capital and surplus). Section 22(h) also requires that loans to directors, executive officers and principal shareholders be made on terms substantially the same as offered in comparable transactions to other persons unless the loans are made pursuant to a benefit or compensation program that (i) is widely available to employees of the association and (ii) does not give preference to any director, executive officer or principal shareholder, or certain affiliated interests of either, over other employees of the savings association. Section 22(h) also requires prior board approval for certain loans. In addition, the aggregate amount of extensions of credit by a savings association to all insiders cannot exceed the association's unimpaired capital and surplus. Furthermore, Section 22(g) places additional restrictions on loans to executive officers. Malvern Federal Savings Bank currently is subject to Sections 22(g) and (h) of the Federal Reserve Act and at September 30, 2015, was in compliance with the above restrictions.

Community Reinvestment Act. All federal savings associations have a responsibility under the Community Reinvestment Act and related regulations to help meet the credit needs of their communities, including low- and moderate-income neighborhoods. An institution's failure to comply with the provisions of the Community Reinvestment Act could result in restrictions on its activities. Malvern Federal Savings Bank received a "satisfactory" Community Reinvestment Act rating in its most recently completed examination.

Anti-Money Laundering. All financial institutions, including savings and loan associations are subject to federal laws that are designed to prevent the use of the U.S. financial system to fund terrorist activities. Financial institutions operating in the United States are required to develop new anti-money laundering compliance programs, due diligence policies and controls to ensure the detection and reporting of money laundering. Such compliance programs are intended to supplement existing compliance requirements, also applicable to financial institutions, under the Bank Secrecy Act and the Office of Foreign Assets Control Regulations. Malvern Federal Savings Bank has established policies and procedures to ensure compliance with these provisions, and their impact on our operations has not been material.

Federal Home Loan Bank System. Malvern Federal Savings Bank is a member of the Federal Home Loan Bank of Pittsburgh, which is one of 12 regional Federal Home Loan Banks that administers the home financing credit function of savings institutions. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the board of directors of the FHLB. At September 30, 2015, Malvern Federal Savings Bank had $103.0 million of FHLB advances and $108.5 million outstanding on its line of credit with the FHLB.

As a member, Malvern Federal Savings Bank is required to purchase and maintain stock in the FHLB of Pittsburgh in an amount equal to at least 1.0% of its aggregate unpaid residential mortgage loans or similar obligations at the beginning of each year. At September 30, 2015, Malvern Federal Savings Bank had $4.8 million in FHLB stock, which was in compliance with this requirement.

The Federal Home Loan Banks are required to provide funds for the resolution of troubled savings institutions and to contribute to affordable housing programs through direct loans or interest subsidies on advances targeted for community investment and low- and moderate-income housing projects. The FHLB has communicated that it believes the calculation of risk-based capital under the current rules of the FHFA significantly overstates the market risk of the FHLB's private-label mortgage-backed securities in the current market environment and that it has enough capital to cover the risks reflected in the FHLB's balance sheet. As a result, an "other than temporary impairment" has not been recorded for the Bank's investment in FHLB stock. However, continued deterioration in the FHLB's financial position may result in impairment in the value of those securities. Management will continue to monitor the financial condition of the FHLB as it relates to, among other things, the recoverability of the Bank's investment.

Federal Reserve System. The Federal Reserve Board requires all depository institutions to maintain reserves against their transaction accounts (primarily NOW and Super NOW checking accounts) and non-personal time deposits. Because required reserves must be maintained in the form of vault cash or a noninterest-bearing account at a Federal Reserve Bank, the effect of this reserve requirement is to reduce an institution's earning assets. At September 30, 2015, Malvern Federal Savings Bank had met its reserve requirement.

Employees

As of September 30, 2015, we had a total of 71 full-time equivalent employees. No employees are represented by a collective bargaining group, and we believe that our relationship with our employees is excellent.

Item 1A. Risk Factors.

In analyzing whether to make or to continue an investment in our securities, investors should consider, among other factors, the following risk factors.

We are subject to credit risk in connection with our lending activities, and our financial condition and results of operations may be negatively impacted by economic conditions and other factors that adversely affect our borrowers.

Our financial condition and results of operations are affected by the ability of our borrowers to repay their loans, and in a timely manner. Lending money is a significant part of the banking business. Borrowers, however, do not always repay their loans. The risk of non-payment is assessed through our underwriting and loan review procedures based on several factors including credit risks of a particular borrower, changes in economic conditions, the duration of the loan and in the case of a collateralized loan, uncertainties as to the future value of the collateral and other factors. Despite our efforts, we do and will experience loan losses, and our financial condition and results of operations will be adversely affected. Our non-performing assets were approximately $2.6 million at September 30, 2015. Our allowance for loan losses was approximately $4.7 million at September 30, 2015. Our loans between thirty and eighty-nine days delinquent totaled $2.6 million at September 30, 2015.

The changing economic environment may continue to adversely impact our operations and results.

Negative developments in the financial services industry from 2008 into 2015 have resulted in uncertainty in the financial markets in general and a related general economic downturn globally. As a consequence of the recent United States recession, business activities across a wide range of industries face serious difficulties due to the decline in the housing market and lack of consumer spending. Unemployment continues to be higher than historical averages.

As a result of these financial economic crises, many lending institutions, including us, have experienced declines in the performance of their loans, including residential, construction, commercial and consumer loans. In addition, the values of real estate collateral supporting many commercial loans and home mortgages have declined and may continue to decline. Moreover, competition among depository institutions for deposits and quality loans has increased significantly while the significant decline in economic growth has led to a slowdown in banking related activities. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and others in the financial services industry. In particular, we may face the following risks in connection with these events:

- we potentially face increased regulation of our industry and compliance with such regulation may increase our costs and limit our ability to pursue business opportunities;
- customer demand for loans secured by real estate could be reduced due to weaker economic conditions, an increase in unemployment, a decrease in real estate values or an increase in interest rates;
- the process we use to estimate losses inherent in our credit exposure requires difficult, subjective and complex judgments, including forecasts of economic conditions and how these economic conditions might impair the ability of our borrowers to repay their loans; and
- the value of the portfolio of investment securities that we hold may be adversely affected.

Changes in interest rates could adversely affect our financial condition and results of operation.

We are unable to predict fluctuations of market interest rates, which are affected by many factors, including inflation, recession, unemployment, monetary policy, domestic and international disorder and instability in domestic and foreign financial markets, and investor and consumer demand.

Our primary source of income is net interest income, which is the difference between the interest earned on our interest-earning assets, such as loans and investments, and the interest paid on our interest-bearing liabilities, such as deposits and borrowings. The level of net interest income is primarily a function of the average balance of our interest-earning assets, the average balance of our interest-bearing liabilities, and the spread between the yield on such assets and the cost of such liabilities. These factors are influenced by both the pricing and mix of our interest-earning assets and our interest-bearing liabilities which, in turn, are impacted by such external factors as the local economy, competition for loans and deposits, the monetary policy of the Federal Open Market Committee of the Board of Governors of the Federal Reserve System and market interest rates.

A sustained increase in market interest rates would adversely affect our earnings. A significant portion of our loans have fixed interest rates and longer terms than our deposits and borrowings and our net interest income could be adversely affected if the rates we pay on deposits and borrowings increase more rapidly than the rates we earn on loans. In addition, the market value of our fixed-rate assets would decline if interest rates increase. Net portfolio value is the difference between incoming and outgoing discounted cash flows from assets, liabilities and off-balance sheet contracts. See "Management's Discussion and Analysis of Financial Condition and Results of Operations –Asset and Liability Management."

Our loan portfolio exhibits a high degree of risk.

We have a significant amount of commercial real estate loans, as well as construction and development loans and second mortgages (home equity loans) that have a higher risk of default and loss than single-family residential mortgage loans. Although permanent single-family, owner-occupied loans represent the largest single component of assets and currently impaired loans, commercial real estate loans, as well as construction and development loans and second mortgages (home equity loans) amounted to $156.1 million, or 39.6% of our loan portfolio at September 30, 2015. Commercial real estate and construction and development loans generally are considered to involve a higher degree of risk due to a variety of factors, including generally larger loan balances and loan terms which often do not require full amortization of the loan over its term and, instead, provide for a balloon payment at the stated maturity date. Repayment of commercial real estate loans generally is dependent on income being generated by the rental property or underlying business in amounts sufficient to cover operating expenses and debt service. Repayment of construction and development loans generally is dependent on the successful completion of the project and the ability of the borrower to repay the loan from the sale of the property or obtaining permanent financing. Our second mortgage loans generally are considered to involve a higher degree of risk than single-family residential mortgage loans due to the generally higher loan-to-value ratios and their secondary position in the collateral to the existing first mortgage. Our monitoring of higher risk loans and the internal asset review function may be inadequate in view of current real estate market weaknesses.

Our provisions to our allowance for loan losses and our net charge-offs to our allowance for loan losses have adversely affected, and may continue to adversely affect, our results of operations.

Our customers may not repay their loans according to the original terms, and the collateral securing the payment of those loans may be insufficient to pay any remaining loan balance. While we maintain an allowance for loan losses to provide for loan defaults and non-performance, losses may exceed the value of the collateral securing the loans and the allowance may not fully cover any excess loss.

We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of loans. Our allowance for loan losses is based on these judgments, as well as historical loss experience and an evaluation of the other risks associated with our loan portfolio, including but not limited to, the size and composition of the loan portfolio, current economic conditions and geographic concentrations within the portfolio. Federal regulatory agencies, as part of their examination process, review our loans and allowance for loan losses. If our assumptions or judgments used to determine the allowance prove to be incorrect, if the value of the collateral securing the loans decreases substantially or if our regulators disagree with our judgments, we may need to increase the allowance in amounts that exceed our expectations. Additions to the allowance adversely affect our results of operations and financial condition. We recorded a $90,000 provision for loan losses during the year ended September 30, 2015, compared to provisions of $263,000 and $11.2 million for the years ended September 30, 2014 and 2013, respectively.

Failure to comply with the Formal Agreement could adversely affect our business, financial condition and operating results.

In October 2014, the Bank, entered into the Formal Agreement. The Formal Agreement imposes a number of operating restrictions and requirements that the Bank revise and/or implement and monitor various identified policies, procedures and reports. Failure to comply with the Formal Agreement could result in additional supervisory and enforcement actions against the Bank and/or its directors and senior executive officers, including the issuance of a cease and desist order or the imposition of civil money penalties. In addition, compliance efforts related to the Formal Agreement have an adverse impact on our non-interest expense.

Our deferred tax asset valuation allowance adversely impacted our results of operations.

We recognize deferred tax assets and liabilities based on differences between the financial statement carrying amounts and the tax bases of assets and liabilities. At September 30, 2015, the net deferred tax asset was approximately $2.9 million, compared to a balance of approximately $2.4 million at September 30, 2014. The increase in net deferred tax asset from prior fiscal year is primarily due to the change in tax planning strategies.

We regularly review our deferred tax assets for recoverability to determine whether it is more likely that not (i.e. likelihood of more that 50%) that some portion, or all, of the deferred tax asset will not be realized within its life cycle, based on the weight of available evidence. If management makes a determination based on the available evidence that it is more likely than not that some portion or all of the deferred tax assets will not be realized in future periods, a valuation allowance is calculated and recorded. The determinations are inherently subjective and dependent upon estimates and judgments concerning management's evaluation of both positive and negative evidence.

Strong competition within our market area could hurt our profits and slow growth.

The banking and financial services industry in our market area is highly competitive. We may not be able to compete effectively in our markets, which could adversely affect our results of operations. The increasingly competitive environment is a result of changes in regulation, changes in technology and product delivery systems, and consolidation among financial service providers. Larger institutions have greater access to capital markets, with higher lending limits and a broader array of services. Competition may require increases in deposit rates and decreases in loan rates, and adversely impact our net interest margin.

The effects of the current economic conditions have been particularly severe in our primary market areas.

Substantially all of our loans are to individuals, businesses and real estate developers in Chester County, Pennsylvania and neighboring areas in southern Pennsylvania and our business depends significantly on general economic conditions in these market areas. Severe declines in housing prices and property values have been particularly acute in our primary market areas. A further deterioration in economic conditions or a prolonged delay in economic recovery in our primary market areas could result in the following consequences, any of which could have a material adverse effect on our business:

- Loan delinquencies may increase further;
- Problem assets and foreclosures may increase further;
- Demand for our products and services may decline;
- The carrying value of our other real estate owned may decline further; and
- Collateral for loans made by us, especially real estate, may continue to decline in value, in turn reducing a customer's borrowing power, and reducing the value of assets and collateral associated with our loans.

We operate in a highly regulated environment and we may be adversely affected by changes in laws and regulations.

We are subject to extensive regulation, supervision and examination by the FRB, our primary federal regulator, the OCC, the Bank's primary federal regulator, and by the Federal Deposit Insurance Corporation, as insurer of the Bank's deposits. Such regulation and supervision governs the activities in which an institution and its holding company may engage and are intended primarily for the protection of the insurance fund and the depositors and borrowers of the Bank rather than for holders of our common stock. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on our operations, the classification of our assets and determination of the level of our allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on our operations.

The fair value of our investment securities can fluctuate due to market conditions outside of our control.

As of September 30, 2015, the fair value of our investment securities portfolio was approximately $185.2 million. We have historically taken a conservative investment strategy, with concentrations of securities that are backed by government sponsored enterprises. Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. These factors include, but are not limited to, rating agency actions in respect of the securities, defaults by the issuer or with respect to the underlying securities, and changes in market interest rates and continued instability in the capital markets. Any of these factors, among others, could cause other-than-temporary impairments and realized and/or unrealized losses in future periods and declines in other comprehensive income, which could have a material adverse effect on us. The process for determining whether impairment of a security is other-than-temporary usually requires complex, subjective judgments about the future financial performance and liquidity of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security.

We are dependent on our information technology and telecommunications systems and third-party servicers, and systems failures, interruptions or breaches of security could have a material adverse effect on us.

Our business is highly dependent on the successful and uninterrupted functioning of our information technology and telecommunications systems and third-party servicers. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If significant, sustained or repeated, a system failure or service denial could compromise our ability to operate effectively, damage our reputation, result in a loss of customer business, and/or subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on us.

In addition, we provide our customers with the ability to bank remotely, including over the Internet and over the telephone. The secure transmission of confidential information over the Internet and other remote channels is a critical element of remote banking. Our network could be vulnerable to unauthorized access, computer viruses, phishing schemes and other security breaches. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. To the extent that our activities or the activities of our customers involve the storage and transmission of confidential information, security breaches and viruses could expose us to claims, regulatory scrutiny, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in our systems and could materially and adversely affect us.

Additionally, financial products and services have become increasingly technology-driven. Our ability to meet the needs of our customers competitively, and in a cost-efficient manner, is dependent on the ability to keep pace with technological advances and to invest in new technology as it becomes available. Many of our competitors have greater resources to invest in technology than we do and may be better equipped to market new technology-driven products and services. The ability to keep pace with technological change is important, and the failure to do so could have a material adverse impact on our business and therefore on our financial condition and results of operations.

We identified a material weakness in our internal control over financial reporting at September 30, 2015 and cannot assure you that additional material weaknesses will not be identified in the future. If we fail to implement and maintain effective internal control over financial reporting, it could result in material misstatements in our financial statements in the future which could require us to restate financial statements, cause investors to lose confidence in our reported financial information and have a negative effect on our stock price.

Our management identified a material weakness in our internal control over financial reporting at September 30, 2015. See Item 9A, “Controls and Procedures.” While the material weakness had no impact upon our reported financial condition or results of operation at and for the fiscal year ended September 30, 2015 or any prior periods, we cannot assure you that additional significant deficiencies or material weaknesses in our internal control over financial reporting will not be identified in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could result in additional material weaknesses, cause us to fail to meet our periodic reporting obligations or result in material misstatements in our financial statements in future periods. Any such failure could also adversely affect the results of periodic management evaluations and annual auditor attestation reports regarding the effectiveness of our internal control over financial reporting required under Section 404 of the Sarbanes-Oxley Act of 2002 and the rules promulgated by the SEC under Section 404. The existence of a material weakness could result in errors in our financial statements in future periods that could result in a restatement of financial statements, cause us to fail to meet our reporting obligations and cause investors or customers to lose confidence in our reported financial information, leading to a decline in our stock price or a loss of business.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

The Bank owns and maintains the premises in which the headquarters and six full-service financial centers are located, and leases an office in Concordville. The location of each of the offices is as follows:

Paoli Headquarters	42 East Lancaster Avenue, Paoli, PA 19301
Paoli Financial Center	34 East Lancaster Avenue, Paoli, PA 19301
Malvern Financial Center	100 West King Street, Malvern, PA 19355
Exton Financial Center	109 North Pottstown Pike, Exton, PA 19341
Coventry Financial Center	100 Ridge Road, Pottstown, PA 19465
Berwyn Financial Center	650 Lancaster Avenue, Berwyn, PA 19312
Lionville Financial Center	537 West Uwchlan Avenue, Downingtown, PA 19335
Concordville Financial Center	940 Baltimore Pike, Glen Mills, PA 19342

Item 3. Legal Proceedings.

The Company and its subsidiaries are subject to various legal actions arising in the normal course of business. In the opinion of management, the resolution of these legal actions is not expected to have a material adverse effect on the Company's financial condition or results of operations.

Item 4. Mine Safety Disclosures.

Not Applicable.

PART II.

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

The common stock of the Company is traded on the NASDAQ Global Select Market under the symbol “MLVF”. As of September 30, 2015, the Company had 483 stockholders of record, not including the number of persons or entities whose stock is held in nominee or “street” name through various brokerage firms and banks. On September 30, 2015, the closing sale price was $15.65.

The following table sets forth the high and low closing sales price on a share of the Company's common stock for the years ended September 30, 2015 and 2014.

	Year Ended September 30,			
	2015		2014	
	High	Low	High	Low
First Quarter	$12.17	$11.10	$12.94	$10.75
Second Quarter	$14.00	$11.80	$11.30	$10.23
Third Quarter	$15.25	$13.24	$11.01	$10.13
Fourth Quarter	$15.96	$14.51	$11.39	$10.50

For the years ended September 30, 2015 and 2014, no cash dividends per share of common stock were declared by the Company. In December 2013, the Company's board of directors adopted the Supervisory Resolution, as recommended by the Federal Reserve Bank of Philadelphia, that it will not declare or pay any dividends without the prior written approval of the Reserve Bank.

Item 6. Selected Financial Data.

The following tables set forth selected consolidated financial data as of the dates and for the periods presented. The selected consolidated statement of financial condition data as of September 30, 2015 and 2014 and the selected consolidated summary of operating data for the years ended September 30, 2015, 2014 and 2013 have been derived from our audited consolidated financial statements and related notes that we have included elsewhere in this Annual Report. The selected consolidated statement of financial condition data as of September 30, 2013, 2012 and 2011 and the selected consolidated summary of operating data for the years ended September 30, 2012 and 2011 have been derived from audited consolidated financial statements that are not presented in this Annual Report.

The selected historical consolidated financial data as of any date and for any period are not necessarily indicative of the results that may be achieved as of any future date or for any future period. You should read the following selected statistical and financial data in conjunction with the more detailed information contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the related notes that we have presented elsewhere in this Annual Report.

	At September 30,				
	2015	2014	2013	2012	2011
	(Dollars in thousands)				
Summary of Operating Data:					
Total interest and dividend income	$20,462	$20,167	$22,301	$25,775	$29,726
Total interest expense	5,248	5,071	6,944	8,412	10,198
Net interest income	15,214	15,096	15,357	17,363	19,528
Provision for loan losses	90	263	11,235	810	12,392
Net interest income after provision for loan losses	15,124	14,833	4,122	16,553	7,136
Total other income	2,535	2,155	2,860	2,427	1,702
Total other expenses	13,961	16,644	19,775	16,393	18,529
Income tax expense (benefit)	-	21	6,010	628	(3,579)
Net income (loss)	$3,698	$323	$(18,803)	$1,959	$(6,112)
Earnings (loss) per share(5)	$0.58	$0.05	$(2.96)	$0.31	$(0.96)
Dividends per share	$0.00	$0.00	$0.00	$0.00	$0.03
Statement of Financial Condition Data					
Securities available for sale	$128,354	$100,943	$124,667	$80,508	$74,389
Securities held to maturity	57,221	-	-	-	3,797
Loans held for sale	-	-	10,367	-	-
Loans receivable, net	391,307	386,074	401,857	457,001	506,019
Total assets	655,690	542,264	601,554	711,812	666,568
Deposits	465,522	412,953	484,596	540,988	554,455
FHLB borrowings	103,000	48,000	38,000	48,085	49,098
Shareholders' equity	81,391	76,772	75,406	62,636	60,284
Allowance for loan losses	4,667	4,589	5,090	7,581	10,101
Non-accrual loans in portfolio	1,399	2,391	1,901	9,749	12,915
Non-performing assets in portfolio	2,567	4,355	5,863	14,343	21,236
Performing troubled debt restructurings in portfolio	1,091	1,009	1,346	8,187	10,340
Non-performing assets and performing troubled debt restructurings in portfolio	3,658	5,364	7,209	22,530	31,576
Performance Ratios:					
Return on average assets	0.60 %	0.06 %	(2.79)%	0.30 %	(0.90)%
Return on average equity	4.65	0.43	(20.24)	3.15	(9.64)
Interest rate spread(1)	2.48	2.59	2.25	2.66	2.86
Net interest margin(2)	2.62	2.74	2.43	2.79	3.05
Non-interest expenses to average total assets	2.25	2.84	2.93	2.50	2.72
Efficiency ratio(3)	77.62	96.74	110.95	85.95	87.21
Asset Quality Ratios:					
Non-accrual loans as a percent of gross loans	0.35	0.62	0.47	2.11	2.52
Non-performing assets as a percent of total assets	0.39	0.80	0.97	2.01	3.19
Non-performing assets and performing troubled debt restructurings as a percent of total assets	0.56	0.99	1.20	3.17	4.74
Allowance for loan losses as a percent of gross loans	1.18	1.18	1.26	1.64	1.97
	333.60	191.93	267.75	77.76	78.21

Allowance for loan losses as a percent of non-accrual loans					
Net charge-offs to average loans outstanding	0.00	0.19	3.07	0.69	1.96
Capital Ratios(4)**:**					
Total risk-based capital to risk weighted assets	16.99	20.75	18.97	14.22	12.01
Tier 1 risk-based capital to risk weighted assets	15.90	19.50	17.72	12.96	10.76
Tangible capital to tangible assets	N/A	12.09	10.91	7.70	7.54
Tier 1 leverage (core) capital to adjustable tangible assets	10.80	12.09	10.91	7.70	7.54
Shareholders' equity to total assets	12.41	14.16	12.54	8.80	9.04

(1) Represents the difference between the weighted average yield on interest earning assets and the weighted average cost of interest bearing liabilities.

(2) Net interest income divided by average interest earning assets.

(3) Efficiency ratio, which is a non-GAAP financial measure, is computed by dividing other expense by net interest income on a tax equivalent basis plus other income, excluding net securities gains (losses). See Item 7, MD&A, " – Other Income," page 42.

(4) Other than shareholders' equity to total assets, all capital ratios are for the Bank only.

(5) The calculation for the years ended September 2012 and 2011have been adjusted for the exchange and additional share issuance in the reorganization and offering completed on October 11, 2012.

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Item 7. Management's Discussion and Analysis ("MD&A") of Financial Condition and Results of Operations.

The purpose of this analysis is to provide the reader with information relevant to understanding and assessing the Company's results of operations for each of the past three years and financial condition for each of the past two years. In order to fully appreciate this analysis, the reader is encouraged to review the consolidated financial statements and accompanying notes thereto appearing under Item 8 of this report, and statistical data presented in this document.

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

See Page 1 of this Annual Report on Form 10-K for information regarding forward-looking statements.

Critical Accounting Policies and Estimates

Management's Discussion and Analysis of Financial Condition and Results of Operations is based on our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 2 to our audited consolidated financial statements contains a summary of our significant accounting policies. Management believes our policy with respect to the methodology for the determination of the allowance for loan losses involves a higher degree of complexity and requires management to make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. This critical policy and its application are periodically reviewed with the Audit Committee and our Board of Directors.

Allowance for Loan Losses

The allowance for loan losses represents management's estimate of probable loan losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the Company's Consolidated Statements of Financial Condition.

The evaluation of the adequacy of the allowance for loan losses includes, among other factors, an analysis of historical loss rates by loan category applied to current loan totals. However, actual loan losses may be higher or lower than historical trends, which vary. Actual losses on specified problem loans, which also are provided for in the evaluation, may vary from estimated loss percentages, which are established based upon a limited number of potential loss classifications. The allowance for loan losses is established through a provision for loan losses charged to expense. Management believes that the current allowance for loan losses will be adequate to absorb loan losses on existing loans that may become uncollectible based on the evaluation of known and inherent risks in the loan portfolio. The evaluation takes into consideration such factors as changes in the nature and size of the portfolio, overall portfolio quality, and specific problem loans and current economic conditions which may affect our borrowers' ability to pay.

The evaluation also details historical losses by loan category and the resulting loan loss rates which are projected for current loan total amounts. Loss estimates for specified problem loans are also detailed. In addition, OCC, as an integral part of their examination process, periodically review our allowance for loan losses. The OCC may require us to make additional provisions for loan losses based upon information available to them at the time of their examination. All of the factors considered in the analysis of the adequacy of the allowance for loan losses may be subject to change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required that could materially adversely impact earnings in future periods.

Other Real Estate Owned

Assets acquired through foreclosure consist of other real estate owned and financial assets acquired from debtors. Other real estate owned is carried at the lower of cost or fair value, less estimated selling costs. The fair value of other real estate owned is determined using current market appraisals obtained from approved independent appraisers, agreements of sale, and comparable market analysis from real estate brokers, where applicable. Changes in the fair value of assets acquired through foreclosure at future reporting dates or at the time of disposition will result in an adjustment in assets acquired through foreclosure expense or net gain (loss) on sale of assets acquired through foreclosure, respectively.

Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain assets to determine fair value disclosures. Investment and mortgage-backed securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans, real estate owned and certain other assets. These nonrecurring fair value adjustments typically involve application of lower-of-cost-or-market accounting or write-downs of individual assets.

Under the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 820, Fair Value Measurements, the Company groups its assets at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

· Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.

· Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

· Level 3 – Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company’s own estimates of assumptions that market participants would use in pricing the asset.

Under FASB ASC Topic 820, the Company bases its fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is our policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements, in accordance with the fair value hierarchy in FASB ASC Topic 820.

Fair value measurements for assets where there exists limited or no observable market data and, therefore, are based primarily upon the Company's or other third-party's estimates, are often calculated based on the characteristics of the asset, the economic and competitive environment and other such factors. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset. Additionally, there may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, that could significantly affect the results of current or future valuations. At September 30, 2015, the Company had $48,000 of assets that were measured at fair value on a non-recurring basis using Level 3 measurements.

Income Taxes

We make estimates and judgments to calculate some of our tax liabilities and determine the recoverability of some of our deferred tax assets ("DTAs"), which arise from temporary differences between the tax and financial statement recognition of revenues and expenses. We also estimate a reserve for deferred tax assets if, based on the available evidence, it is more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods. These estimates and judgments are inherently subjective. Historically, our estimates and judgments to calculate our deferred tax accounts have not required significant revision to our initial estimates.

In evaluating our ability to recover deferred tax assets, we consider all available positive and negative evidence, including our past operating results and our forecast of future taxable income. In determining future taxable income, we make assumptions for the amount of taxable income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require us to make judgments about our future taxable income and are consistent with the plans and estimates we use to manage our business. Any reduction in estimated future taxable income may require us to record a valuation allowance against our deferred tax assets. An increase in the valuation allowance would result in additional income tax expense in the period and could have a significant impact on our future earnings.

Realization of a deferred tax asset requires us to exercise significant judgment and is inherently uncertain because it requires the prediction of future occurrences. Our net deferred tax asset amounted to $2.9 million at September 30, 2015 compared to $2.4 million at September 30, 2014. In evaluating the need for a valuation allowance, we estimated our viable tax planning strategies that we could employ so that the asset would not go unused. We feel that the DTA balance of $2.9 million as of September 30, 2015 is appropriate since it is the amount of such estimated tax planning strategies. Our total deferred tax assets decreased to $11.4 million at September 30, 2015 compared to $12.6 million at September 30, 2014. Our DTA valuation allowance amounted to $8.0 million at September 30, 2015 compared to $10.1 million at September 30, 2014. In the future, the DTA allowance may be reversed, depending on the Company’s financial position and results of operations in the future, among other factors, and, in such event, may be available to increase future net income. There can be no assurance, however, as to when we could be in a position to recapture our DTA allowance.

Other-Than-Temporary Impairment of Securities

Securities are evaluated on a quarterly basis, and more frequently when market conditions warrant such an evaluation, to determine whether declines in their value are other-than-temporary. To determine whether a loss in value is other-than-temporary, management utilizes criteria such as the reasons underlying the decline, the magnitude and duration of the decline and whether or not management intends to sell or expects that it is more likely than not that it will be required to sell the security prior to an anticipated recovery of the fair value. The term “other-than-temporary” is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value for a debt security is determined to be other-than-temporary, the other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

Derivaties

The Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the payment of future uncertain cash amounts, the value of which are determined by interest rates. The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk primarily by managing the amount, sources, and duration of its debt funding and the use of derivative financial instruments. The Company primarily uses interest rate swaps as part of its interest rate risk management strategy.

Interest rate swaps are valued by a third party, using models that primarily use market observable inputs, such as yield curves, and are validated by comparison with valuations provided by the respective counterparties. The credit risk associated with derivative financial instruments that are subject to master netting agreements is measured on a net basis by counterparty portfolio. The significant assumptions used in the models, which include assumptions for interest rates, are independently verified against observable market data where possible. Where observable market data is not available, the estimate of fair value becomes more subjective and involves a high degree of judgment. In this circumstance, fair value is estimated based on management's judgment regarding the value that market participants would assign to the asset or liability. This valuation process takes into consideration factors such as market illiquidity. Imprecision in estimating these factors can impact the amount recorded on the balance sheet for a particular asset or liability with related impacts to earnings or other comprehensive income.

Overview and Strategy

Our business strategy is to operate as a well-capitalized and profitable financial institution dedicated to providing exceptional personal service to our individual and business customers. Highlights of our business strategy are discussed below:

Improving Core Earnings. With interest rates falling to historically low levels, it has become increasingly difficult for financial institutions to maintain acceptable levels of net interest income. Until recently, with the Bank unable to grow its asset base and loan portfolio, increasing interest income has been a challenge. This lack of growth in the loan portfolio through fiscal year-end 2014, combined with higher deposit and borrowing costs, have all contributed to a decline in the Banks' net interest margin. In an effort to achieve consistent sustainable earnings, i.e. improve the net interest margin, we are implementing specific product and pricing strategies designed to increase the yield on loans and reduce the cost of funding. In fiscal 2014, we resumed originating commercial real estate loans and commercial business loans, which have higher yields than single-family residential mortgage loans, on a relatively modest basis in accordance with our business plan and our strengthened loan underwriting and loan administration policies and procedures. We also have established a funding composition plan, which is designed to increase checking accounts, primarily non-interest bearing accounts, as well as savings and money market accounts. We are attempting to increase our core deposits, which we define as all deposit accounts other than certificates of deposit. At September 30, 2015, our core deposits amounted to 56.7% of total deposits ($263.8 million), compared to 50.7% of total deposits ($209.4 million) at September 30, 2014. We have continued our promotional efforts to increase core deposits. We review our deposit products on an ongoing basis and we are considering additional deposit products and are currently offering more flexible delivery options, such as mobile banking, as part of our efforts to increase core deposits. We expect to increase our commercial checking accounts and we plan to enhance our cross-marketing as part of our efforts to gain additional deposit relationships with our loan customers.

Seek Supervisory Relief. We entered into the Formal Agreement with the OCC in October 2014. Among other things, the Formal Agreement requires that we provide the OCC with relatively extensive reports and data on our business and operations on a quarterly basis. In light of the numerous reporting requirements and operating restrictions imposed by the Formal Agreement, we plan to seek relief from the Formal Agreement that the Bank entered into in 2014 as well as the IMCRs that the OCC has imposed as promptly as practicable.

Maintain Low Levels of Problem Assets. We are continuing in our efforts to maintain low levels of problem assets. At September 30, 2015, our total non-performing assets in portfolio were $2.6 million or 0.39% of total assets, reflecting a reduction of $18.7 million, or 87.9%, compared to $21.2 million of total non-performing assets at September 30, 2011 (when total non-performing assets amounted to 3.19% of total assets). The October 2013 bulk sale of problem loans resulted in a dramatic reduction of the Company's non-performing assets. The bulk sale was undertaken as an efficient mechanism for disposing of non-performing and underperforming assets and improving the Bank's credit quality in the process. As a result of the sale, the Company significantly reduced its exposure to sectors that experienced economic weakness and significant declines in collateral valuations and has substantially reduced the amount of non-accruing loans.

Growing Our Loan Portfolio and Resuming Commercial Real Estate and Construction and Development Lending. We have resumed, on a relatively modest basis, the origination of commercial real estate loans and construction and development loans in our market area. Such loans are being underwritten in accordance with our strengthened loan underwriting standards and our enhanced credit review and administration procedures. We continue to believe that we can be a successful niche lender to small and mid-sized commercial borrowers and homebuilders in our market area. In light of the improvements in economic conditions and real estate values, we believe that the resumption of commercial real estate and construction and development lending in a planned, deliberative fashion with the loan underwriting and administrative enhancements that we have implemented in recent periods, together with modest loan growth, will increase our interest income and our returns in future periods.

Increasing Market Share Penetration. We operate in a competitive market area for banking products and services. In recent years, we have been working to increase our deposit share in Chester and Delaware counties and we increased our marketing and promotional efforts. In our effort to increase market share as well as non-interest income, we plan to evaluate increasing our business in non-traditional products, such as wealth management.

Continuing to Provide Exceptional Customer Service. As a community-oriented savings bank, we take pride in providing exceptional customer service as a means to attract and retain customers. We deliver personalized service to our customers that distinguish us from the large regional banks operating in our market area. Our management team has strong ties to and deep roots in, the local community. We believe that we know our customers' banking needs and can respond quickly to address them.

Introduction

The following introduction to Management’s Discussion and Analysis highlights the principal factors that contributed to the Company’s earnings performance for the year ended September 30, 2015.

2015 has been challenging not only for the banking industry in general but also for the Company in particular. The current domestic economic issues, ongoing global financial uncertainty and continued headwinds from new regulatory requirements created challenges to financial institutions both domestically and abroad.

The Company was proactive with its balance sheet strategies throughout fiscal 2015 in order to reduce exposure to interest rates through a reduction in higher cost funding and non-core balances in the deposit mix coupled with an improvement in the earning asset mix. The Company’s progress in growing and improving its balance sheet earning asset mix has helped to expand its spread and margin.

The Company’s net income in fiscal 2015 was $3.7 million, $0.58 per common share, compared to net income of $323,000 in fiscal 2014 or $0.05 per common share. The growth in earnings performance in fiscal 2015 was primarily attributable to earnings from core operations. Earnings for fiscal 2015 and associated operating performance was characterized by solid revenue growth, loan generation and a continuation of our stable and favorable asset quality profile. Earnings were positively impacted by growth in net interest income, primarily from an increase in the average balance of earning assets of $33.2 million, which was partially offset by a decline of 13 basis points in the average yield. The decline in the average yield on earning assets was somewhat offset by a decline of two basis points in the average rate paid on interest-bearing liabilities in fiscal 2015 compared to fiscal 2014, primarily from a lower cost of funds in fiscal 2015 as compared to fiscal 2014.

For the year ended September 30, 2015, net interest income on a fully taxable equivalent basis amounted to $15.4 million, compared to $15.2 million for fiscal 2014. For fiscal 2015, interest income increased by $425,000 while interest expense increased by $177,000 from last year. As noted above, in fiscal 2015 compared to fiscal 2014, the average balance of our average interest earning assets increased $33.2 million while net interest spread and margin decreased on a tax-equivalent basis by 11 basis points and 12 basis points, respectively. For fiscal 2015, the Company’s net interest margin decreased to 2.62 percent as compared to 2.74 percent for fiscal 2014.

Total non-interest income improved as a percentage of total revenue, which is the sum of interest income and non-interest income, in fiscal 2015 largely due to an increase in net securities gains, which amounted to $515,000 in fiscal 2015 as compared to $83,000 in fiscal 2014. For the year ended September 30, 2015, total other income increased $380,000 as compared with the year ended September 30, 2014, from $2.2 million to $2.5 million. Excluding net securities gains and losses, the Company recorded total other income of $2.0 million and $2.1 million for the years ended September 30, 2015 and 2014, respectively.

For the year ended September 30, 2015, total other expense decreased $2.7 million, or 16.1 percent, compared to the year ended September 30, 2014. Decreases primarily included salaries and employee benefits of $1.8 million, $376,000 in occupancy expense, $322,000 in advertising costs, $634,000 in professional fees, and $9,000 in data processing expense. These decreases were partially offset by a $253,000 reduction in other real estate owned income and by an increase in other operating expenses of $128,000 and a $49,000 increase in federal deposit insurance premium.

The Company continues to move forward with momentum in expanding our presence in key markets. We continue to execute on our business plans and are positioning the Company to take advantage of the growth activity we are achieving in our markets, which includes our new loan production location in New Jersey. Our business plans call for us to achieve the transition to a commercial bank balance sheet. With entry into New Jersey lending market, we are working to solidify and expand the service relationship with our new customers. We remain excited by the potential to create incremental shareholder value from our strategic growth. We believe that this type of earnings performance demonstrates the Company’s commitment to achieving meaningful growth in earnings performance, an essential component of providing consistent and favorable long-term returns to our shareholders. However, while we continue to see an improvement in balance sheet strength and core earnings performance, we still remain cautious about the credit stability of the broader markets.

Total assets at September 30, 2015 were $655.7 million, an increase of 20.9 percent from assets of $542.3 million at September 30, 2014. The increase in assets reflects the growth of $84.6 million in our investment securities portfolio, as well as an increase of $21.1 million in cash an cash equivalent and a $5.2 million in our net loan portfolio as the Company continued to expand its client base and loan production, deploying cash from increased deposit production into a more efficient earning asset mix. The growth in the earning asset portfolio was funded in part through deposit growth of $52.6 million.

Our loan portfolio increased in fiscal 2015 as compared to fiscal 2014. Overall, the total portfolio increased year over year by approximately $5.6 million or 1.5 percent from fiscal 2014. Demand for both commercial loans and real estate loans prevailed throughout the year in the Company's market in Pennsylvania, despite the economic climate at both the state and national levels. The $5.6 million increase in the total loan portfolio at September 30, 2015 compared to September 30, 2014, primarily reflected an increase of $30.4 million in commercial loans and a $822,000 increase in construction and development loans. These increases were partially offset by a $16.4 million decrease in residential mortgage loans and a $9.2 million reduction in consumer loans at September 30, 2015 as compared to September 30, 2014. The Company is encouraged by loan demand and positive momentum is expected to continue in growing our loan portfolio in fiscal 2016. At September 30, 2015, the Company had $67.7 million in overall undisbursed loan commitments, which includes largely unused commercial lines of credit, home equity lines of credit and available usage from active construction facilities. Included in the overall undisbursed commitments are the Company's ''Approved, Accepted but Unfunded'' pipeline, which includes approximately $15.0 million in commercial real estate loans, $9.0 million in construction loans and $2.8 million in residential mortgages expected to fund over the next 90 days.

Asset quality remains high and a primary focus of the Company. Even so, the stability of the economy and credit markets remains uncertain and as such, has had an impact on certain credits within our portfolio. At September 30, 2015, non-performing assets totaled $2.6 million or 0.39 percent of total assets, a decline from $4.4 million or 0.80 percent at September 30, 2014. The reduction in non-performing assets from September 30, 2014 was achieved notwithstanding the addition of one new residential loan (totaling approximately $40,000), one construction and development loan (totaling approximately $12,000), two commercial loans (totaling approximately $97,000), and two second mortgage loans (totaling approximately $41,000) into non-performing status. This was more than offset by decreases from pay-downs and pay offs of $527,000 of non-performing loans and the return to performing status of $368,000, while $288,000 was moved within the non-performing asset category from non-accrual loans to OREO. We also sold OREO properties with an aggregate carrying value of $1.1 million during fiscal 2015.

At September 30, 2015, the total allowance for loan losses amounted to approximately $4.7 million, or 1.18 percent of total loans. The allowance for loan losses as a percent of total non-performing loans amounted to 333.6 percent at September 30, 2015 and 191.9 percent at September 30, 2014. This increase in the ratio of the allowance for loan losses to total non-performing loans from September 30, 2014 to September 30, 2015 was due to the reduction in the level of non-performing loans.

Deposits grew strongly during fiscal 2015, with total deposits of $465.5 million at September 30, 2015, increasing $52.6 million, or 12.7 percent, since September 30, 2014. Interest-bearing demand, savings, money market, and certificates of deposit less than $100,000 increased $39.1 million or 13.7 percent during fiscal 2015 from fiscal 2014. Time certificates of deposit of $100,000 or more at September 30, 2015, increased by $9.5 million or 24.5 percent from September 30, 2014.

Total shareholders' equity increased 6.0 percent in fiscal 2015 to $81.4 million, and represented 12.41 percent of total assets at September 30, 2015. Book value per common share (total common shareholders' equity divided by the number of shares outstanding) increased to $12.41 at September 30, 2015, as compared with $11.71 at September 30, 2014, primarily as a result of earnings of $3.7 million in fiscal 2015.

At September 30, 2015, the Bank's common equity tier 1 ratio was 15.90 percent, tier 1 leverage ratio was 10.80 percent, tier 1 risk-based capital ratio was 15.90 percent and the total risk-based capital ratio was 16.99 percent. At September 30, 2014, the Bank's tier 1 leverage ratio was 12.09 percent, tier 1 risk-based capital ratio was 19.50 percent and the total risk-based capital ratio was 20.75 percent. At September 30, 2015, the Bank was in compliance with all applicable regulatory capital requirements.

The following sections discuss the Company's Results of Operations, Asset and Liability Management, Liquidity and Capital Resources.

Results of Operations

Net income for the year ended September 30, 2015 was $3.7 million as compared to $323,000 earned in fiscal 2014 and a net loss of $18.8 million in fiscal 2013. Out net income for fiscal 2015 increased by 1044.9 percent compared to fiscal 2014. For fiscal 2015, the basic earnings per common share was $0.58 as compared with $0.05 per share in fiscal 2014 and a net loss of $2.96 per share in fiscal 2013.

For the year ended September 30, 2015, the Company's return on average shareholders' equity (''ROE'') was 4.65 percent and its return on average assets (''ROA'') was 0.60 percent. The comparable ratios for the year ended September 30, 2014, were ROE of 0.43 percent and ROA of 0.06 percent.

Earnings for fiscal 2015 benefitted from increases in net interest income and increases in non interest income, primarily service charges and other fees, net gain on sale of investments and earnings on bank owned life insurance, which were partially offset by a decrease in net gain on sale of loans. The decrease in non-interest expenses was due to decreases in salaries and benefits, occupancy expenses, advertising expenses and professional fees. These decreases were partially offset by increases in FDIC insurance, OREO expenses, and other operating expenses.

Net Interest Income

Net interest income is the difference between the interest earned on the portfolio of earning assets (principally loans and investments) and the interest paid for deposits and borrowings, which support these assets. Net interest income is presented on a fully tax-equivalent basis by adjusting tax-exempt income (primarily interest earned on obligations of state and political subdivisions) by the amount of income tax which would have been paid had the assets been invested in taxable issues. We believe this to be the preferred measurement of net interest income as it provides a relevant comparison between taxable and non-taxable amounts.

The following table presents the components of net interest income on a fully tax-equivalent basis, a non-GAAP measure, for the periods indicated, together with a reconciliation of net interest income as reported under GAAP.

	Year Ended September 30,								
	2015			2014			2013		
(Dollars in thousands)	Amount	**Increase (Decrease) from Prior Year**	**Percent Change**	Amount	**Increase (Decrease) from Prior Year**	**Percent Change**	Amount	**Increase (Decrease) from Prior Year**	**Percent Change**
Interest income:									
Loans, including fees	$16,492	$(1,251)	(7.05)	$17,743	$(2,436)	(12.07)	$20,179	$(3,867)	(16.08)
Investment securities	3,773	1,470	63.83	2,303	252	12.29	2,051	352	20.72
Dividends, restricted stock	311	188	152.85	123	104	547.37	19	15	375.00
Interest-bearing cash accounts	72	18	33.33	54	(83)	(60.58)	137	86	168.63
Total interest income	20,648	425	2.10	20,223	(2,163)	(9.66)	22,386	(3,414)	(13.23)
Interest expense:									
Deposits	3,431	(538)	(13.56)	3,969	(1,310)	(24.82)	5,279	(1,413)	(21.11)
Borrowings	1,817	715	64.88	1,102	(563)	(33.81)	1,665	(55)	(3.20)
Total interest expense	5,248	177	3.49	5,071	(1,873)	(26.97)	6,944	(1,468)	(17.45)
Net interest income on a fully tax-equivalent basis	15,400	248	1.64	15,152	(290)	(1.88)	15,442	(1,946)	(11.19)
Tax-equivalent adjustment [1]	(186)	(130)	232.14	(56)	29	(34.12)	(85)	(60)	240.00
Net interest income, as reported under GAAP	$15,214	$118	0.78	$15,096	$(261)	(1.70)	$15,357	$(2,006)	(11.55)

[1] Computed using a federal income tax rate of 34 percent for Years ended September 30, 2015, 2014 and 2013.

Net interest income is directly affected by changes in the volume and mix of interest-earning assets and interest-bearing liabilities, which support those assets, as well as changes in the rates earned and paid. Net interest income is presented in this financial review on a tax equivalent basis by adjusting tax-exempt income (primarily interest earned on various obligations of state and political subdivisions) by the amount of income tax which would have been paid had the assets been invested in taxable issues, and then in accordance with the Company's consolidated financial statements. Accordingly, the net interest income data presented in this financial review differ from the Company's net interest income components of the Consolidated Financial Statements presented elsewhere in this report.

Net interest income, on a tax-equivalent basis, for the year ended September 30, 2015 increased $248,000, or 1.6 percent, to $15.4 million, from $15.2 million for fiscal 2014. The Company's net interest margin contracted 12 basis points to 2.62 percent in fiscal 2015 from 2.74 percent for the fiscal year ended September 30, 2014. From fiscal 2013 to fiscal 2014, net interest income on a tax equivalent basis decreased by $290,000 and the net interest margin increased by 31 basis points. During fiscal 2015, our net interest margin was impacted by increases in yield on investment and FHLB stock and decreases in yield on deposits and borrowings, which were offset by decreases in yields on loans.

The change in net interest income during fiscal 2015 was attributable in part to the reduction in short-term interest rates that have remained at historic low levels throughout 2015 coupled with a sustained steepening of the interest rate yield curve. The Company experienced growth of $4.0 million in non-interest bearing deposits during fiscal 2015 and $39.1 million in interest-bearing demand, savings, money market and time deposits under $100,000 during fiscal 2015 as customers' desire for safety and liquidity remained paramount in light of their overall investment concerns. During the twelve months ended September 30, 2015, the Company's net interest spread declined by 11 basis points as a 13 basis point decrease in the average yield on interest-earning assets was not quite offset by a two basis point decrease in the average interest rates paid on interest-bearing liabilities.

For the year ended September 30, 2015, average interest-earning assets increased by $33.2 million to $586.8 million, as compared with the year ended September 30, 2014. The fiscal 2015 change in average interest-earning asset volume was primarily due to increased investment volume. Average interest-bearing liabilities increased by $27.6 million in fiscal 2015 compared to fiscal 2014, due primarily to an increase in average borrowings of $46.6 million partially offset by decreases in average interest bearing deposits of $19.0 million.

For the year ended September 30, 2014, average interest-earning assets decreased by $83.1 million to $553.6 million, as compared with the year ended September 30, 2013. The 2014 change in average interest-earning asset volume was primarily due to decreased loan volume and decreased deposits in other banks. Decreased average loan volume in fiscal 2014 was reflected in net decreases in single-family residential loans, construction loans and consumer loans in the loan portfolio. Average interest-bearing liabilities decreased by $69.8 million, due primarily to a decrease in interest bearing deposits of $67.2 million partially and a $2.6 million decrease in borrowings.

The factors underlying the year-to-year changes in net interest income are reflected in the tables presented on pages 27 and 28, each of which have been presented on a tax-equivalent basis (assuming a 34 percent tax rate for fiscal 2015, 2014 and 2013). The table on page 30 (Average Statements of Condition with Interest and Average Rates) shows the Company's consolidated average balance of assets, liabilities and shareholders' equity, the amount of income produced from interest-earning assets and the amount of expense incurred from interest-bearing liabilities, and net interest income as a percentage of average interest-earning assets.

Net Interest Margin

The following table quantifies the impact on net interest income (on a tax-equivalent basis) resulting from changes in average balances and average rates over the past three years. Any change in interest income or expense attributable to both changes in volume and changes in rate has been allocated in proportion to the relationship of the absolute dollar amount of change in each category.

Analysis of Variance in Net Interest Income Due to Volume and Rates

(In thousands)	**Fiscal 2015/2014 Increase (Decrease) Due to Change in:**			**Fiscal 2014/2013 Increase (Decrease) Due to Change in:**		
	Average Volume	**Average Rate**	**Net Change**	**Average Volume**	**Average Rate**	**Net Change**
Interest-earning assets:						
Loans, including fees	$(1,005)	$ (246)	$(1,251)	$(1,805)	$ (631)	$(2,436)
Investment securities	802	668	1,470	201	51	252
Interest-bearing cash accounts	30	(12)	18	(90)	7	(83)
Dividends, restricted stock	38	150	188	(2)	106	104
Total interest-earning assets	(135)	560	425	(1,696)	(467)	(2,163)
Interest-bearing liabilities:						
Money market deposits	20	87	107	(14)	(50)	(64)
Savings deposits	—	2	2	1	2	3
Certificates of deposit	(423)	(222)	(645)	(1,009)	(206)	(1,215)
Other interest-bearing deposits	—	(2)	(2)	(4)	(30)	(34)
Total interest-bearing deposits	(403)	(135)	(538)	(1,026)	(284)	(1,310)
Borrowings	1,141	(426)	715	(91)	(472)	(563)
Total interest-bearing liabilities	738	(561)	177	(1,117)	(756)	(1,873)
Change in net interest income	$(873)	$ 1,121	$248	$(579)	$ 289	$(290)

Interest income on a tax-equivalent basis for the year ended September 30, 2015 increased by approximately $425,000 or 2.1 percent as compared with the year ended September 30, 2014. This increase was due primarily to increases in the balances of the Company's investment securities portfolios offset in part by a decrease in loans and decline in rates due to the actions taken by the Federal Reserve to maintain historically low market interest rates.

The average balance of the Company's loan portfolio decreased $23.0 million in fiscal 2015 to $384.1 million from $407.2 million in fiscal 2014, primarily driven by reduction in residential and consumer loans.

The loan portfolio represented approximately 65.5 percent of the Company's interest-earning assets (on average) during fiscal 2015 and 73.6 percent for fiscal 2014. Average investment securities increased during fiscal 2015 by $40.9 million compared to fiscal 2014 as the Company has continued to increase its concentration in tax-exempt securities and corporate bonds. The average yield on interest-earning assets decreased from 3.65 percent in fiscal 2014 to 3.52 percent in fiscal 2015.

Interest income (tax-equivalent) decreased by $290,000 from fiscal 2013 to fiscal 2014 primarily due to decreases in the balances of the Company's loan portfolios offset in part by a decline in rates due to the actions taken by the Federal Reserve to maintain historically low market interest rates.

Interest expense for the year ended September 30, 2015 was principally impacted by both volume and rate mix related factors. The rate related changes resulted in increased expense of $177,000 due primarily to increase in borrowings partially offset by a decline in certificates of deposit in fiscal 2015. For the year ended September 30, 2014, interest expense decreased $1.9 million or 27.0 percent as compared with fiscal 2013, principally reflecting a reduction in the volume of interest-bearing deposits. Average interest-bearing liabilities decreased $69.8 million; the decline was represented in all deposit categories, except savings accounts.

The Company's net interest spread on a tax-equivalent basis (i.e., the average yield on average interest-earning assets, calculated on a tax equivalent basis, minus the average rate paid on interest-bearing liabilities) decreased 11 basis points to 2.48 percent in fiscal 2015 from 2.59 percent for the year ended September 30, 2014. The decrease in fiscal 2015 reflected a decline of spreads between yields earned on loans and investments and rates paid for supporting funds.

The net interest spread increased 34 basis points in fiscal 2014 as compared with fiscal 2013, primarily as a result of a increase of spreads between yields earned on loans and investments and a decline in rates paid for supporting funds.

The cost of total average interest-bearing liabilities decreased to 1.04 percent, a decrease of two basis points, for the year ended September 30, 2015, from 1.06 percent for the year ended September 30, 2014, which followed a decrease of 21 basis points from 1.27 percent for the year ended September 30, 2013.

The following table, ‘‘Average Statements of Condition with Interest and Average Rates’’, on a tax-equivalent basis presents for the years ended September 30, 2015, 2014 and 2013, the Company’s average assets, liabilities and shareholders’ equity. The Company’s net interest income, net interest spreads and net interest income as a percentage of interest-earning assets (net interest margin) are also reflected.

Average Statements of Condition with Interest and Average Rates

	Year Ended September 30,								
	2015			2014			2013		
	Average Outstanding Balance	Interest Earned/ Paid	**Average Yield/ Rate**	Average Outstanding Balance	Interest Earned/ Paid	**Average Yield/ Rate**	Average Outstanding Balance	Interest Earned/ Paid	**Average Yield/ Rate**
	(Dollars in thousands)								
ASSETS									
Interest earning assets:									
Loans receivable[(1)]	$384,125	$16,492	4.29%	$407,169	$17,743	4.36%	$447,196	$20,179	4.51%
Investment securities	158,282	3,773	2.38	117,366	2,303	1.96	106,903	2,051	1.92
Deposits in other banks	39,975	72	0.18	25,714	54	0.21	78,902	137	0.17
FHLB stock	4,369	311	7.12	3,342	123	3.68	3,696	19	0.51
Total interest earning assets[(1)]	586,751	20,648	3.52	553,591	20,223	3.65	636,696	22,386	3.52
Non-interest earning assets									
Cash and due from banks	7,003			1,356			2,943		
Bank owned life insurance	18,492			21,092			19,083		
Other assets	13,592			14,164			22,287		
Allowance for loan losses	(4,610)			(4,893)			(6,839)		
Total non-interest earning assets	34,477			31,719			37,474		
Total assets	$621,228			$585,310			$674,170		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest bearing liabilities:									
Money Market accounts	$72,467	$271	0.37%	$64,499	$164	0.25%	$68,782	$228	0.33%
Savings accounts	44,975	29	0.06	44,379	27	0.06	43,382	24	0.06
Certificate accounts	209,994	3,048	1.45	237,090	3,693	1.56	298,229	4,908	1.65
Other interest- bearing deposits	86,814	83	0.10	87,283	85	0.10	90,085	119	0.13
Total deposits	414,250	3,431	0.83	433,251	3,969	0.92	500,478	5,279	1.05
Borrowed funds	91,588	1,817	1.98	45,007	1,102	2.45	47,593	1,665	3.50
Total interest- bearing liabilities	505,838	5,248	1.04	478,258	5,071	1.06	548,071	6,944	1.27
Non-interest bearing liabilities									
Demand deposits	28,650			25,499			26,899		
Other liabilities	7,163			5,733			6,306		
Total non-interest- bearing liabilities	35,813			31,232			33,205		
Shareholders' equity	79,577			75,820			92,894		
	$621,228			$585,310			$674,170		

Total liabilities and shareholders' equity						
Net interest income (tax-equivalent basis)	$15,400		$15,152		$15,442	
Net interest spread		2.48%		2.59%		2.25%
Net interest margin		2.62%		2.74%		2.43%
Tax-equivalent adjustment(2)	(186)		(56)		(85)	
Net Interest income	$15,214		$15,096		$15,357	

(1) Includes non-accrual loans during the respective periods. Calculated net of deferred loan fees and loan discounts.

(2) The tax-equivalent adjustment was computed based on a statutory Federal income tax rate of 34 percent for fiscal years 2015, 2014 and 2013.

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Investment Portfolio

For the year ended September 30, 2015, the average volume of investment securities increased by $40.9 million to approximately $158.3 million or 27.0 percent of average earning assets, from $117.4 million on average, or 21.2 percent of average earning assets, in fiscal 2014. At September 30, 2015, the total investment portfolio amounted to $185.6 million, an increase of $84.6 million from September 30, 2014. The increase in average volume of investment securities reflects the fact that with the strong borrowing growth experienced during fiscal 2015 and large buildup of liquidity, the Company continued to prudently expand the size of its investment portfolio in an effort to deploy excess cash into earning assets. At September 30, 2015, the principal components of the investment portfolio were U.S. Treasury and government agency obligations, Federal agency obligations including mortgage-backed securities, obligations of U.S. states and political subdivision, corporate bonds and notes, and equity securities.

During the year ended September 30, 2015, volume related factors increased investment revenue by $802,000, while rate related factors increased investment revenue by $668,000. The tax-equivalent yield on investments increased by 42 basis points to 2.38 percent from a yield of 1.96 percent during the year ended September 30, 2014. The increase in the investment portfolio resulted from the large buildup of liquidity, which caused the Company to prudently expand the size of its investment portfolio in an effort to deploy excess cash into earning assets. The yield on the portfolio increased in fiscal 2015 compared to fiscal 2014 due primarily to higher rates earned on taxable securities.

During fiscal 2015, the Company reclassified at fair value approximately $57.5 million in available-for-sale investment securities to the held-to-maturity category. The net unrealized loss at date of transfer amounted to $115,000. This will be amortized over the remaining life of the securities as an adjustment of yield, offsetting the related amortization of the premium or accretion of the discount on the transferred securities. No gains or losses were recognized at the time of reclassification. Management considers the held-to-maturity classification of these investment securities to be appropriate as the Company has the positive intent and ability to hold these securities to maturity.

As of September 30, 2015, the estimated fair value of the available-for-sale securities disclosed below was primarily dependent upon the movement in market interest rates, particularly given the negligible inherent credit risk associated with these securities. These investment securities are comprised of securities that are rated investment grade by at least one bond credit rating service. Although the fair value will fluctuate as the market interest rates move, management believes that these fair values will recover as the underlying portfolios mature and are reinvested in market rate yielding investments. As of September 30, 2015, the Company held six U.S. government agency securities, 20 municipal bonds, 29 corporate securities, 37 mortgage-backed securities and one single issuer trust preferred security which were in an unrealized loss position. The Company does not intend to sell and expects that it is not more likely than not that it will be required to sell these securities until such time as the value recovers or the securities mature. Management does not believe any individual unrealized loss as of September 30, 2015 represents other-than-temporary impairment.

Securities available-for-sale are a part of the Company’s interest rate risk management strategy and may be sold in response to changes in interest rates, changes in prepayment risk, liquidity management and other factors. The Company continues to reposition the investment portfolio as part of an overall corporate-wide strategy to produce reasonable and consistent margins where feasible, while attempting to limit risks inherent in the Company’s balance sheet.

For fiscal 2015, proceeds of available-for-sale investment securities sold amounted to approximately $70.4 million. Gross realized gains on investment securities sold amounted to approximately $610,000, while gross realized losses amounted to approximately $95,000, for the period. For fiscal 2014, proceeds of investment securities sold amounted to approximately $16.8 million. Gross realized gains on investment securities sold amounted to approximately $118,000, while gross realized losses amounted to approximately $35,000, for the period. For fiscal 2013, proceeds of investment securities sold amounted to approximately $18.2 million. Gross realized gains on investment securities sold amounted to approximately $549,000, while gross realized losses amounted to approximately $70,000, for the period.

The varying amount of sales from the available-for-sale portfolio over the past few years, and the significant volume of such sales in fiscal 2015, reflect the significant volatility present in the market. Given the historic low interest rates prevalent in the market, it is necessary for the Company to protect itself from interest rate exposure. Securities that once appeared to be sound investments can, after changes in the market, become securities that the Company has the flexibility to sell to avoid losses and mismatches of interest-earning assets and interest-bearing liabilities at a later time.

The table below illustrates the maturity distribution and weighted average yield on a tax-equivalent basis for investment securities at September 30, 2015 on a contractual maturity basis.

	One year or less		More than One Year through Five Years		More than Five Years through Ten Years		More than Ten Years		Total		
	Amortized Cost	**Weighted Average Yield**	**Amortized Cost**	**Weighted Average Yield**	**Amortized Cost**	**Weighted Average Yield**	**Amortized Cost**	**Weighted Average Yield**	**Amortized Cost**	**Fair Value**	**Weighted Average Yield**
	(Dollars in thousands)										
Available for Sale Securities:											
U.S. government agencies and obligations	$-	-%	$-	-%	$-	-%	$816	2.28 %	$816	$815	2.28 %
State and municipal obligations	-	-	2,666	2.31	17,415	2.23	21,926	2.33	42,007	42,083	2.29
Mortgage-backed securities	-	-	-	-	-	-	14,783	2.09	14,783	14,624	2.09
Single issuer trust preferred security	-	-	-	-	-	-	1,000	0.93	1,000	850	0.93
Corporate debt securities	-	-	10,372	2.54	60,502	3.09	-	-	70,874	69,982	3.00
Total	$-	-%	$13,038	2.46 %	$77,917	2.90 %	$38,525	2.20 %	$129,480	$128,354	2.65 %
Held to Maturity Securities:											
U.S. government agencies and obligations	$-	-%	14,301	1.49 %	$-	-%	$-	-%	14,301	14,296	1.49 %
State and municipal obligations	-	-	-	-	-	-	10,075	1.63	10,075	10,023	1.63
	-	-	-	-	-	-	4,011	1.63	4,011	3,956	3.82

Corporate debt securities											
Mortgage-backed securities	-	-	-	-	-	-	28,834	1.77	28,834	28,550	1.77
Total	$-	-%	$14,301	1.49 %	$-	-%	42,920	1.93 %	57,221	56,825	1.82 %
Total Investment Securities	$-	-%	$27,339	1.95 %	$77,917	2.90 %	$81,445	2.06 %			