

Section 1: 10-K (SEPTEMBER 30, 2019 FORM 10-K)

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K**

(Mark One)

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended: September 30, 2019

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

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

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 NO

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). YES 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.

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

| | | | |
|-------------------------|--------------------------|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/> | Accelerated filer | <input checked="" type="checkbox"/> |
| Non-accelerated filer | <input type="checkbox"/> | Smaller reporting company | <input checked="" type="checkbox"/> |
| | | Emerging growth company | <input type="checkbox"/> |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates was approximately \$142.9 million, based on the last sale price on the 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 16, 2019 was 7,763,785.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2020 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" 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) 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; (9) 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 (10) the outcome of any regulatory or 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

General

Malvern Bancorp, Inc. (the "Company" or "Malvern Bancorp"), a Pennsylvania corporation, is a registered bank holding company registered under the Bank Holding Company Act of 1956, as amended (the "Holding Company Act"). Malvern Bancorp is the holding company for Malvern Bank, National Association ("Malvern Bank" or the "Bank"), a national bank that was originally organized in 1887 as a federally-chartered savings bank. Malvern Bank now serves as one of the oldest banks headquartered on the Philadelphia Main Line. For more than a century, the Bank has been committed to helping people build prosperous communities as a trusted financial partner, forging lasting relationships through teamwork, respect and integrity. Effective February 12, 2018, the Bank converted from a federal savings bank charter to a national bank charter and Malvern Bancorp converted from a savings and loan holding company to a bank holding company.

The Bank conducts business from its headquarters in Paoli, Pennsylvania, a suburb of Philadelphia, and through its twelve other banking locations in Chester, Delaware and Bucks counties, Pennsylvania, Morristown, New Jersey, its New Jersey regional headquarters, Palm Beach, Florida, and Montchanin, Delaware. The Bank also maintains representative offices in Wellington, Florida and Allentown, Pennsylvania. The Bank's primary market niche is providing personalized service to its client base.

The Bank, through its Private Banking division and strategic partnership with Bell Rock Capital, LLC ("Bell Rock") in Rehoboth Beach, Delaware, provides personalized wealth management and advisory services to high net worth individuals and families. Those services include banking, liquidity management, investment services, 401(k) accounts and planning, custody, tailored lending, wealth planning, trust and fiduciary services, family wealth advisory services and philanthropic advisory services. The Bank offers insurance services through Malvern Insurance Associates, LLC, which provides clients a rich array of financial services, including commercial and personal insurance and commercial and personal lending.

The Bank's principal business consists of attracting deposits from businesses and the general public and investing those deposits, together with borrowings and funds generated from operations, in commercial and multi-family real estate loans, one- to four-family residential real estate loans, construction and development loans, commercial business loans, home equity loans and lines of credit and other consumer loans, as well as investing in investment securities.

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.

The Bank owns 100 percent of Malvern Insurance Associates, LLC ("Malvern Associates"), a Pennsylvania limited liability company. Malvern Associates is a licensed insurance broker under Pennsylvania and New Jersey law.

The Bank owns a 10 percent non-controlling interest in Bell Rock an investment advisor registered with the SEC.

Certain mortgage-backed securities of the Bank are held through Delaware statutory trusts, 5 percent of which are owned by the Bank and 95 percent of which are owned by Coastal Asset Management Co., a Delaware corporation which is wholly owned by the Bank.

The Bank owns a 3.39 percent interest in Bankers Settlement Services Capital Region, LLC, a Pennsylvania limited liability company which acts as a title insurance agent or agency.

The Bank owns 100 percent of Joliet 55 LLC., a New Jersey limited liability company which holds an other real estate owned ("OREO") asset.

The Bank has representative offices, which are not branches, in Wellington, Florida and Allentown, Pennsylvania.

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 <http://ir.malvernbankcorp.com> without charge as soon as reasonably practicable after filing with 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, upon request. Requests should be sent to Malvern Bancorp, Inc., Attention: Shareholder Relations, 42 East Lancaster Avenue, Paoli, Pennsylvania, 19301. 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 among other things, invest in technology and finance wide-ranging advertising campaigns.

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 the members of our Board of Directors help us develop business relationships by increasing our profile in our communities.

Products 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. 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, safe deposit boxes, credit cards, wire transfers, access to automated teller services, internet banking, ACH origination, telephone banking, and mobile banking. The Bank also offers remote deposit capture banking for both business and retail customers, providing the ability to electronically scan and transmit checks for deposit, reducing time and cost.

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 through the Bank's participation in Promontory Interfinancial Network, LLC ("the Network"). Customers who are Federal Deposit Insurance Corporation (the "FDIC") insurance sensitive are able to place large dollar deposits with the Bank and the Bank 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, through its private banking division and a strategic partnership with Bell Rock Capital, offers personalized wealth management and advisory services to high net worth individuals and families. Services provided include liquidity management, investment services, custody, wealth planning, trust and fiduciary services, insurance and 401(k) services.

The Bank, through its wholly-owned subsidiary, Malvern Insurance Associates, offers insurance services including life and health insurance, long term care, automobile, homeowners and liability insurance.

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 credit and debit card interchange fees, gift card fees, and other miscellaneous fees. In addition, the Bank generates additional non-interest revenue associated with residential loan origination and sale, back to back customer swaps, 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 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 market area. However, the Bank will make loans to persons outside of our primary market 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 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.

As a national bank, the Bank's lending limit to any one borrower is 15 percent of the Bank's capital and surplus (defined as Tier 1 and Tier 2 capital calculated under the risk-based capital standards applicable to the Bank plus the allowance for loan losses ("ALLL", "allowance") not included in the Bank's Tier 2 capital) for most loans (\$24.5 million at September 30, 2019) and 25 percent of the Bank's capital and surplus for loans secured by readily marketable collateral (\$40.8 million at September 30, 2019). At September 30, 2019, the Bank's largest committed relationship totaled \$20.0 million.

Our business model includes using industry best practices for community banks, including personalized service, technology and extended hours. We believe that these generate deposit accounts with larger average balances than we might attract otherwise. From time to time 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.

Regulation of Malvern Bancorp, Inc.

Malvern Bancorp is a bank holding company within the meaning of the Holding Company Act. As a bank holding company, Malvern Bancorp is supervised by the Board of Governors of the Federal Reserve System (the "FRB") and is required to file reports with the FRB and provide such additional information as the FRB may require.

The Holding Company Act prohibits Malvern Bancorp, with certain exceptions, from acquiring direct or indirect ownership or control of more than five percent of the voting shares of any company which is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to subsidiary banks, except that it may, upon application, engage in, and may own shares of companies engaged in, certain businesses found by the FRB to be so closely related to banking "as to be a proper incident thereto." The Holding Company Act requires prior approval by the FRB of the acquisition by Malvern Bancorp of more than five percent of the voting stock of any other bank. Satisfactory capital ratios, Community Reinvestment Act ratings, and anti-money laundering policies are generally prerequisites to obtaining federal regulatory approval to make acquisitions. The Dodd-Frank Act requires a bank holding company where so directed by the FRB to act as a source of financial and managerial strength to its subsidiary bank and to commit resources to support its subsidiary bank in circumstances in which it might not be otherwise inclined to do so. Acquisitions by Malvern Bank require approval of the Office of the Comptroller of the Currency (the "OCC").

The Holding Company Act does not place territorial restrictions on the activities of non-bank subsidiaries of bank holding companies.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 enables bank holding companies to acquire banks in states other than the bank holding company's home state and to open branches of such banks in other states, subject to certain restrictions. The Dodd-Frank Act, discussed below, authorized interstate *de novo* branching regardless of state law.

Regulation of Malvern Bank

As a national bank, Malvern Bank is subject to the supervision of, and to regular examination by the OCC. Various laws and the regulations promulgated thereunder applicable to Malvern Bancorp and Malvern Bank impose restrictions and requirements in many areas, including capital requirements, the maintenance of reserves, establishment of new offices, the making of loans and investments, consumer protection, employment practices, bank acquisitions and entry into new types of business. There are various legal limitations, including Sections 23A and 23B of the Federal Reserve Act, which govern the extent to which a bank subsidiary may finance or otherwise supply funds to or engage in certain other types of transactions with its holding company or its holding company's non-bank subsidiaries. Under federal law, no bank subsidiary may, subject to certain limited exceptions, make loans or extensions of credit to, or investments in the securities of, its parent or the non-bank subsidiaries of its parent (other than direct subsidiaries of such bank which are not financial subsidiaries) or take their securities as collateral for loans to any borrower. Each bank subsidiary is also subject to collateral security requirements for any loans or extensions of credit permitted by such exceptions.

Capital Requirements

Pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), each federal banking agency has promulgated regulations, specifying the levels at which a financial institution would be considered "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized," and to take certain mandatory and discretionary supervisory actions based on the capital level of the institution.

In July 2013, the FRB and the OCC published final rules establishing a new comprehensive capital framework for U.S. banking organizations, referred to as the Basel III rules. The Basel III rules implement the Basel Committee's December 2010 framework, commonly referred to as Basel III, for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. Basel III substantially revised the risk-based capital requirements applicable to bank holding companies and depository institutions, including Malvern Bancorp and Malvern Bank. Basel III became effective for us on January 1, 2015 (subject to phase-in periods for certain components).

Basel III (i) introduced a new capital measure called "Common Equity Tier 1," or CET1, (ii) specified that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements, (iii) applied most deductions/adjustments to regulatory capital measures to CET1 and not to the other components of capital, thus potentially requiring higher levels of CET1 in order to meet minimum ratios, and (iv) expanded the scope of the reductions/adjustments from capital as compared to existing regulations.

Under Basel III, the minimum capital ratios for Malvern Bancorp and Malvern Bank are as follows:

- 4.5 percent CET1 to risk-weighted assets
- 6.0 percent Tier 1 capital (i.e., CET1 plus Additional Tier 1) to risk-weighted assets
- 8.0 percent Total capital (i.e., Tier 1 plus Tier 2) to risk-weighted assets
- 4.0 percent Tier 1 capital to average consolidated assets as reported on consolidated financial statements (known as the "leverage ratio").

Basel III also requires Malvern Bancorp and Malvern Bank to maintain a 2.5 percent "capital conservation buffer", composed entirely of CET1, on top of the minimum risk-weighted asset ratios, effectively resulting in minimum ratios of (i) CET1 to risk-weighted assets of at least 7.0 percent, (ii) Tier 1 capital to risk-weighted assets of at least 8.5 percent, and (iii) total capital to risk-weighted assets of at least 10.5 percent. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of (i) CET1 to risk-weighted assets, (ii) Tier 1 capital to risk-weighted assets or (iii) total capital to risk-weighted assets above the respective minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and discretionary bonus payments to executive officers based on the amount of the shortfall. The implementation of the capital conservation buffer began to be phased in on January 1, 2016 at the 0.625 percent level and increased by 0.625 percent on each subsequent January 1st, until it became fully implemented at 2.5 percent on January 1, 2019.

Basel III provides for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in common equity issued by nonconsolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10 percent of CET1 or all such categories in the aggregate exceed 15 percent of CET1. The deductions and other adjustments to CET1 were being phased in incrementally between January 1, 2015 and January 1, 2018. However, in November 2017, banking regulators announced that the phase in of certain of these adjustments for non-advanced approaches banking organizations, such as Malvern Bank, was frozen.

Under current capital standards, the effects of accumulated other comprehensive income items included in capital are excluded for the purposes of determining regulatory capital ratios. Under Basel III, the effects of certain accumulated other comprehensive items are not excluded; however, non-advanced approaches banking organizations, including Malvern Bancorp and Malvern Bank, were permitted to make a one-time permanent election to continue to exclude these items effective as of January 1, 2015. We made this one-time election in the applicable bank regulatory reports as of March 31, 2015.

With respect to Malvern Bank, Basel III also revised the “prompt corrective action” regulations pursuant to Section 38 of FDICIA, by (i) introducing a CET1 ratio requirement at each capital quality level (other than critically undercapitalized); (ii) increasing the minimum Tier 1 capital ratio requirement for each category; and (iii) requiring a leverage ratio of 5 percent to be well-capitalized. The OCC’s regulations implementing these provisions of FDICIA provide that an institution will be classified as “well capitalized” if it (i) has a total risk-based capital ratio of at least 10.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 8.0 percent, (iii) has a CET1 ratio of at least 6.5 percent, (iv) has a Tier 1 leverage ratio of at least 5.0 percent, and (v) meets certain other requirements. An institution will be classified as “adequately capitalized” if it meets the aforementioned minimum capital ratios under Basel III. An institution will be classified as “undercapitalized” if it (i) has a total risk-based capital ratio of less than 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 6.0 percent, (iii) has a CET1 ratio of less than 4.5 percent or (iv) has Tier 1 leverage ratio of less than 4.0 percent. An institution will be classified as “significantly undercapitalized” if it (i) has a total risk-based capital ratio of less than 6.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 4.0 percent, (iii) has a CET1 ratio of less than 3.0 percent or (iv) has a Tier 1 leverage ratio of less than 3.0 percent. An institution will be classified as “critically undercapitalized” if it has a tangible equity to total assets ratio that is equal to or less than 2.0 percent. An insured depository institution may be deemed to be in a lower capitalization category if it receives an unsatisfactory examination rating. Similar categories apply to bank holding companies. The capital ratios applicable to depository institutions under Basel III currently exceed the ratios to be considered well-capitalized under the prompt corrective action regulations. See Economic Growth, Regulatory Relief and Consumer Protection Act below.

Basel III prescribes a standardized approach for calculating risk-weighted assets that expand the risk-weighting categories from the four Basel I-derived categories (0 percent, 20 percent, 50 percent and 100 percent) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets.

As indicated in the following tables, as of September 30, 2019 Malvern Bank’s and Malvern Bancorp’s current capital levels exceed the required capital amounts to be considered “well capitalized” and also meet the fully-phased in minimum capital requirements, including the related capital conservation buffers, as required by the Basel III capital rules.

Malvern Bank's capital ratios as of September 30, 2019 are as follows:

| | <u>Actual</u> | | <u>Required for Capital Adequacy Purposes</u> | | <u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u> | | <u>Excess Over Well-Capitalized Provision</u> | |
|--|---------------|--------------|---|--------------|---|--------------|---|--------------|
| | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> |
| <i>(Dollars in thousands)</i> | | | | | | | | |
| Tier 1 leverage (core) capital (to adjusted tangible assets) | \$ 153,086 | 12.23% | \$ 50,055 | 4.00% | \$ 62,569 | 5.00% | \$ 90,517 | 7.23% |
| Common equity Tier 1 (to risk-weighted assets) | \$ 153,086 | 15.38 | 44,788 | 4.50 | 64,694 | 6.50 | 88,392 | 8.88 |
| Tier 1 risk-based capital (to risk-weighted assets) | \$ 153,086 | 15.38 | 59,717 | 6.00 | 79,623 | 8.00 | 73,463 | 7.38 |
| Total risk-based capital (to risk-weighted assets) | \$ 163,253 | 16.40 | 79,623 | 8.00 | 99,529 | 10.00 | 63,724 | 6.40 |

Failure to meet any of the capital requirements could result in enforcement actions by the regulators, including 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.

Malvern Bancorp's capital ratios as of September 30, 2019 are as follows:

| | <u>Actual</u> | | <u>Required for Capital Adequacy Purposes</u> | | <u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u> | | <u>Excess Over Well-Capitalized Provision</u> | |
|--|---------------|--------------|---|--------------|---|--------------|---|--------------|
| | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> |
| <i>(Dollars in thousands)</i> | | | | | | | | |
| Tier 1 leverage (core) capital (to adjusted tangible assets) | \$ 142,508 | 11.38% | \$ 50,091 | 4.00% | \$ 62,614 | 5.00% | \$ 79,894 | 6.38% |
| Common equity Tier 1 (to risk-weighted assets) | \$ 142,508 | 14.30 | 44,838 | 4.50 | 64,766 | 6.50 | 77,741 | 7.80 |
| Tier 1 risk-based capital (to risk-weighted assets) | \$ 142,508 | 14.30 | 59,784 | 6.00 | 79,713 | 8.00 | 62,795 | 6.30 |
| Total risk-based capital (to risk-weighted assets) | \$ 177,293 | 17.79 | 79,713 | 8.00 | 99,641 | 10.00 | 77,652 | 7.79 |

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

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 impacted the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act required various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. It is still uncertain to what extent and how full implementation and promulgation of rules under the Dodd-Frank Act will occur and impact the Company and the Bank. The federal agencies have been given significant discretion in drafting the implementing rules and regulations. 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 Dodd-Frank Act are related to the operations of the Bank:

- 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. Financial institutions with assets of \$10 billion or

less, such as 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 national bank, prevents or significantly interferes with the exercise by a national bank 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 another state law with substantively equivalent terms.
- Deposit insurance has been permanently increased to \$250,000.
- The 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, 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 Dodd-Frank Act are related to the operations of the Company:

- 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 Stock Market, LLC (“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. See “Incentive Compensation” below.
- 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 has been 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. This information must be reported for the first time for the first full fiscal year beginning on or after January 1, 2017; accordingly, this information will be included in the Company’s proxy statement for its 2019 annual meeting of shareholders.

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 contain prohibitions and restrictions on the ability of financial institution 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. However, Congress has provided an exception to the Volcker Rule's applicability for banks with less than \$10 billion in assets. Therefore, the Volcker Rule is not expected to impact Malvern Bank in any significant way at this time.

Transactions with Affiliates, Directors, Executive Officers and Shareholders

Sections 23A and 23B of the Federal Reserve Act and FRB Regulation W generally:

- limit the extent to which a bank or its subsidiaries may engage in "covered transactions" with any one affiliate;
- limit the extent to which a bank or its subsidiaries may engage in "covered transactions" with all affiliates; and
- require that all such transactions be on terms substantially the same, or at least as favorable to the bank or subsidiary, as those provided to a non-affiliate.

An affiliate of a bank is any company or entity which controls, is controlled by, or is under common control with the bank. The term "covered transaction" includes the making of loans to the affiliate, the purchase of assets from the affiliate, the issuance of a guarantee on behalf of the affiliate, the purchase of securities issued by the affiliate, and other similar types of transactions.

A bank's authority to extend credit to executive officers, directors and greater than 10 percent shareholders, as well as entities such persons control, is subject to Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O promulgated thereunder by the Federal Reserve Board. Among other things, these loans must be made on terms (including interest rates charged and collateral required) substantially the same as those offered to unaffiliated individuals or be made as part of a benefit or compensation program and on terms widely available to employees and must not involve a greater than normal risk of repayment. In addition, the amount of loans a bank may make to these persons is based, in part, on the bank's capital position, and specified approval procedures must be followed in making loans which exceed specified amounts.

Incentive Compensation

The Dodd-Frank Act requires the federal bank regulatory agencies and the SEC to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities with at least \$1 billion in total assets, such as Malvern Bancorp and the Bank, that encourage inappropriate risks by providing an executive officer, employee, director or principal shareholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity. In addition, these agencies must establish regulations or guidelines requiring enhanced disclosure to regulators of incentive-based compensation arrangements. The agencies proposed such regulations in April 2011 and subsequently proposed revised regulations in May 2016, but the revised regulations have not been finalized. If the revised regulations are adopted in the form proposed, they will impose limitations on the manner in which Malvern Bancorp may structure compensation for its executives and employees.

In 2010, the FRB, OCC and FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. These three principles are incorporated into the proposed joint compensation regulations under the Dodd-Frank Act.

The FRB will review, as part of its regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as Malvern Bancorp, that are not "large, complex banking organizations." These reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Dividend Limitations

Malvern Bancorp is a legal entity separate and distinct from its subsidiaries. Malvern Bancorp's revenues (on a parent company only basis) result in substantial part from dividends paid by the Bank. The Bank's dividend payments, without prior regulatory approval, are subject to regulatory limitations. Under the National Bank Act, dividends may be declared only if, after payment thereof, capital would be unimpaired and remaining surplus would equal 100 percent of capital. Moreover, a national bank may declare, in any one year, dividends only in an amount aggregating not more than the sum of its net profits for such year and its retained net profits for the preceding two years. However, declared dividends in excess of net profits in either of the preceding two years can be offset by retained net profits in the third and fourth years preceding the current year when determining the Bank's dividend limitation. In addition, the bank regulatory agencies have the authority to prohibit the Bank from paying dividends or otherwise supplying funds to Malvern Bancorp if the supervising agency determines that such payment would constitute an unsafe or unsound banking practice.

Loans to Related Parties

Malvern Bank's authority to extend credit to its directors, executive officers and 10 percent shareholders, as well as to entities controlled by such persons, is currently governed by the requirements of the National Bank Act, Sarbanes-Oxley Act and Regulation O of the FRB thereunder. Among other things, these provisions require that extensions of credit to insiders (i) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features and (ii) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the Bank's capital. In addition, extensions of credit in excess of certain limits must be approved by the Bank's Board of Directors. Under the Sarbanes-Oxley Act, Malvern Bancorp and its subsidiaries, other than the Bank under the authority of Regulation O, may not extend or arrange for any personal loans to its directors and executive officers.

Economic Growth, Regulatory Relief and Consumer Protection Act

On May 25, 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the "Regulatory Relief Act") was signed into law. The Regulatory Relief Act was designed to provide regulatory relief for banking organizations, particularly for all but the very largest, those with assets in excess of \$250 billion. Bank holding companies with assets of less than \$100 billion are no longer subject to enhanced prudential standards, and those with assets between \$100 billion and \$250 billion will be relieved of those requirements in eighteen months, unless the FRB takes action to maintain those standards. Certain regulatory requirements applied only to banks with assets in excess of \$50 billion and so did not apply to the Company even before the enactment of the Regulatory Relief Act.

The Regulatory Relief Act also provides that the banking regulators must adopt regulations implementing the provision that banking organizations with assets of less than \$10 billion are permitted to satisfy capital standards and be considered "well capitalized" under the prompt corrective action framework if their leverage ratios of tangible assets to average consolidated assets is between 8 percent and 10 percent, unless the banking organization's federal banking agency determines that the banking organization's risk profile warrants a more stringent leverage ratio. The OCC, the FRB and the FDIC have proposed for comment the leverage ratio framework for any banking organization with total consolidated assets of less than \$10 billion, limited amounts of certain types of assets and off-balance sheet exposures, and a community bank leverage ratio greater than 9 percent. The community bank leverage ratio would be calculated as the ratio of tangible equity capital divided by average total consolidated assets. Tangible equity capital would be defined as total bank equity capital or total holding company equity capital, as applicable, prior to including minority interests, and excluding accumulated other comprehensive income, deferred tax assets arising from net operating loss and tax credit carry forwards, goodwill and other intangible assets (other than mortgage servicing assets). Average total assets would be calculated in a manner similar to the current tier 1 leverage ratio denominator in that amounts deducted from the community bank leverage ratio numerator would also be excluded from the community bank leverage ratio denominator.

The OCC, the FRB, and the FDIC also adopted a rule providing banking organizations with the option to phase in over a three-year period the day-one adverse effects on regulatory capital that may result from the adoption of new current expected credit loss methodology accounting under U. S. generally accepted accounting principles.

The Regulatory Relief Act also relieves bank holding companies and banks with assets of less than \$100 billion in assets from certain record-keeping, reporting and disclosure requirements.

Community Reinvestment

Under the Community Reinvestment Act (CRA), as implemented by OCC regulations, a national bank has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate-income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community. The CRA requires the OCC, in connection with its examination of a national bank, to assess the institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such association. The CRA also requires all institutions to make public disclosure of their CRA ratings. Malvern Bank received an overall "satisfactory" CRA rating in its most recent examination. A bank which does not have a CRA program that is deemed satisfactory by its regulator will be prevented from making acquisitions. The OCC is expected to propose new CRA regulations and/or guidance which may impact how Malvern Bank approaches compliance with the CRA.

Corporate Governance

The Sarbanes-Oxley Act of 2002 added new legal requirements for public companies affecting corporate governance, accounting and corporate reporting, to increase corporate responsibility and to protect investors. Among other things, the Sarbanes-Oxley Act of 2002:

- required our management to evaluate our disclosure controls and procedures and our internal control over financial reporting, and required our auditors to issue a report on our internal control over financial reporting;
- imposed on our chief executive officer and chief financial officer additional responsibilities with respect to our external financial statements, including certification of financial statements within the Annual Report on Form 10-K and Quarterly Reports on Form 10-Q by the chief executive officer and the chief financial officer;
- established independence requirements for audit committee members and outside auditors;
- created the Public Company Accounting Oversight Board which oversees public accounting firms; and
- increased various criminal penalties for violations of securities laws.

NASDAQ, where Malvern Bancorp's common stock is listed, has corporate governance listing standards, including rules strengthening director independence requirements for boards, as well as the audit committee and the compensation committee, and requiring the adoption of charters for the nominating, corporate governance, compensation and audit committees.

Privacy and Data Security Laws

The federal Gramm-Leach-Bliley Act includes limitations on financial institutions' disclosure of nonpublic personal information about a consumer to nonaffiliated third parties, in certain circumstances requires financial institutions to limit the use and further disclosure of nonpublic personal information by nonaffiliated third parties to whom they disclose such information, and requires financial institutions to disclose certain privacy policies and practices with respect to information sharing with affiliated and nonaffiliated entities as well as to safeguard personal customer information. We have a detailed privacy policy, which is accessible from every page of our website. We maintain consumers' personal information securely, and only share such information with third parties for marketing purposes in accordance with our privacy policy and with the consent of the consumer. In addition, we take measures to safeguard the personal information of our borrowers and investors and protect against unauthorized access to this information.

USA PATRIOT Act

As part of the USA PATRIOT Act, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (the "Anti Money Laundering Act"). The Anti Money Laundering Act authorizes the Secretary of the U.S. Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to financial institutions such as banks, bank holding companies, broker-dealers and insurance companies. Among its other provisions, the Anti Money Laundering Act requires each financial institution: (i) to establish an anti-money laundering program; (ii) to establish due diligence policies, procedures and controls that are reasonably designed to detect and report instances of money laundering in United States private banking accounts and correspondent accounts maintained for non-United States persons or their representatives; and (iii) to avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign shell bank that does not have a physical presence in any country.

Regulations implementing the due diligence requirements require minimum standards to verify customer identity and maintain accurate records, encourage cooperation among financial institutions, federal banking agencies, and law enforcement authorities regarding possible money laundering or terrorist activities, prohibit the anonymous use of "concentration accounts," and require all covered financial institutions to have in place an anti-money laundering compliance program.

The OCC, along with other banking agencies, have strictly enforced various anti-money laundering and suspicious activity reporting requirements using formal and informal enforcement tools to cause banks to comply with these provisions.

A bank which is issued a formal or informal enforcement requirement with respect to its Anti Money Laundering program will be prevented from making acquisitions.

Insurance of Accounts

The deposits of the 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 national banks, after giving the OCC an opportunity to take such action.

The FDIC'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 FDIC 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, or FICO, 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 percent to 1.35 percent 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 adopted a rule to accomplish this by imposing a surcharge on larger institutions commencing when the reserve ratio reaches 1.15 percent and ending when it reaches 1.35 percent. The reserve ratio reached 1.15 percent on June 30, 2016. Accordingly, surcharges began on July 1, 2016. Small institutions will receive credits for the portion of their regular assessments that contributed to growth in the reserve ratio between 1.15 percent and 1.35 percent. The credits will apply for each quarter the reserve ratio is above 1.38 percent, in amounts as determined by the FDIC.

Federal Home Loan Bank System.

Malvern Bank is a member of the Federal Home Loan Bank of Pittsburgh, which is one of 12 regional Federal Home Loan Banks ("FHLB"). 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, 2019, the Bank had \$133.0 million of FHLB advances and \$150.0 million available on its line of credit with the FHLB.

As a member, the Bank is required to purchase and maintain stock in the FHLB of Pittsburgh in an amount equal to at least 1.0 percent of its aggregate unpaid residential mortgage loans or similar obligations at the beginning of each year. At September 30, 2019, Malvern Bank had \$8.4 million in FHLB stock, which was in compliance with this requirement.

Federal Reserve System. The FRB, 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, 2019, the Bank had met its reserve requirement.

Federal Securities Laws. Malvern Bancorp has registered its common stock with the Securities and Exchange Commission (the "SEC") under Section 12(b) of the Securities Exchange Act of 1934 (the "Exchange Act"). Accordingly, Malvern Bancorp is subject to the proxy and tender offer rules, insider trading reporting requirements and restrictions, and certain other requirements under the Exchange Act.

Other Regulations. Malvern Bank is subject to federal consumer protection statutes and regulations promulgated under those laws, including, but not limited to, the:

- Truth-In-Lending Act and Regulation Z, governing disclosures of credit terms to consumer borrowers;
- the Real Estate Settlement Procedures Act, or RESPA, and Regulation X, which governs certain mortgage loan origination activities and practices and the actions of servicers related to escrow accounts, loan servicing transfers, lender-placed insurance, loss mitigation, error resolution and other customer communications and
- Right to Financial Privacy Act, which imposes a duty to maintain the confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records.

Employees

As of September 30, 2019, we had a total of 82 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. The risks of non-payment and late payments are 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. Unfavorable or uncertain economic and market conditions can be caused by declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; high unemployment, natural disasters, terrorist acts, or a combination of these or other factors.

Our results of operations and financial condition may be adversely affected by changing economic conditions.

While the economy and real estate market conditions have significantly improved in recent years, a return to a recessionary period could adversely affect our customers in a manner that would adversely affect our results of operations and financial condition. Volatility in the housing markets, real estate values and unemployment levels, and the deterioration of economic conditions in our market area, could affect our customers' ability to repay loans and adversely affect our results of operations and future growth potential in the following ways:

- Loan delinquencies may increase;
- Problem assets and foreclosures may increase;
- 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.

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

Our net income depends primarily upon our net interest income. Net interest income is the difference between interest income earned on loans, investments and other interest-earning assets and the interest expense incurred on deposits and borrowed funds. 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 Federal Reserve Board of Governors (the “FOMC”), and market interest rates.

Different types of assets and liabilities may react differently, and at different times, to changes in market interest rates. We expect that we will periodically experience gaps in the interest rate sensitivities of our assets and liabilities. That means either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. When interest-bearing liabilities mature or re-price more quickly than interest-earning assets, an increase in market rates of interest could reduce our net interest income. Likewise, when interest-earning assets mature or re-price more quickly than interest-bearing liabilities, falling interest rates could reduce our net interest income. We are unable to predict changes in market interest rates, which are affected by many factors beyond our control, including inflation, deflation, recession, unemployment, money supply, domestic and international events and changes in the United States and other financial markets.

We also attempt to manage risk from changes in market interest rates, in part, by controlling the mix of interest rate sensitive assets and interest rate sensitive liabilities. However, interest rate risk management techniques are not exact. A rapid increase or decrease in interest rates could adversely affect our results of operations and financial performance.

Our high concentration of commercial real estate loans exposes us to increased lending risk.

As of September 30, 2019, the primary composition of our total loan portfolio was as follows:

- commercial real estate loans of \$543.5 million, or 53.4 percent of total loans;
- residential real estate loans of \$220.0 million, or 21.6 percent of total loans;
- commercial and industrial loans of \$99.7 million, or 9.8 percent of total loans;
- construction and development loans of \$43.8 million, or 4.3 percent of total loans and
- consumer loans of \$35.3 million, or 3.6 percent of total loans.

Commercial real estate loans, which comprised 53.4 percent of our total loan portfolio as of September 30, 2019, expose us to a greater risk of loss than do residential mortgage loans. Commercial real estate loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to residential loans. Consequently, an adverse development with respect to one commercial loan or one credit relationship exposes us to a significantly greater risk of loss compared to an adverse development with respect to one residential mortgage loan. Any significant failure to pay on time by our customers or a significant default by our customers would materially and adversely affect us.

Although the economy in our market area generally, and the real estate market in particular, have been relatively strong, we can give you no assurance that it will continue to grow or that the rate of growth will accelerate to historic levels. Many factors could reduce or halt growth in our local economy and real estate market. Accordingly, it may become more difficult for commercial real estate borrowers to repay their loans in a timely manner than in the current economic climate, as commercial real estate borrowers’ ability to repay their loans frequently depends on the successful development of their properties. The deterioration of one or a few of our commercial real estate loans could cause a material increase in our level of nonperforming loans, which would result in a loss of revenue from these loans and could result in an increase in the provision for loan and lease losses and/or an increase in charge-offs, all of which could have a material adverse impact on our net income. We also may incur losses on commercial real estate loans due to declines in occupancy rates and rental rates, which may decrease property values and may reduce the likelihood that a borrower may find permanent financing alternatives. Weaknesses in the commercial real estate market in general could negatively impact our collateral. Any weakening of the commercial real estate market may increase the likelihood of default of these loans, which could negatively impact our loan portfolio’s performance and asset quality. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, we could incur material losses. Any of these events could increase our costs, require management time and attention, and materially and adversely affect our financial condition and results of operations.

The concentration of our commercial real estate loan portfolio subjects us heightened regulatory scrutiny.

The FDIC, the Federal Reserve and the OCC have promulgated joint guidance on sound risk management practices for financial institutions with concentrations in commercial real estate lending. Under the joint guidance, a financial institution that, like us, is actively involved in commercial real estate lending should perform a risk assessment to identify concentrations. A financial institution may have a concentration in commercial real estate lending if, among other factors: (i) total reported loans for construction, land development, and other land represent 100 percent or more of total risk-based capital or (ii) total reported loans for construction, land development and other land and loans secured by multifamily and non-owner occupied non-farm residential properties (excluding loans secured by owner-occupied properties) represent 300 percent or more of total risk-based capital and the institution's commercial real estate loan portfolio has increased by 50 percent or more during the prior 36 month period. In such event, management should employ heightened risk management practices, including board and management oversight and strategic planning, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing.

The Bank's total reported loans for construction, land development and other land represented 24.7 percent of capital at September 30, 2019 as compared to 32.5 percent of capital at September 30, 2018. This ratio is below the regulatory commercial real estate concentration guideline level of 100 percent for land and construction loans. The Bank's total reported commercial real estate loans to total capital was 306.5 percent at September 30, 2019, as compared to 343.5 percent of capital at September 30, 2018. This ratio is above the regulatory commercial real estate concentration guideline level of 300 percent for all investor real estate loans. The Bank's commercial real estate portfolio has increased by 134.8 percent over the preceding 36 months.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings will decrease.

Like all financial institutions, we maintain an allowance for loan losses to provide for loan defaults and nonperformance. In determining the amount of the allowance for loan losses, we review our loans and our loss and delinquency experience and we evaluate economic conditions. If our assumptions are incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio.

In addition, bank regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by regulatory authorities might have a material adverse effect on our financial condition and results of operations.

A new accounting standard will likely require us to increase our allowance for loan losses and may have a material adverse effect on our financial condition and results of operations.

The Financial Accounting Standards Board ("FASB") has adopted a new accounting standard that will be effective for the Company and the Bank for fiscal years beginning on October 1, 2023. This standard, referred to as Current Expected Credit Loss, or ("CECL"), will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and recognize the expected credit losses as allowances for loan losses. This will change the current method of providing allowances for loan losses that are probable, which would likely require us to increase our allowance for loan losses, and to greatly increase the types of data we would need to collect and review to determine the appropriate level of the allowance for loan losses. Any increase in our allowance for loan losses or expenses incurred to determine the appropriate level of the allowance for loan losses may have a material adverse effect on our financial condition and results of operations.

Failure to maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act could have a material adverse effect on our business and stock price.

Section 404 of the Sarbanes-Oxley Act requires us to evaluate periodically the effectiveness of our internal controls over financial reporting and to include a management report assessing the effectiveness of our internal controls over financial reporting in our Annual Report on Form 10-K. Section 404 also requires our independent registered public accounting firm to report on our internal controls over financial reporting. If we fail to maintain the adequacy of our internal controls, we cannot assure you that we will be able to conclude in the future that we have effective internal controls over financial reporting. If we fail to maintain effective internal controls, we might be subject to sanctions or investigation by regulatory authorities, such as the SEC or NASDAQ. Any such action could

adversely affect our financial results and the market price of our common stock and may also result in delayed filings with the SEC.

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, advances in technology and product delivery systems, and consolidation among financial service providers. Larger institutions have greater resources and access to capital markets, with higher lending limits, more advanced technology and broader suites of services. Competition at times requires increases in deposit rates and decreases in loan rates, and adversely impact our net interest margin.

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 FDIC, as insurer of the Bank's deposits. Such regulation and supervision govern 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, 2019, the fair value of our investment securities portfolio was approximately \$41.0 million. We have historically adopted 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.

Our growth-oriented business strategy could be adversely affected if we are not able to attract and retain skilled employees or if we lose the services of our senior management team.

Our ability to manage growth will depend upon our ability to continue to attract, hire and retain skilled employees. The unanticipated loss of members of our senior management team, could have a material adverse effect on our results of operations and ability to execute our strategic goals. Our success will also depend on the ability of our officers and key employees to continue to implement and improve our operational and other systems, to manage multiple, concurrent customer relationships and to hire, train and manage our employees.

Reforms to and uncertainty regarding London Interbank Offered Rate ("LIBOR") may adversely affect the business.

In 2017, a committee of private-market derivative participants and their regulators convened by the Federal Reserve, the Alternative Reference Rates Committee ("ARRC"), was created to identify an alternative reference interest rate to replace LIBOR. The ARRC announced Secured Overnight Financing Rate ("SOFR"), a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities, as its preferred alternative to LIBOR. The Chief Executive of the United Kingdom Financial Conduct Authority, which regulates LIBOR, announced its intention to stop persuading or compelling banks to submit rates for the calculation of LIBOR to the administrator of LIBOR after 2021. Subsequently, the Federal Reserve Bank announced final plans for the

production of SOFR, which resulted in the commencement of its published rates by the Federal Reserve Bank of New York on April 2, 2018. Whether or not SOFR attains market traction as a LIBOR replacement tool remains in question and the future of LIBOR at this time is uncertain. The uncertainty as to the nature and effect of such reforms and actions and the political discontinuance of LIBOR may adversely affect the value of and return on the Company's financial assets and liabilities that are based on or are linked to LIBOR, the Company's results of operations or financial condition. In addition, these reforms may also require extensive changes to the contracts that govern these LIBOR based products, as well as the Company's systems and processes.

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

Information technology systems are critical to our business. We use various technology systems to manage our customer relationships, general ledger, securities, deposits, and loans. We have established policies and procedures to prevent or limit the impact of system failures, interruptions, and security breaches (including privacy breaches), but such events may still occur and may not be adequately addressed if they do occur. In addition any compromise of our systems could deter customers from using our products and services. Although we rely on security systems to provide security and authentication necessary to effect the secure transmission of data, these precautions may not protect our systems from compromises or breaches of security.

In addition, we outsource a majority of our data processing to certain third-party providers. If these third-party providers encounter difficulties, or if we have difficulty communicating with them, our ability to adequately process and account for transactions could be affected, and our business operations could be adversely affected. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

The occurrence of any system failures, interruption, or breach of security could damage our reputation and result in a loss of customers and business thereby subjecting us to additional regulatory scrutiny, or could expose us to litigation and possible financial liability. Furthermore, we may be required to expend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures arising from operational and security risks. Any of these events could have a material adverse effect on our financial condition and results of operations.

Recent New Jersey legislative changes may increase our tax expense.

In connection with adopting the 2019 fiscal year budget, the New Jersey legislature adopted, and the Governor signed, legislation that imposes a temporary surtax on corporations earning New Jersey allocated income in excess of \$1 million of 2.5 percent for tax years beginning on or after January 1, 2018 through December 31, 2019, and of 1.5 percent for tax years beginning on or after January 1, 2020 through December 31, 2021. The legislation also requires combined filing for members of an affiliated group for tax privilege periods ending on or after July 31, 2019, changing New Jersey's current status as a separate return state, and limits the deductibility of dividends received. These changes are not temporary. Regulations implementing the legislative changes have not yet been issued, and the Company cannot yet fully evaluate the impact of the legislation on overall tax expense or the valuation of the deferred tax asset. It is likely that the Company will lose benefits of various tax management strategies and, as a result, the total tax expense will increase.

Our ability to pay cash dividends is limited, and we may be unable to pay dividends even if we desire to do so.

We are a legal entity separate and distinct from our banking and other subsidiaries. Our principal source of cash flow, including cash flow to pay dividends to our shareholders if we desire to do so in the future, and to pay the principal of and interest on our outstanding debt, is dividends from the Bank. There are various regulations that limit the Bank's ability to pay dividends to us, and our ability to pay dividends to shareholders. In particular, the prior approval of the FRB and OCC may be required in certain circumstances prior to the payment of dividends by us or the Bank. There can be no assurances that we would receive such approval, if it were required.

In addition, the OCC has the authority to prohibit a national bank from paying dividends if such payment is deemed to be an unsafe or unsound practice. The FRB and the FDIC also have the authority to prohibit or to limit the payment of dividends by a banking organization under its jurisdiction if, in the regulator's opinion, the organization is engaged in or is about to engage in an unsafe or unsound practice. Depending on the financial

condition of the Bank, we may be deemed to be engaged in an unsafe or unsound practice if the Bank were to pay dividends.

Payment of dividends could also be subject to regulatory limitations if the Bank became “under-capitalized” for purposes of the “prompt corrective action” regulations of the federal bank regulatory agencies.

No assurances can be given that the Bank will, in any particular circumstances, pay dividends to us. If the Bank fails to make dividend payments to us, and sufficient cash or liquidity is not otherwise available, we may not be able to make principal and interest payments on our outstanding debt, or dividend payments on our common stock even if we desire to pay cash dividends in the future.

Item 1B. Unresolved Staff Comments.

None

Item 2. Properties.

At September 30, 2019, the Bank owns and maintains the premises in which the headquarters and five full-service financial centers are located in Paoli, Malvern, Coventry, Berwyn and Lionville, Pennsylvania. The Bank also leases a financial center in Glen Mills, Pennsylvania and private banking offices in Villanova, West Chester and Quakertown, Pennsylvania; one private banking office in New Castle County located in Montchanin, Delaware; one private banking office in Morris County located in Morristown, New Jersey; one private banking office in Palm Beach County located in Palm Beach, Florida; one representative office located in Wellington, Florida; and one representative office in Allentown, Pennsylvania. The location of each of the offices are 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 |
| Coventry Financial Center | 1000 Ridge Road, Pottstown, PA 19465 |
| Berwyn Financial Center | 650 Lancaster Avenue, Berwyn, PA 19312 |
| Lionville Financial Center | 537 West Uwchlan Avenue, Downingtown, PA 19335 |
| Glen Mills Financial Center | 940 Baltimore Pike, Glen Mills, PA 19342 |
| Villanova Private Banking Office | 801 East Lancaster Avenue, Villanova, PA 19085 |
| West Chester Private Banking Office | 535 N. Church Street, Suite 227, West Chester, PA 19380 |
| Quakertown Private Banking Office | 2100 Quaker Point Drive, Quakertown PA 18951 |
| Morristown Private Banking Office | 163 Madison Avenue, 3 rd Floor, Morristown, NJ 07960 |
| Palm Beach Private Banking Office | 205 Worth Avenue, Suite 308, Palm Beach, FL 33480 |
| Montchanin Private Banking Office | 16 W. Rockland Road, Montchanin, Delaware 19710 |
| Wellington Representative Office | 12773 W Forest Hill Blvd., Ste. 120, Wellington, FL 33414 |
| Allentown Representative Office | 1275 Glenlivet Drive, Ste. 100, Allentown, PA 18106 |

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, 2019, the Company had 391 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, 2019, the closing sale price was \$21.83.

The following table sets forth the high and low closing sales price of a share of the Company’s common stock for the years ended September 30, 2019 and 2018.

| | Year Ended September 30, | | | |
|----------------|--------------------------|----------|----------|----------|
| | 2019 | | 2018 | |
| | High | Low | High | Low |
| First Quarter | \$ 23.10 | \$ 18.03 | \$ 28.20 | \$ 24.75 |
| Second Quarter | \$ 21.15 | \$ 18.99 | \$ 26.83 | \$ 21.00 |
| Third Quarter | \$ 22.01 | \$ 19.31 | \$ 27.25 | \$ 23.57 |
| Fourth Quarter | \$ 22.76 | \$ 20.10 | \$ 25.65 | \$ 22.78 |

For the years ended September 30, 2019 and 2018, no cash dividends per share of common stock were declared by the Company.

Equity Compensation Plan Information

The following table provides information about the Company’s common stock that may be issued upon the exercise of stock options under our 2014 Long-Term Incentive Compensation Plan (the “2014 Plan”) as of September 30, 2019. The 2014 Plan permits the grant of equity awards and other awards, including stock options and restricted stock.

| Plan Category | Number of securities to be issued upon exercise of outstanding options, warrants and rights (a) | Weighted-average exercise price of outstanding options, warrants and rights (b) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c) |
|--|--|--|--|
| Equity compensation plans approved by security holders | 18,830 | \$ 22.05 | 347,862 |
| Equity compensation plans not approved by security holders | — | — | — |
| Total | 18,830 | \$ 22.05 | 347,862 |

Information on Stock Repurchases

On March 14, 2019, the Company’s Board of Directors approved a stock repurchase plan, under which the Company was authorized to repurchase up to 194,516 shares, or approximately 2.5 percent of the Company’s current outstanding common stock. This authority extends through March 31, 2020 and may be exercised from time to time and in such amounts as market conditions warrant. The repurchases may be made on the open market, in block trades or otherwise. The program may be suspended or discontinued at any time. At September 30, 2019, the Company had 177,653 shares remaining in the repurchase plan. During the three months ended September 30, 2019, the Company did not purchase any shares of its common stock in the open market under the repurchase plan.

Item 6. Selected Financial Data.

This Item has been omitted based on the Company's status as a smaller reporting company.

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. 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 the first page 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 more 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 and qualitative factors. 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, the OCC, as an integral part of its examination process, periodically reviews our allowance for loan losses. The OCC may require us to make additional provisions for loan losses based upon information available at the time of the 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.

Qualitative or environmental factors that may result in further adjustments to the quantitative analyses include items such as changes in lending policies and procedures, economic and business conditions, nature and volume of the portfolio, changes in delinquency, concentration of credit trends, and value of underlying collateral. The total net adjustments due to all qualitative factors increased the allowance for loan losses by approximately \$6.7 million and \$6.2 million at September 30, 2019 and September 30, 2018, respectively.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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 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, 2019, the Company had \$14.9 million 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 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 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 \$2.8 million and \$3.2 million at September 30, 2019 and at September 30, 2018, respectively. In accordance with ASC Topic 740, the Company evaluates on a quarterly basis, all evidence, both positive and negative, to determine whether, based on the weight of that evidence, a valuation allowance for DTAs is needed. In conducting this evaluation, management explores all possible sources of taxable income available under existing tax laws to realize the net deferred tax asset beginning with the most objectively verifiable evidence first, including available carry back claims and viable tax planning strategies. If needed, management will look to future taxable income as a potential source. Management reviews the Company's current financial position and its results of operations for the current and preceding years. That historical information is supplemented by all currently available information about future years. The Company understands that projections about future performance are subjective. The Company did not have a DTA valuation allowance as of September 30, 2019 and September 30, 2018.

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 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.

Derivatives

The Company enters 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 an asset or liability with related impacts to earnings or other comprehensive income.

Other assets increased from \$4.5 million at September 30, 2018 to \$12.5 million at September 30, 2019 while other liabilities increased from \$1.9 million at September 30, 2018 to \$8.5 million at September 30, 2019 primarily due to the Bank's commercial loan hedging program during fiscal 2019.

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:

Deposit Growth and Strategies. The Federal Reserve cut interest rates three times or 75 basis points during 2019, reversing nearly all of the 2018 rate increases based on its view of slowing global growth and trade war uncertainty. With the Federal Reserve now signaling a pause to evaluate economic data, the Bank is focusing on continuing to shifting its asset sensitivity to neutral. Competition for deposits in the Company's marketplace was intense during the fiscal year, and this competition, impacted by higher deposit betas and borrowing costs, has caused compression in the Bank's net interest margin. In an effort to continue improving earnings, i.e. improve the net interest margin, we are implementing specific product and pricing strategies designed to decrease the yield on deposits and control the cost of funding. We are also focused on increasing our core deposits, which we define as all deposit accounts other than certificates of deposit. At September 30, 2019, our core deposits amounted to 70.9 percent of total deposits (\$676.2 million), compared to 69.9 percent of total deposits (\$541.2 million) at September 30, 2018. 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 through flexible delivery options, such as mobile banking, as part of our efforts to increase core deposits. We expect to increase our commercial checking and business accounts and we also plan to enhance our cross-marketing as part of our efforts to gain secure additional deposit relationships with our deposits from loan customers and private banking clients.

Growing and Diversifying Our Loan Portfolio and Resuming Commercial Real Estate and Construction and Development Lending. We intend to continue to grow our loan portfolio in a planned, deliberative fashion consistent with our strengthened loan underwriting standards and our enhanced credit review and administration procedures. While we expect commercial real estate loans to grow, we plan to focus on the origination of commercial and industrial, owner occupied commercial real estate, and one- to four-family residential loans to a greater degree than in fiscal 2019.

Increasing Market Share Penetration. We continue to position the Company to take advantage of the growth activity in our markets, including our new private banking office in West Chester, Pennsylvania and representative office in Wellington, Florida. With the recent entry into Florida and Delaware markets, we are working to solidify and expand the service relationship with our new and existing customers. We believe that we can create incremental shareholder value from our strategic growth, including by working to increase our deposit share and evaluating expanding our business in non-traditional products, such as wealth management and insurance services.

Continuing to Provide Exceptional Customer Service. As a community-oriented 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 distinguishes 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 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, 2019 was \$9.3 million as compared to \$7.3 million earned in fiscal 2018. Our net income for fiscal 2019 increased by 27.7 percent compared to fiscal 2018. For fiscal 2019, the fully diluted earnings per common share was \$1.22 as compared with \$1.13 per share in fiscal 2018. Net income prior to income tax expense was \$11.8 million for 2019 and \$11.6 million for 2018, an increase of \$219,000 or 1.9 percent.

For the year ended September 30, 2019, the Company's return on average equity ("ROAE") was 6.78 percent and its return on average assets ("ROAA") was 0.80 percent. The comparable ratios for the year ended September 30, 2018 were ROAE of 6.88 percent and ROAA of 0.69 percent.

Earnings for fiscal 2019 benefitted from an increase in net interest income after the provision for loan losses and a decrease in non-interest expense, partially offset by a decrease in non-interest income. The decrease in non-interest income was primarily a result of a one-time gain recorded in 2018 on the sale of the Exton, Pennsylvania branch location, partially offset by an increase in service charges and other fees which was primarily due to the recognition of \$795,000 of net swap fees through the Bank's commercial loan hedging program. The decrease in non-interest expense was mainly due to a decrease in professional fees.

Net Interest Income and Margin

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.

The following table presents the components of net interest income for the periods indicated.

Net Interest Income

| <i>(In thousands)</i> | Year Ended September 30, | | | | | |
|-----------------------------------|--------------------------|--|-------------------|-----------|--|-------------------|
| | 2019 | | | 2018 | | |
| | Amount | Increase (Decrease) from Prior Year | Percent Change | Amount | Increase (Decrease) from Prior Year | Percent Change |
| Interest income: | | | | | | |
| Loans, including fees | \$ 43,574 | \$ 6,712 | 18.21 | \$ 36,862 | \$ 6,021 | 19.52 |
| Investment securities | 1,189 | (156) | (11.60) | 1,345 | (708) | (34.49) |
| Dividends, restricted stock | 627 | 160 | 34.26 | 467 | 210 | 81.71 |
| Interest-bearing cash accounts | 2,265 | 909 | 67.04 | 1,356 | 725 | 114.90 |
| Total interest income | 47,655 | 7,625 | 19.05 | 40,030 | 6,248 | 18.50 |
| Interest expense: | | | | | | |
| Deposits | 14,348 | 5,148 | 55.96 | 9,200 | 2,964 | 47.53 |
| Short-term borrowings | 7 | (61) | (89.71) | 68 | 34 | 100.00 |
| Long-term borrowings | 2,693 | 493 | 22.41 | 2,200 | 24 | 1.10 |
| Subordinated debt | 1,532 | 5 | 0.33 | 1,527 | 527 | 52.70 |
| Total interest expense | 18,580 | 5,585 | 42.98 | 12,995 | 3,549 | 37.57 |
| Net interest income | \$ 29,075 | \$ 2,040 | 7.55 | \$ 27,035 | \$ 2,699 | 11.09 |

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 for the year ended September 30, 2019 increased \$2.0 million, or 7.6 percent, to \$29.1 million, from \$27.0 million for fiscal 2018. The Company's net interest margin decreased seven basis points to 2.57 percent in fiscal 2019 from 2.64 percent for the fiscal year ended September 30, 2018. During fiscal 2019, our net interest margin was impacted by an increase in the yield on interest-earning assets, as well as an increase in the cost of deposits and borrowings.

The increase in net interest income during fiscal 2019 was attributable in part to the increase in short-term interest rates throughout 2019. The Company experienced an increase of \$14.0 million in non-interest bearing deposits during fiscal 2019 and an increase of \$124.0 million in interest-bearing demand, savings, money

market and time deposits under \$100,000 during fiscal 2019. During the fiscal year ended September 30, 2019, the Company's net interest spread decreased by sixteen basis points reflecting a twenty-nine basis points increase in the average yield on interest-earning assets as well as a forty-five basis points increase in the average interest rates paid on interest-bearing liabilities.

For the fiscal year ended September 30, 2019, average interest-earning assets increased by \$109.5 million to \$1.1 billion, as compared with the fiscal year ended September 30, 2018. The fiscal 2019 change in average interest-earning asset volume was primarily due to increased loan volume. Average interest-bearing liabilities increased by \$83.5 million in fiscal 2019 compared to fiscal 2018, due primarily to an increase in average interest-bearing deposits of \$88.3 million offset by a \$4.8 million decrease in average borrowings.

The factors underlying the year-to-year changes in net interest income are reflected in the tables presented on page 29. 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.

Total Interest Income

Interest income for the year ended September 30, 2019 increased by approximately \$7.6 million or 19.1 percent as compared with the year ended September 30, 2018. This increase was due primarily to increased loan volume.

The average balance of the Company's loan portfolio increased \$117.5 million in fiscal 2019 to \$973.6 million from \$856.1 million in fiscal 2018, primarily driven by an increase in commercial real estate loans and to a lesser extent, a net increase in residential loans.

The average loan portfolio represented approximately 86.0 percent of the Company's interest-earning assets (on average) during fiscal 2019 and 83.7 percent for fiscal 2018. Average investment securities decreased during fiscal 2019 by \$21.2 million compared to fiscal 2018. The average yield on interest-earning assets increased from 3.92 percent in fiscal 2018 to 4.21 percent in fiscal 2019.

Interest Expense

Interest expense for the year ended September 30, 2019 was principally impacted by rate related factors. The changes resulted in increased expense of \$5.6 million primarily due to an increase in rates paid on interest bearing liabilities and to a lesser degree the \$83.5 million increase in interest bearing liabilities from fiscal 2018 to fiscal 2019.

The Company's net interest spread, (i.e., the average yield on average interest-earning assets minus the average rate paid on interest-bearing liabilities) decreased sixteen basis points to 2.31 percent in fiscal 2019 from 2.47 percent for the year ended September 30, 2018. The decrease in fiscal 2019 reflected a spread increase between yields earned on interest-earning assets and an increase in overall cost of funds.

The cost of total average interest-bearing liabilities increased to 1.90 percent, an increase of forty-five basis points, for the year ended September 30, 2019, from 1.45 percent for the year ended September 30, 2018.

Net Interest Margin

The following table quantifies the impact on net interest income 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 2019/2018 Increase (Decrease) Due to Change in: | | |
|--------------------------------------|--|-----------------|---------------|
| | Average Volume | Average Rate | Net Change |
| Interest-earning assets: | | | |
| Loans, including fees | \$ 5,065 | \$ 1,647 | \$ 6,712 |
| Investment securities | (410) | 254 | (156) |
| Interest-bearing cash accounts | 176 | 733 | 909 |
| Dividends, restricted stock | 101 | 59 | 160 |
| Total interest-earning assets | 4,932 | 2,693 | 7,625 |
| Interest-bearing liabilities: | | | |
| Money market deposits | 3 | 1,196 | 1,199 |
| Savings deposits | (1) | 14 | 13 |
| Certificates of deposit | 270 | 1,305 | 1,575 |
| Other interest-bearing deposits | 576 | 1,785 | 2,361 |
| Total interest-bearing deposits | 848 | 4,300 | 5,148 |
| Borrowings | (124) | 561 | 437 |
| Total interest-bearing liabilities | 724 | 4,861 | 5,585 |
| Change in net interest income | \$ 4,208 | \$ (2,168) | \$ 2,040 |

The following table, “Average Statements of Condition with Interest and Average Rates” presents for the years ended September 30, 2019 and 2018, 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.

| | Year Ended September 30, | | | | | |
|--|-----------------------------|-----------------------|---------------------|-----------------------------|-----------------------|---------------------|
| | 2019 | | | 2018 | | |
| | Average Outstanding Balance | Interest Earned /Paid | Average Yield /Rate | Average Outstanding Balance | Interest Earned /Paid | Average Yield/ Rate |

(In thousands)

| ASSETS | | | | | | |
|--|---------------------|------------------|--------------|---------------------|------------------|--------------|
| Interest earning assets: | | | | | | |
| Loans receivable ⁽¹⁾ | \$ 973,588 | \$ 43,574 | 4.48% | \$ 856,066 | \$ 36,862 | 4.31% |
| Investment securities | 48,327 | 1,189 | 2.46 | 69,485 | 1,345 | 1.94 |
| Deposits in other banks | 100,864 | 2,265 | 2.25 | 89,304 | 1,356 | 1.52 |
| FHLB stock | 8,954 | 627 | 7.00 | 7,359 | 467 | 6.35 |
| Total interest earning assets ⁽¹⁾ | <u>1,131,733</u> | <u>47,655</u> | <u>4.21</u> | <u>1,022,214</u> | <u>40,030</u> | <u>3.92</u> |
| Non-interest earning assets | | | | | | |
| Cash and due from banks | 1,426 | | | 1,524 | | |
| Bank owned life insurance | 19,656 | | | 19,173 | | |
| Other assets | 20,627 | | | 18,668 | | |
| Other real estate owned | 4,510 | | | — | | |
| Allowance for loan losses | (9,562) | | | (8,629) | | |
| Total non-interest earning assets | <u>36,657</u> | | | <u>30,736</u> | | |
| Total assets | <u>\$ 1,168,390</u> | | | <u>\$ 1,052,950</u> | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | |
| Interest bearing liabilities: | | | | | | |
| Money Market accounts | \$ 277,644 | \$ 4,786 | 1.72% | \$ 277,449 | \$ 3,587 | 1.29% |
| Savings accounts | 43,587 | 49 | 0.11 | 44,357 | 36 | 0.08 |
| Certificate accounts | 263,086 | 5,727 | 2.18 | 247,029 | 4,152 | 1.68 |
| Other interest-bearing deposits | <u>253,936</u> | <u>3,786</u> | <u>1.49</u> | <u>181,087</u> | <u>1,425</u> | <u>0.79</u> |
| Total deposits | 838,253 | 14,348 | 1.71 | 749,922 | 9,200 | 1.23 |
| Borrowed funds | <u>141,461</u> | <u>4,232</u> | <u>2.99</u> | <u>146,245</u> | <u>3,795</u> | <u>2.59</u> |
| Total interest-bearing liabilities | <u>979,714</u> | <u>18,580</u> | <u>1.90</u> | <u>896,167</u> | <u>12,995</u> | <u>1.45</u> |
| Non-interest bearing liabilities | | | | | | |
| Demand deposits | 41,932 | | | 42,821 | | |
| Other liabilities | <u>9,024</u> | | | <u>7,723</u> | | |
| Total non-interest-bearing liabilities | 50,956 | | | 50,544 | | |
| Shareholders' equity | <u>137,720</u> | | | <u>106,239</u> | | |
| Total liabilities and shareholders' equity | <u>\$ 1,168,390</u> | | | <u>\$ 1,052,950</u> | | |
| Net interest spread | | | <u>2.31%</u> | | | <u>2.47%</u> |
| Net interest margin | | | <u>2.57%</u> | | | <u>2.64%</u> |
| Net Interest income | | <u>\$ 29,075</u> | | | <u>\$ 27,035</u> | |

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

Other Income

The following table presents the principal categories of other (“non-interest”) income for each of the years in the two-year period ended September 30, 2019.

| | Year Ended September 30, | | | |
|---------------------------------------|--------------------------|-----------------|---------------------|-----------------|
| | 2019 | 2018 | Increase (Decrease) | % Change |
| | (In thousands) | | | |
| Service charges and other fees | \$ 1,796 | \$ 1,268 | \$ 528 | 41.64% |
| Rental income-other | 243 | 268 | (25) | (9.33) |
| Net gains on sale of investments | 28 | — | 28 | 100.00 |
| Net gains on sale of loans | 37 | 102 | (65) | (63.73) |
| Net gains on sale of real estate | — | 1,186 | (1,186) | (100.00) |
| Earnings on bank-owned life insurance | 488 | 480 | 8 | 1.67 |
| Total other income | <u>\$ 2,592</u> | <u>\$ 3,304</u> | <u>\$ (712)</u> | <u>(21.55)%</u> |

For the year ended September 30, 2019, total other income decreased \$712,000 compared to fiscal 2018. This decrease was primarily a result of a one-time \$1.2 million gain recorded in 2018 on the sale of the Exton, Pennsylvania branch location. This was partially offset by an increase of \$528,000 in service charges and a \$28,000 gain on sale of investments. The change in service charges and other fees during the fiscal year ended September 30, 2019 is primarily due to the recognition of approximately \$795,000 of net swap fees through the Bank’s commercial loan hedging program during fiscal 2019.

Other Expense

The following table presents the principal categories of other expense for each of the years in the two-year period ended September 30, 2019.

| | Year Ended September 30, | | | |
|--------------------------------------|---------------------------------|------------------|--------------------------------|---------------------|
| | 2019 | 2018 | Increase (Decrease) | % Change |
| | <i>(In thousands)</i> | | | |
| Salaries and employee benefits | \$ 8,541 | \$ 8,193 | \$ 348 | 4.25% |
| Occupancy expense | 2,256 | 2,295 | (39) | (1.70) |
| Federal deposit insurance premium | 221 | 298 | (77) | (25.84) |
| Advertising | 107 | 152 | (45) | (29.61) |
| Data processing | 1,024 | 1,098 | (74) | (6.74) |
| Professional fees | 1,799 | 2,891 | (1,092) | (37.77) |
| Other real estate owned expense, net | 192 | — | 192 | 100.00 |
| Pennsylvania shares tax | 431 | — | 431 | 100.00 |
| Other operating expense | 2,916 | 2,876 | 40 | 1.39 |
| Total other expense | <u>\$ 17,487</u> | <u>\$ 17,803</u> | <u>\$ (316)</u> | <u>(1.77)%</u> |

Total other expense decreased \$316,000, or 1.8 percent, compared to the same period in 2018. The decrease primarily reflected a \$1.1 million decrease in professional fees, and a \$77,000 decrease in the federal deposit insurance premium. These decreases were offset by a \$431,000 increase in Pennsylvania shares tax expense, a \$348,000 increase in salaries and employee benefits and a \$192,000 increase in net other real estate owned expense.

The Company's ratio of other expenses to average assets decreased to 1.50 percent in fiscal 2019 compared to 1.69 percent in fiscal 2018.

Salaries and employee benefits increased \$348,000 or 4.3 percent in fiscal 2019 compared to fiscal 2018. The increase in salaries and employee benefits during fiscal 2019 primarily reflects normal increases to salary and benefits. Salaries and employee benefits accounted for 48.8 percent of total non-interest other expense in fiscal 2019 as compared to 46.0 percent in fiscal 2018.

Occupancy expense for fiscal 2019 decreased by \$39,000 or 1.7 percent, over fiscal 2018.

Federal deposit insurance premium for fiscal 2019 decreased \$77,000, or 25.8 percent, compared to fiscal 2018. The decrease in the federal deposit insurance premium is due to the Deposit Insurance Fund reserve ratio exceeding the official required reserve ratio, which in turn generates credits to qualified participating banks. The Company has a current credit balance of approximately \$160,000 that can be used to offset premiums during the next several quarters, should FDIC reserves remain above the required reserve ratio level.

Advertising expense for fiscal 2019 decreased \$45,000, or 29.6 percent, compared to fiscal 2018. The decrease for fiscal 2019 is due to decrease in advertising retainers.

Data processing expense for fiscal 2019 decreased \$74,000, or 6.7 percent, compared to fiscal 2018.

Professional fees for fiscal 2019 decreased \$1.1 million, or 37.8 percent, compared to fiscal 2018, and reflects lower legal expense.

Net other real estate owned expense increased \$192,000, or 100.0 percent, compared to fiscal 2018. The increase in net other real estate owned expense was mainly due to the payment of real estate taxes.

Pennsylvania shares tax expense increased in fiscal 2019 by approximately \$431,000, or 100.0 percent, compared to fiscal 2018. The increase during the year ended September 30, 2019 was primarily due to the imposition of the Pennsylvania shares tax related to the Bank's new standing as a National Association.

Other operating expense increased in fiscal 2019 by approximately \$40,000, or 1.4 percent, compared to fiscal 2018.

Investment Portfolio

For the year ended September 30, 2019, the average volume of investment securities decreased by \$21.2 million to approximately \$48.3 million or 4.3 percent of average interest-earning assets, from \$69.5 million, or 6.8 percent of average interest-earning assets, in fiscal 2018. At September 30, 2019, the total investment portfolio amounted to \$40.9 million, a decrease of \$13.5 million from September 30, 2018. The decrease in the investment portfolio was primarily due to calls in the amount of \$26.6 million and sales in the amount of \$2.1 million, partially offset by purchases \$17.9 million during fiscal 2019. At September 30, 2019, the principal components of the investment portfolio were government agency obligations, federal agency obligations, including mortgage-backed securities, obligations of U.S. states and political subdivision, corporate bonds and notes, a trust preferred security and equity securities.

During the year ended September 30, 2019, volume related factors decreased investment revenue by \$410,000 while rate related factors increased investment revenue by \$254,000. The yield on investments increased by fifty-two basis points to 2.46 percent from a yield of 1.94 percent during the year ended September 30, 2018. The decrease in the investment portfolio was attributed to the sales, amortization, and calls recorded during fiscal 2019. The yield on the portfolio increased in fiscal 2019 compared to fiscal 2018 due primarily to an increase in average rates.

As of September 30, 2019, 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. As of September 30, 2019, the Company held one U.S. government agency security, one municipal bond, two corporate securities, thirty-four mortgage-backed securities, and one single issuer trust preferred security which were in an unrealized loss position. 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. 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, 2019 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 2019, proceeds of available-for-sale investment securities sold amounted to approximately \$2.1 million. Gross realized gains on investment securities sold amounted to approximately \$28,000. For fiscal 2018, no available-for-sale investment securities were sold.

The varying amount of sales from the available-for-sale portfolio over the past few years, 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 long-term investments can, after changes in the market, become securities that the Company wishes 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, 2019, based on a contractual maturity.

| | 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 |
| <i>(In thousands)</i> | | | | | | | | | | | |
| Available for Sale Securities: | | | | | | | | | | | |
| U.S. government agencies and obligations | \$ — | — | \$ — | —% | \$ 3,000 | 2.53 | \$ — | —% | \$ 3,000 | \$ 3,000 | 2.53% |
| State and municipal obligations | 1,105 | 2.39 | 3,111 | 1.78 | 499 | 2.55 | — | — | 4,715 | 4,732 | 2.60 |
| Single issuer trust preferred security | — | — | — | — | 1,000 | 2.88 | — | — | 1,000 | 923 | 2.88 |
| Corporate debt securities | — | — | 3,082 | 3.01 | 6,475 | 3.47 | — | — | 9,557 | 9,506 | 3.24 |
| Mutual fund | — | — | 250 | 2.00 | — | — | — | — | 250 | 250 | 2.00 |
| Total | \$ 1,105 | 2.39% | \$ 6,443 | 2.38% | \$ 10,974 | 3.12% | \$ — | — | \$ 18,522 | \$ 18,411 | 2.82% |
| Held to Maturity Securities: | | | | | | | | | | | |
| U.S. government agencies and obligations | \$ 1,000 | 1.37% | \$ — | — | \$ — | —% | \$ — | —% | \$ 1,000 | 1,000 | 1.37% |
| State and municipal obligations | — | — | — | — | 1,828 | 2.24 | 2,687 | 1.48 | 4,515 | 4,590 | 1.79 |
| Corporate debt securities | — | — | — | — | 3,608 | 3.82 | — | — | 3,608 | 3,790 | 3.82 |
| Mortgage-backed securities | — | — | — | — | 628 | 1.88 | 12,734 | 1.74 | 13,362 | 13,229 | 1.74 |
| Total | \$ 1,000 | 1.37% | \$ — | — | \$ 6,064 | 2.15% | \$ 15,421 | 1.71% | \$ 22,485 | \$ 22,609 | 2.42% |
| Total Investment Securities | \$ 2,105 | 1.88% | \$ 6,443 | 2.38% | \$ 17,038 | 2.77% | \$ 15,421 | 1.71% | \$ 41,007 | \$ 41,020 | 2.44% |

For information regarding the carrying value of the investment portfolio, see Note 6 and Note 12 of the Notes to the Consolidated Financial Statements.

The following table sets forth the carrying value of the Company's investment securities, as of September 30, for each of the last two years.

| | 2019 | 2018 |
|--|------------------|------------------|
| <i>(In thousands)</i> | | |
| Investment Securities Available-for-Sale: | | |
| U.S. government agencies and obligations | \$ 3,000 | \$ 9,986 |
| State and municipal obligations | 4,732 | 6,887 |
| Single issuer trust preferred security | 923 | 921 |
| Corporate debt securities | 9,506 | 6,254 |
| Mutual fund | 250 | 250 |
| Total available-for-sale | \$ 18,411 | \$ 24,298 |
| Investment Securities Held-to-Maturity: | | |
| U.S. government agencies | \$ 1,000 | \$ 1,999 |
| State and municipal obligations | 4,515 | 8,181 |
| Corporate debt securities | 3,608 | 3,715 |
| Mortgage-backed securities: | | |
| Collateralized mortgage obligations, fixed-rate | 13,362 | 16,197 |
| Total held-to-maturity | \$ 22,485 | \$ 30,092 |
| Total investment securities | \$ 40,896 | \$ 54,390 |

For additional information regarding the Company's investment portfolio, see Note 6 and Note 12 of the Notes to the Consolidated Financial Statements.

Loan Portfolio

Lending is one of the Company's primary business activities. The Company's loan portfolio consists of residential, construction and development, commercial and consumer loans, serving the diverse customer base in its market area. The composition of the Company's portfolio continues to change due to the local economy. Factors such as the economic climate, interest rates, real estate values and employment all contribute to these changes in the composition of the Company's portfolio. Growth is generated through business development efforts, repeat customer requests for new financings, penetration into existing markets and entry into new markets.

The Company seeks to create growth in commercial lending, which primarily includes commercial real estate, multi-family, farmland, and commercial and industrial lending, by offering customer-focused products and competitive pricing and by capitalizing on the positive trends in its market area. Products offered are designed to meet the financial requirements of the Company's customers. It is the objective of the Company's credit policies to diversify the commercial loan portfolio to limit concentrations in any single industry.

At September 30, 2019, total gross loans amounted to \$1.0 billion, an increase of \$106.6 million or 11.7 percent as compared to September 30, 2018. For the year ended September 30, 2019, growth of \$86.9 million in commercial loans and \$22.8 million in residential mortgage loans were partially offset by decreases of \$2.9 million in construction and development loans and \$289,000 in total consumer loans. Even though the Company continues to be challenged by the competition for lending relationships that exists within its market, growth in volume has been achieved through successful lending sales efforts to build on continued customer relationships.

The average balance of our total loans increased \$117.5 million or 13.7 percent for the year ended September 30, 2019 as compared to September 30, 2018, while the average yield on loans increased sixteen basis points to 4.48 percent in fiscal 2019 from 4.32 percent in fiscal 2018. The increase in average total loan volume was due primarily to the volume of new loan originations. During fiscal 2019 compared to fiscal 2018, the volume-related factors during the period contributed to an increase of interest income on loans of \$5.1 million, while the rate-related changes increased interest income by \$1.5 million.

The following table presents information regarding the components of the Company's loan portfolio (which does not include loans held for sale, except as noted below) on the dates indicated.

| | September 30, | | | | |
|--------------------------------------|-----------------------|-------------------|-------------------|-------------------|-------------------|
| | 2019 | 2018 | 2017 | 2016 | 2015 |
| | <i>(In thousands)</i> | | | | |
| Residential mortgage | \$ 220,011 | \$ 197,219 | \$ 192,500 | \$ 209,186 | \$ 214,958 |
| Construction and Development: | | | | | |
| Residential and commercial | 40,346 | 37,433 | 35,622 | 18,579 | 5,677 |
| Land | 3,420 | 9,221 | 18,377 | 10,013 | 2,142 |
| Total construction and development | 43,766 | 46,654 | 53,999 | 28,592 | 7,819 |
| Commercial: | | | | | |
| Commercial real estate | 543,452 | 493,929 | 437,760 | 231,439 | 87,686 |
| Multi-family | 62,884 | 45,102 | 39,768 | 19,515 | 7,444 |
| Farmland | 7,563 | 12,066 | 1,723 | — | — |
| Commercial and industrial | 99,747 | 73,895 | 70,677 | 33,832 | 13,380 |
| Other | 4,450 | 6,164 | 4,160 | 4,947 | — |
| Total commercial | 718,096 | 631,156 | 554,088 | 289,733 | 108,510 |
| Consumer: | | | | | |
| Home equity lines of credit | 19,506 | 14,884 | 16,509 | 19,757 | 22,919 |
| Second mortgages | 13,737 | 18,363 | 22,480 | 29,204 | 37,633 |
| Other | 2,030 | 2,315 | 2,570 | 1,914 | 2,359 |
| Total consumer | 35,273 | 35,562 | 41,559 | 50,875 | 62,911 |
| Total loans | 1,017,146 | 910,591 | 842,146 | 578,386 | 394,198 |
| Deferred loan fees and costs, net | 663 | 566 | 590 | 1,208 | 1,776 |
| Allowance for loan losses | (10,095) | (9,021) | (8,405) | (5,434) | (4,667) |
| Loans receivable, net | <u>\$ 1,007,714</u> | <u>\$ 902,136</u> | <u>\$ 834,331</u> | <u>\$ 574,160</u> | <u>\$ 391,307</u> |

At September 30, 2019, our net loan portfolio totaled \$1.0 billion or 79.6 percent of total assets. Our principal lending activity has been the origination of commercial and commercial real estate loans. Through our loan policy, we utilize strict underwriting guidelines maintain low average loan-to-value ("LTV") ratios, and require maximum gross debt ratios and minimum debt coverage ratios. We have invested in software which facilitates our ability to internally review and grade loans in our portfolio and to monitor loan performance.

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

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

Residential Lending. Residential mortgage originations are secured primarily by properties located in the Company's primary market area and surrounding areas. At September 30, 2019, \$220.0 million, or 21.6 percent, of our total loans in portfolio consisted of single-family residential mortgage loans. During fiscal 2019, we had \$17,000 of charge-offs of residential loans, as compared to \$60,000 of charge-offs of residential loans at fiscal 2018.

Our single-family residential mortgage loans generally are underwritten on terms and documentation conforming to guidelines issued by Freddie Mac and Fannie Mae. Applications for one- to four-family residential mortgage loans are taken by our loan origination officers and are accepted at any of our banking offices and are then referred to the lending department at our Morristown office in order to process the loan, which consists primarily of obtaining all documents required by Freddie Mac and Fannie Mae underwriting standards, and completing the underwriting, which includes making a determination whether the loan meets our underwriting standards such that the Bank can extend a loan commitment to the customer. We generally have retained for portfolio a substantial portion of the single-family residential mortgage loans that we originate. We currently originate fixed-rate, fully amortizing mortgage loans with maturities of 10 to 30 years. We also offer adjustable rate mortgage (“ARM”) loans where the interest rate either adjusts on an annual basis or is fixed for the initial one, three, five or seven years and then adjusts annually. However, due to the low interest rate environment and demand for fixed rate products, we have not originated a significant amount of ARM loans in recent years. At September 30, 2019, \$72.5 million, or 32.9 percent, of our one- to four-family residential mortgage loans consisted of ARM loans.

In prior years, the Company purchased single-family residential mortgage loans and consumer loans from a network of mortgage brokers. The Company has re-established correspondent lending relationships, but the Bank independently underwrites these loans.

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

Construction and Development Loans. The amount of our outstanding construction and development loans in portfolio decreased to \$43.8 million or 4.3 percent of gross loans at September 30, 2019 from \$46.7 million, or 5.1 percent of total loans as of September 30, 2018. From October 2009 through September 30, 2013, we ceased originating any new construction and development loans, with certain limited exceptions. We generally limit construction loans to builders and developers with whom we have an established relationship, or who are otherwise known to officers of the Bank. Our construction loans also include single-family residential construction loans which may if approved convert to permanent, long-term mortgage loans upon completion of construction (“construction/perm” loans). During the initial or construction phase, these construction/perm loans require payment of interest only, which generally is tied to prime rate, as the home is being constructed. On residential construction to perm loans the interest rate is as approved. Upon the earlier of the completion of construction or one year, these loans if approved by the appropriate approving authority convert to long-term (generally 30 years), amortizing, fixed-rate single-family mortgage loans. During fiscal 2019, \$25.7 million of construction and development loans were originated.

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

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

Our construction loans also include loans for the acquisition and development of land for sale (i.e. roads, sewer and water lines). We typically make these loans only in conjunction with a commitment for a construction loan for the units to be built on the site. These loans are secured by a lien on the property and are limited to a loan-to-value ratio not exceeding 75 percent of the appraised value at the time of origination. The loans have a variable rate of interest and require monthly payments of interest. The principal of the loan is repaid as units are sold and released.

We limit loans of this type to our market area and to developers with whom we have established relationships. In most cases, we also obtain personal guarantees from the borrowers.

Our loan portfolio included six loans secured by unimproved real estate and lots (“land loan”), with an outstanding balance of \$3.4 million, constituting 0.3 percent of total loans, at September 30, 2019.

In order to mitigate some of the risks inherent to construction lending, we inspect properties under construction, review construction progress prior to advancing funds, work with builders with whom we have established relationships, require annual updating of tax returns and other financial data of developers and obtain personal guarantees from the principals. At September 30, 2019, approximately \$543,000, or 5.4 percent, of our allowance for loan losses was attributed to construction and development loans. We had no construction and development loans that were non-performing at September 30, 2019 and at September 30, 2018. At September 30, 2019, we had no construction and development loans that were performing troubled debt restructurings (“TDR”). At September 30, 2018, we had \$76,000 in construction and development loans that were performing TDRs.

Commercial Lending. At September 30, 2019, our loans secured by commercial real estate amounted to \$543.5 million and constituted 53.4 percent of our gross loans at such date. During the year ended September 30, 2019, the commercial real estate loan portfolio increased by \$49.5 million, or 10.0 percent. During fiscal 2019, we had \$1.4 million of charge-offs of commercial real estate loans, as compared to \$276,000 of charge-offs of commercial real estate loans and \$45,000 of charge-offs of commercial and industrial loans for fiscal 2018. As previously disclosed in the Company’s 2018 Annual Report on Form 10-K, one commercial real estate loan classified as a TDR with an aggregate outstanding balance of approximately \$7.0 million ceased to perform under modified terms and as a result the Bank accepted a deed in lieu of foreclosure. During the quarter ended September 30, 2018, the Company established a specific reserve of approximately \$1.3 million in its allowance for loan losses as part of its quarterly credit review of the loan. The loan was performing under the terms of its modification agreement and had a letter of intent in place with an interested national tenant. During the quarter ended December 31, 2018, the Bank was alerted that the letter of intent fell through with a prospective national tenant. Subsequently, the loan was charged down by \$1.2 million, to the appraised estimated fair market value less additional costs to sell the property, to a value of \$5.8 million and transferred to OREO. The Bank engaged a national real estate broker to list and market the property. During the fourth fiscal quarter of 2019 a national tenant signed a lease agreement that is expected to make this OREO property produce income.

Our commercial real estate loan portfolio consists primarily of loans secured by office buildings, retail and industrial use buildings, strip shopping centers, mixed-use and other properties used for commercial purposes located in our market area.

Although terms for commercial real estate and multi-family loans vary, our underwriting standards generally allow for terms up to 10 years with the interest rate being reset in the fifth year and with amortization typically not greater than 25 years and loan-to-value ratios of not more than 80 percent. Interest rates are either fixed or adjustable, based upon the index rate plus a margin, and fees ranging from 0.5 percent to 1.50 percent are charged to the borrower at the origination of the loan. Prepayment fees are charged on most loans in the event of early repayment. Generally, we obtain personal guarantees of the principals as additional collateral for commercial real estate and multi-family real estate loans.

Commercial and multi-family real estate loans generally present a higher level of risk than loans secured by one- to four-family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effect of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by commercial and multi-family real estate is typically dependent upon the successful operation of the related real estate project. If the cash flow from the project is reduced (for example, if leases are not obtained or renewed, a bankruptcy court modifies a lease term, or a major tenant is unable to fulfill its lease obligations), the borrower’s ability to repay the loan may be impaired. As of September 30, 2019, there were no non-accruing commercial real estate mortgage loans and an aggregate of \$10.0 million of our commercial real estate loans at such date were classified for regulatory reporting purposes as substandard. As of September 30, 2019, \$5.9 million, or 58.5 percent of our allowance for loan losses was allocated to commercial real estate mortgage loans. In addition, at September 30, 2019 we had \$5.8 million of OREO which was acquired from a foreclosure, or our acceptance of a deed-in-lieu of foreclosure, on a commercial real estate loan. At September 30, 2018, we had no OREO. As of September 30, 2019, our commercial real estate loans held in portfolio that were deemed performing troubled debt restructurings decreased to \$9.7 million from \$16.9 million at September 30, 2018 primarily due to one commercial

real estate loan with an aggregate outstanding balance of approximately \$7.0 million moving to OREO in the first fiscal quarter of 2019.

At September 30, 2019, our loan portfolio included 19 loans with an aggregate book value of \$62.9 million secured by multi-family (more than four units) properties, constituting 6.2 percent of our gross loans at such date. As of September 30, 2019, we had no non-accruing multi-family loans.

At September 30, 2019, we had \$104.2 million in commercial business loans (10.2 percent of gross loans outstanding) in portfolio. Our commercial business loans generally have been made to small to mid-sized businesses located in our market area. The commercial business loans in our portfolio assist us in our asset/liability management since they generally provide shorter maturities and/or adjustable rates of interest in addition to generally having higher rates of return which are designed to compensate for the additional credit risk associated with these loans. The commercial business loans which we have originated may be either a revolving line of credit or for a fixed term of generally 10 years or less. Interest rates are adjustable, indexed to a published prime rate of interest, or fixed. Generally, equipment, machinery, real property or other corporate assets secure such loans. Personal guarantees from the business principals are generally obtained as additional collateral.

Generally, commercial business loans are characterized as having higher risks associated with them than single-family residential mortgage loans. As of September 30, 2019, we had no non-accruing other commercial loans in our loan portfolio. At such date, approximately \$636,000 or 6.3 percent of the allowance for loan losses was allocated to commercial business loans. At September 30, 2019 and 2018, we held no other commercial loans in portfolio that were deemed performing troubled debt restructurings.

In our underwriting procedures, consideration is given to the stability of the property's cash flow history, future operating projections, current and projected occupancy levels, location and physical condition. Generally, our practice in recent periods is to impose a debt service ratio (the ratio of net cash flows from operations before the payment of debt service/debt service) of not less than 120 percent. We also evaluate the credit and financial condition of the borrower, and if applicable, the guarantor. Appraisal reports prepared by independent appraisers are obtained on each loan to substantiate the property's market value, and are reviewed by us prior to the closing of the loan.

Consumer Lending. In our efforts to provide a full range of financial services to our customers, we offer various types of consumer loans. Our consumer loans amounted to \$35.3 million or 3.6 percent of our total loan portfolio at September 30, 2019. The largest components of our consumer loans are home equity lines of credit, which amounted to \$19.5 million at September 30, 2019 and loans secured by second mortgages, consisting primarily of home equity loans, which amounted to \$13.7 million at September 30, 2019. Our consumer loans also include automobile loans, unsecured personal loans and loans secured by deposits. Consumer loans are originated primarily through existing and walk-in customers and direct advertising.

Our home equity lines of credit are variable rate loans tied to LIBOR, treasury, and prime rates. Our second mortgages may have fixed or variable rates, although they generally have had fixed rates in recent periods. Our second mortgages have a maximum term to maturity of 15 years. Both our second mortgages and our home equity lines of credit generally are secured by the borrower's primary residence. However, our security generally consists of a second lien on the property. Our lending policy provides that the maximum loan-to-value ratio on our home equity lines of credit is 80 percent, when the Bank has the first mortgage. However, the maximum loan-to-value ratio on our home equity lines of credit is reduced to 75 percent, when the Bank does not have the first mortgage. At September 30, 2019, the unused portion of our home equity lines of credit was \$21.4 million.

Consumer loans generally have higher interest rates and shorter terms than residential loans; however, they have additional credit risk due to the type of collateral securing the loan or in some cases the absence of collateral. In the year ended September 30, 2019, we charged-off \$82,000 of consumer loans mostly consisting of second mortgage loans, as compared to \$90,000 of charge-offs, mostly consisting of second mortgage loans, during fiscal 2018. As of September 30, 2019, we had \$259,000 of non-accruing second mortgage loans and no non-accruing home equity lines of credit, representing a decrease of \$65,000 over the amount of non-accruing second mortgage loans and home equity lines of credit at September 30, 2018. At September 30, 2019, \$1.0 million of our consumer loans were classified as substandard consumer loans. At September 30, 2019, an aggregate of \$389,000 of our allowance for loan losses was allocated to second mortgages and home equity lines of credit.

The following table presents the contractual maturity of our loans held in portfolio at September 30, 2019. The table does not include the effect of prepayments or scheduled principal amortization. Loans having no stated repayment schedule or maturity and overdraft loans are reported as being due in one year or less.

| | At September 30, 2019, Maturing | | | |
|--------------------------------------|--|---|-----------------------------|---------------------|
| | In One Year or Less | After One Years Through Five Years | After Five Years | Total |
| | <i>(In thousands)</i> | | | |
| Residential mortgage | \$ 726 | \$ 4,774 | \$ 214,511 | \$ 220,011 |
| Construction and Development: | | | | |
| Residential and commercial | 33,114 | 7,232 | — | 40,346 |
| Land | — | 2,356 | 1,064 | 3,420 |
| Total construction and development | 33,114 | 9,588 | 1,064 | 43,766 |
| Commercial: | | | | |
| Commercial real estate | 40,536 | 206,017 | 296,899 | 543,452 |
| Farmland | — | 3,650 | 3,913 | 7,563 |
| Multi-family | 42,322 | 1,551 | 19,011 | 62,884 |
| Commercial and industrial | 26,940 | 58,905 | 13,902 | 99,747 |
| Other | — | 3,780 | 670 | 4,450 |
| Total commercial | 109,798 | 273,903 | 334,395 | 718,096 |
| Consumer: | | | | |
| Home equity lines of credit | — | 1,323 | 18,183 | 19,506 |
| Second mortgages | 455 | 2,931 | 10,351 | 13,737 |
| Other | 1,280 | 382 | 368 | 2,030 |
| Total consumer | 1,735 | 4,636 | 28,902 | 35,273 |
| Total | <u>\$ 145,373</u> | <u>\$ 292,901</u> | <u>\$ 578,872</u> | <u>\$ 1,017,146</u> |
| Loans with: | | | | |
| Fixed rates | \$ 25,816 | \$ 185,773 | \$ 241,620 | \$ 453,209 |
| Variable rates | 119,556 | 107,112 | 337,269 | 563,937 |
| Total | <u>\$ 145,372</u> | <u>\$ 292,885</u> | <u>\$ 578,889</u> | <u>\$ 1,017,146</u> |

For additional information regarding loans, see Note 7 of the Notes to the Consolidated Financial Statements.

Allowance for Loan Losses and Related Provision

The purpose of the allowance for loan losses (the “Allowance”) is to absorb the impact of probable losses inherent in the loan portfolio. Additions to the allowance are made through provisions charged against current operations and through recoveries made on loans previously charged-off. The allowance for loan losses is maintained at an amount considered adequate by management to provide for potential credit losses based upon a periodic evaluation of the risk characteristics of the loan portfolio. In establishing an appropriate allowance, an assessment of the individual borrowers, a determination of the value of the underlying collateral, a review of historical loss experience and an analysis of the levels and trends of loan categories, delinquencies and problem loans are considered. Such qualitative factors as changes in lending policies and procedures, economic and business conditions, nature and volume of the portfolio, changes in delinquency, concentration of credit trends, value of underlying collateral, the level and trend of interest rates, and peer group statistics are also reviewed. At fiscal 2019 year-end, the level of the allowance was \$10.1 million as compared to a level of \$9.0 million at September 30, 2018. The Company made loan loss provisions of \$2.4 million in fiscal 2019 compared with \$954,000 in fiscal 2018 and \$2.8 million in fiscal 2017. Provision expense was higher during the fiscal year ended September 30, 2019 due primarily to the TDR commercial real estate loan write-down of approximately \$1.2 million and continued growth in the commercial loan portfolio. For the quarter ended December 31, 2018, the Company added a new qualitative factor, defined as Regulatory Oversight, to its allowance methodology to address the difference in the required allowance based on asset quality and the directionally consistent level of the allowance. Unique to the other factors, this is a single calculation figure which is subsequently applied to the loan portfolio by loan type (Commercial, Residential and Consumer) based upon the percent of each to total loans. It is derived from a review of a peer group consisting of 10 banks with similar asset size within the same general geographic area of Malvern Bank. This new factor, added during the quarter ended December 31, 2018, amounted to an additional \$390,000 added to the provision for the period. The level of the allowance during the respective annual fiscal periods of 2019, 2018 and 2017 reflects the change in average volume, credit quality within the loan portfolio, the level of charge-offs, loan volume recorded during the periods and the Company’s focus on the changing composition of the commercial and residential real estate loan portfolios.

At September 30, 2019, the allowance for loan losses amounted to 0.99 percent of total loans. In management’s view, the level of the allowance at September 30, 2019 is adequate to cover losses inherent in the loan portfolio. Management’s judgment regarding the adequacy of the allowance constitutes a “Forward Looking Statement” under the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from management’s analysis, based principally upon the factors considered by management in establishing the allowance.

Although management uses the best information available, the level of the allowance for loan losses remains an estimate, which is subject to significant judgment and short-term change. The OCC, as an integral part of its examination process, periodically reviews the Company’s allowance for loan losses. The OCC may require the Company to increase the allowance based on its analysis of information available to it at the time of their examination. Furthermore, the majority of the Company’s loans are secured by real estate in the State of New Jersey and the State of Pennsylvania. Future adjustments to the allowance may be necessary due to economic factors impacting real estate in the Bank’s market areas and a deterioration of the economic climate, as well as, operating, regulatory and other conditions beyond the Company’s control. The allowance for loan losses as a percentage of total loans amounted to 0.99 percent, 0.99 percent and 1.00 percent at September 30, 2019, 2018 and 2017, respectively.

Net charge-offs were \$1.3 million in fiscal 2019, compared to net charge-offs of \$338,000 in fiscal 2018 and net recoveries of \$180,000 in fiscal 2017. Charge-offs were higher in the commercial real estate portfolio segment in fiscal 2019 than in fiscal 2018 due to one commercial real estate loan charged down by \$1.2 million as stated above. Charge-offs related to commercial real estate loans, increased \$1.1 million in fiscal 2019 compared to fiscal 2018.

Five-Year Statistical Allowance for Loan Losses

The following table reflects the relationship of loan volume, the provision and allowance for loan losses and net charge-offs for the past five years.

| | September 30, | | | | |
|--|-----------------------|-----------------|-----------------|-----------------|-----------------|
| | 2019 | 2018 | 2017 | 2016 | 2015 |
| | <i>(In thousands)</i> | | | | |
| Average loans outstanding | \$ 973,588 | \$ 856,066 | \$ 738,496 | \$ 507,973 | \$ 384,125 |
| Total loans at end of period | \$ 1,017,146 | \$ 910,591 | \$ 842,146 | \$ 578,386 | \$ 394,198 |
| Analysis of the Allowance of Loan Losses | | | | | |
| Balance at beginning of year | \$ 9,021 | \$ 8,405 | \$ 5,434 | \$ 4,667 | \$ 4,589 |
| Charge-offs: | | | | | |
| Residential mortgage | 17 | 60 | — | 9 | — |
| Construction and Development: | | | | | |
| Residential and commercial | — | — | — | 91 | 1 |
| Commercial: | | | | | |
| Commercial real estate | 1,418 | 276 | — | 99 | 48 |
| Commercial and industrial | — | 45 | — | — | — |
| Consumer: | | | | | |
| Second mortgages | 45 | 88 | 218 | 291 | 138 |
| Other | 37 | 2 | 5 | 70 | 34 |
| Total charge-offs | <u>1,517</u> | <u>471</u> | <u>223</u> | <u>560</u> | <u>221</u> |
| Recoveries: | | | | | |
| Residential mortgage | 79 | 58 | 2 | 17 | 17 |
| Construction and Development: | | | | | |
| Residential and commercial | — | — | 90 | 243 | 98 |
| Commercial: | | | | | |
| Commercial real estate | 23 | 11 | 40 | 3 | 9 |
| Commercial and industrial | 4 | 4 | 9 | 3 | 3 |
| Consumer: | | | | | |
| Home equity lines of credit | 1 | 1 | 18 | 1 | 2 |
| Second mortgages | 94 | 52 | 232 | 100 | 69 |
| Other | 11 | 7 | 12 | 13 | 11 |
| Total recoveries | <u>212</u> | <u>133</u> | <u>403</u> | <u>380</u> | <u>209</u> |
| Net charge-offs (recoveries) | <u>1,305</u> | <u>338</u> | <u>(180)</u> | <u>180</u> | <u>12</u> |
| Provision for loan losses | <u>2,379</u> | <u>954</u> | <u>2,791</u> | <u>947</u> | <u>90</u> |
| Balance at end of year | <u>\$ 10,095</u> | <u>\$ 9,021</u> | <u>\$ 8,405</u> | <u>\$ 5,434</u> | <u>\$ 4,667</u> |
| Ratio of net charge-offs (recoveries) during the year to average loans outstanding during the year | 0.13% | 0.04% | (0.02)% | 0.04% | 0.00% |
| Allowance for loan losses as a percentage of total loans at end of year | 0.99% | 0.99% | 1.00% | 0.94% | 1.18% |

For additional information regarding loans, see Note 7 of the Notes to the Consolidated Financial Statements.

Implicit in the lending function is the fact that loan losses will be experienced and that the risk of loss will vary with the type of loan being made, the creditworthiness of the borrower and prevailing economic conditions. The allowance for loan losses has been allocated in the table below according to the estimated amount deemed to be reasonably necessary to provide for the possibility of losses being incurred within the following categories of loans at September 30, for each of the past five years.

The table below shows, for three types of loans, the amounts of the allowance allocable to such loans and the percentage of such loans to total loans.

| | September 30, | | | | | | | | | |
|--------------------------------------|-----------------------|----------------------|-----------------|----------------------|-----------------|----------------------|-----------------|----------------------|-----------------|----------------------|
| | 2019 | | 2018 | | 2017 | | 2016 | | 2015 | |
| | Amount | Loans to Total Loans | Amount | Loans to Total Loans | Amount | Loans to Total Loans | Amount | Loans to Total Loans | Amount | Loans to Total Loans |
| | <i>(In thousands)</i> | | | | | | | | | |
| Residential mortgage | \$ 1,364 | 21.6% | \$ 1,062 | 21.7% | \$ 1,004 | 22.8% | \$ 1,201 | 36.2% | \$ 1,486 | 54.5% |
| Construction and Development: | | | | | | | | | | |
| Residential and commercial | 523 | 4.0 | 393 | 4.1 | 523 | 4.2 | 199 | 3.2 | 30 | 1.5 |
| Land loans | 20 | 0.3 | 49 | 1.0 | 132 | 2.2 | 97 | 1.7 | 35 | 0.5 |
| Commercial: | | | | | | | | | | |
| Commercial real estate | 5,903 | 53.4 | 5,031 | 54.2 | 3,581 | 52.0 | 1,874 | 40.0 | 1,235 | 22.2 |
| Farmland | 49 | 0.7 | 66 | 1.3 | 9 | 0.2 | | | | |
| Multi-family | 369 | 6.2 | 232 | 5.0 | 224 | 4.7 | 109 | 3.4 | 104 | 1.9 |
| Commercial and industrial | 615 | 9.8 | 443 | 8.1 | 520 | 8.4 | 155 | 5.8 | 108 | 3.4 |
| Other | 21 | 0.4 | 24 | 0.7 | 21 | 0.5 | 3 | 0.9 | — | — |
| Consumer: | | | | | | | | | | |
| Home equity lines of credit | 122 | 1.9 | 82 | 1.6 | 90 | 2.0 | 116 | 3.4 | 139 | 5.8 |
| Second mortgages | 267 | 1.4 | 326 | 2.0 | 402 | 2.7 | 467 | 5.0 | 761 | 9.6 |
| Other | 23 | 0.3 | 51 | 0.3 | 27 | 0.3 | 34 | 0.4 | 24 | 0.6 |
| Total allocated | <u>9,276</u> | <u>100.0</u> | <u>7,759</u> | <u>100.0</u> | <u>6,533</u> | <u>100.0</u> | <u>4,255</u> | <u>100.0</u> | <u>3,922</u> | <u>100.0</u> |
| Unallocated | 819 | — | 1,262 | — | 1,872 | — | 1,179 | — | 745 | — |
| Balance at end of period | <u>\$ 10,095</u> | <u>100.0%</u> | <u>\$ 9,021</u> | <u>100.0%</u> | <u>\$ 8,405</u> | <u>100.0%</u> | <u>\$ 5,434</u> | <u>100.0%</u> | <u>\$ 4,667</u> | <u>100.0%</u> |

In assessing the adequacy of the ALLL, it is recognized that the process, methodology and underlying assumptions require a significant degree of judgment. The estimation of credit losses is not precise; the range of factors considered is wide and is significantly dependent upon management's judgment, including the outlook and potential changes in the economic environment. At present, components of the commercial loan segments of the portfolio are new originations and the associated volumes continue to see increased growth. At the same time, historical loss levels have decreased as factors in assessing the portfolio. Any unallocated portion of the allowance reflects management's estimate of probable inherent but undetected losses within the portfolio due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition, the difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors.

Asset Quality

The Company manages asset quality and credit risk by maintaining diversification in its loan portfolio and through review processes that include analysis of credit requests and ongoing examination of outstanding loans and delinquencies, with particular attention to portfolio dynamics and mix. The Company strives to identify loans experiencing difficulty early enough to correct the problems, to record charge-offs promptly based on realistic assessments of current collateral values, and to maintain an adequate allowance for loan losses at all times.

It is generally the Company's policy to discontinue interest accruals once a loan is past due as to interest or principal payments for a period of ninety days. When a loan is placed on non-accrual status, interest accruals cease and uncollected accrued interest is reversed and charged against current income. Payments received on non-accrual loans are applied against principal. A loan may only be restored to an accruing basis when it again becomes well secured and in the process of collection or all past due amounts have been collected and a satisfactory period of ongoing repayment exists. Accruing loans past due 90 days or more are generally well secured and in the process of collection. For additional information regarding loans, see Note 6 of the Notes to the Consolidated Financial Statements.

Non-Performing and Past Due Loans and OREO

Non-performing loans include non-accrual loans and accruing loans which are contractually past due 90 days or more. Non-accrual loans represent loans on which interest accruals have been suspended. It is the Company's general policy to consider the charge-off of loans at the point they become past due in excess of 90 days, with the exception of loans that are both well-secured and in the process of collection. Troubled debt restructurings represent loans on which a concession was granted to a borrower, such as a reduction in interest rate to a rate lower than the current market rate for new debt with similar risks, and which are currently performing in accordance with the modified terms. For additional information regarding loans, see Note 7 of the Notes to the Consolidated Financial Statements.

The following table sets forth, as of the dates indicated, the amount of the Company's non-accrual loans, accruing loans past due 90 days or more, OREO and troubled debt restructurings.

| | At September 30, | | | | |
|---|-----------------------|------------------|-----------------|-----------------|-----------------|
| | 2019 | 2018 | 2017 | 2016 | 2015 |
| | <i>(In thousands)</i> | | | | |
| Non-accrual loans | \$ 1,821 | \$ 2,687 | \$ 1,038 | \$ 1,617 | \$ 1,399 |
| Accruing loans past due 90 days or more | 502 | 374 | 173 | 696 | — |
| Total non-performing loans | 2,323 | 3,061 | 1,211 | 2,313 | 1,399 |
| Other real estate owned | 5,796 | — | — | — | 1,168 |
| Total non-performing assets | <u>\$ 8,119</u> | <u>\$ 3,061</u> | <u>\$ 1,211</u> | <u>\$ 2,313</u> | <u>\$ 2,567</u> |
| Troubled debt restructured loans — performing | <u>\$ 12,170</u> | <u>\$ 18,640</u> | <u>\$ 2,238</u> | <u>\$ 2,039</u> | <u>\$ 1,091</u> |

At September 30, 2019, non-performing assets totaled \$8.1 million, or 0.64 percent of total assets, as compared with \$3.1 million, or 0.30 percent, at September 30, 2018. The increase in non-performing assets at September 30, 2019 compared to September 30, 2018 was primarily due to the transfer to OREO of one commercial real estate loan in the amount of \$5.8 million.

TDR loans totaled \$13.3 million and \$18.9 million at September 30, 2019 and at September 30, 2018, respectively. A total of \$12.2 million and \$18.6 million of troubled debt restructured loans were performing pursuant to the terms of their respective modifications at September 30, 2019 and September 30, 2018, respectively. At September 30, 2019, four troubled debt restructured loans with an outstanding balance of approximately \$1.1 million, were deemed non-performing, while three troubled debt restructured loans with an outstanding balance of approximately \$289,000, were deemed non-performing at September 30, 2018. The performing troubled debt restructured loans decreased by \$6.5 million at September 30, 2019 compared to September 30, 2018 primarily due to the transfer of one commercial real estate loan with an aggregate outstanding balance of approximately \$7.0 million to OREO in the first fiscal quarter of 2019 partially offset by three residential loans and two consumer loans with an aggregate outstanding balance of approximately \$496,000 and \$92,000, respectively, moving to TDR status during fiscal 2019.

Total non-performing assets increased \$1.9 million from September 30, 2017 to September 30, 2018. The increase in non-performing assets from September 30, 2017 was attributable to the addition of eight residential mortgage loans with an aggregate outstanding balance of approximately \$1.3 million, one commercial loan with an outstanding balance of approximately \$520,000 and ten consumer loans with an aggregate outstanding balance of approximately \$306,000 moving into non-accrual status and a \$308,000 increase in residential mortgage loans receivable greater than 90 days and accruing.

Provision for Income Taxes

The Company recorded \$2.5 million in income tax expense in fiscal 2019 compared to \$4.3 million in income tax expense in fiscal 2018. The effective tax rates for the Company for the years ended September 30, 2019 and 2018 were 20.9 percent and 36.9 percent, respectively. For a more detailed description of income taxes see Note 13 of the Notes to Consolidated Financial Statements.

Recent Accounting Pronouncements

Please refer to the note on Recent Accounting Pronouncements in Note 2 to the consolidated financial statements in Item 8 for a detailed discussion of new accounting pronouncements.

Asset and Liability Management

Asset and Liability management encompasses an analysis of market risk, the control of interest rate risk (interest sensitivity management) and the ongoing maintenance and planning of liquidity and capital. The composition of the Company's statement of condition is planned and monitored by the Asset and Liability Committee ("ALCO"). In general, management's objective is to optimize net interest income and minimize market risk and interest rate risk by monitoring the components of the statement of condition and the interaction of interest rates.

Short-term interest rate exposure analysis is supplemented with an interest sensitivity gap model. The Company utilizes interest sensitivity analysis to measure the responsiveness of net interest income to changes in interest rate levels. Interest rate risk arises when an earning asset matures or when its interest rate changes in a time period different than that of a supporting interest-bearing liability, or when an interest-bearing liability matures or when its interest rate changes in a time period different than that of an earning asset that it supports. While the Company matches only a small portion of specific assets and liabilities, total earning assets and interest-bearing liabilities are grouped to determine the overall interest rate risk within a number of specific time frames. The difference between interest-sensitive assets and interest-sensitive liabilities is referred to as the interest sensitivity gap. At any given point in time, the Company may be in an asset-sensitive position, whereby its interest-sensitive assets exceed its interest-sensitive liabilities, or in a liability-sensitive position, whereby its interest-sensitive liabilities exceed its interest-sensitive assets, depending in part on management's judgment as to projected interest rate trends.

The Company's interest rate sensitivity position in each time frame may be expressed as assets less liabilities, as liabilities less assets, or as the ratio between rate sensitive assets ("RSA") and rate sensitive liabilities ("RSL"). For example, a short-funded position (liabilities repricing before assets) would be expressed as a net negative position, when period gaps are computed by subtracting repricing liabilities from repricing assets. When using the ratio method, a RSA/RSL ratio of 1 indicates a balanced position, a ratio greater than 1 indicates an asset-sensitive position and a ratio less than 1 indicates a liability-sensitive position.

A negative gap and/or a rate sensitivity ratio less than 1 tends to expand net interest margins in a falling rate environment and reduce net interest margins in a rising rate environment. Conversely, when a positive gap occurs, generally margins expand in a rising rate environment and contract in a falling rate environment. From time to time, the Company may elect to deliberately mismatch liabilities and assets in a strategic gap position.

At September 30, 2019, the Company reflected a positive interest sensitivity gap with an interest sensitivity ratio of 1.54:1.00 at the cumulative one-year position. Based on management's perception of interest rates remaining low throughout 2019, emphasis has been, and is expected to continue to be, placed on controlling liability costs while extending the maturities of liabilities in our efforts to insulate the net interest spread from rising interest rates in the future. However, no assurance can be given that this objective will be met.

The following table sets forth the amounts of our interest-earning assets and interest-bearing liabilities outstanding at September 30, 2019, which we expect, based upon certain assumptions, to reprice or mature in each of the future time periods shown (the “GAP Table”). Except as stated below, the amount of assets and liabilities shown which reprice or mature during a particular period were determined in accordance with the earlier of term to repricing or the contractual maturity of the asset or liability. The table sets forth approximation of the projected repricing of assets and liabilities at September 30, 2019, on the basis of contractual maturities, anticipated prepayments, and scheduled rate adjustments within a three-month period and subsequent selected time intervals. The loan amounts in the table reflect principal balances expected to be redeployed and/or repriced as a result of contractual amortization and anticipated prepayments of adjustable-rate loans and fixed-rate loans, and as a result of contractual rate adjustments on adjustable-rate loans.

| | <u>6 Months or Less</u> | <u>More than 6 Months to 1 Year</u> | <u>More than 1 Year to 3 Years</u> | <u>More than 3 Year to 5 Years</u> | <u>More than 5 Years</u> | <u>Total Amount</u> |
|--|-----------------------------|---|--|--|------------------------------|-------------------------|
| | <i>(In thousands)</i> | | | | | |
| Interest-earning assets⁽¹⁾: | | | | | | |
| Loans receivable ⁽²⁾ | \$ 304,170 | \$ 86,513 | \$ 256,908 | \$ 278,184 | \$ 89,550 | \$ 1,015,325 |
| Investment securities and restricted securities | 13,312 | 5,550 | 5,054 | 8,716 | 19,491 | 52,123 |
| Other interest-earning assets | 152,143 | — | — | — | — | 152,143 |
| Total interest-earning assets | <u>469,625</u> | <u>92,063</u> | <u>261,962</u> | <u>286,900</u> | <u>109,041</u> | <u>1,219,591</u> |
| Interest-bearing liabilities: | | | | | | |
| Demand and NOW accounts | 13,073 | 13,073 | 52,291 | 52,291 | 171,311 | 302,039 |
| Money market accounts | 25,751 | 25,751 | 103,004 | 121,919 | 219 | 276,644 |
| Savings accounts | 1,818 | 1,818 | 7,273 | 7,273 | 23,693 | 41,875 |
| Certificate accounts | 115,975 | 75,243 | 63,617 | 15,738 | 6,996 | 277,569 |
| FHLB advances and subordinated debt | 65,000 | 28,000 | 64,619 | — | — | 157,619 |
| Total interest-bearing liabilities | <u>221,617</u> | <u>143,885</u> | <u>290,804</u> | <u>197,221</u> | <u>202,219</u> | <u>1,055,746</u> |
| Interest-earning assets less interest-bearing liabilities | <u>\$ 248,008</u> | <u>\$ (51,822)</u> | <u>\$ (28,842)</u> | <u>\$ 89,679</u> | <u>\$ (93,178)</u> | <u>\$ 163,845</u> |
| Cumulative interest-rate sensitivity gap⁽³⁾ | <u>\$ 248,008</u> | <u>\$ 196,186</u> | <u>\$ 167,344</u> | <u>\$ 257,023</u> | <u>\$ 163,845</u> | |
| Cumulative interest-rate gap as a percentage of total assets at September 30, 2019 | <u>19.60%</u> | <u>15.51%</u> | <u>13.23%</u> | <u>20.31%</u> | <u>12.95%</u> | |
| Cumulative interest-earning assets as a percentage of cumulative interest-bearing liabilities at September 30, 2019 | <u>211.91%</u> | <u>153.68%</u> | <u>125.50%</u> | <u>130.11%</u> | <u>115.52%</u> | |

(1) Interest-earning assets are included in the period in which the balances are expected to be redeployed and /or repriced as a result of anticipated prepayments, scheduled rate adjustments and contractual maturities.

(2) For purposes of the gap analysis, loans receivable includes non-performing loans gross of the allowance for loan losses, undisbursed loan funds, unamortized discounts and deferred loans fees.

(3) Interest-rate sensitivity gap represents the net cumulative difference between interest-earning assets and interest-bearing liabilities.

Net Portfolio Value and Net Interest Income Analysis. Our interest rate sensitivity also is monitored by management through the use of models which generate estimates of the change in its net portfolio value (“NPV”) and net interest income (“NII”) over a range of interest rate scenarios. NPV is the present value of expected cash flows from assets, liabilities, and off-balance sheet contracts. The NPV ratio, under any interest rate scenario, is defined as the NPV in that scenario divided by the market value of assets in the same scenario.

The table below sets forth as of September 30, 2019 and 2018 the estimated changes in our net portfolio value that would result from designated instantaneous changes in the United States Treasury yield curve. Computations of prospective effects of hypothetical interest rates changes are based on numerous assumptions including relative levels of market interest rates, loan prepayments and deposit decay, and should not be relied upon as indicative of actual results.

| Changes in Interest Rates (basis points) ⁽¹⁾ | As of September 30, 2019 | | | As of September 30, 2018 | | |
|--|--------------------------|-------------------------------|-----------------------------------|--------------------------|-------------------------------|-----------------------------------|
| | Amount | Dollar Change from Base | Percentage Change from Base | Amount | Dollar Change from Base | Percentage Change from Base |
| | <i>(In thousands)</i> | | | | | |
| +300 | \$ 166,280 | \$ (4,588) | (3)% | \$ 124,186 | \$ (25,162) | (17)% |
| +200 | 170,385 | (483) | — | 133,197 | (16,151) | (11) |
| +100 | 172,926 | 2,058 | 1 | 142,132 | (7,216) | (5) |
| 0 | 170,868 | — | — | 149,348 | — | — |
| -100 | 164,043 | (6,825) | (4) | 152,538 | 3,190 | 2 |

(1) Assumes an instantaneous uniform change in interest rates. A basis point equals 0.01%.

In addition to modeling changes in NPV, we also analyze potential changes to NII for a twelve-month period under rising and falling interest rate scenarios. The following table shows our NII model as of September 30, 2019.

| Changes in Interest Rates in Basis Points (Rate Shock) | Net Interest | | |
|--|-----------------------|-----------|----------|
| | Income | \$ Change | % Change |
| | <i>(In thousands)</i> | | |
| 200 | \$ 32,562 | \$ 3,545 | 12.22% |
| 100 | 30,886 | 1,869 | 6.44 |
| Static | 29,017 | — | — |
| (100) | 27,252 | (1,765) | (6.08) |

As is the case with the GAP Table, certain shortcomings are inherent in the methodology used in the above interest rate risk measurements. Modeling changes in NPV and NII require the making of certain assumptions which may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the models presented assume that the composition of our interest sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and also assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or repricing of specific assets and liabilities. Accordingly, although the NPV measurements and net interest income models provide an indication of interest rate risk exposure at a particular point in time, such measurements are not intended to and do not provide a precise forecast of the effect of changes in market interest rates on net interest income and will differ from actual results.

Estimates of Fair Value

The estimation of fair value is significant to a number of the Company's assets, including investment securities available-for-sale. These are all recorded at either fair value or the lower of cost or fair value. Fair values are volatile and may be influenced by a number of factors. Circumstances that could cause estimates of the fair value of certain assets and liabilities to change include a change in prepayment speeds, discount rates, or market interest rates. Fair values for most available-for-sale investment securities are based on quoted market prices. If quoted market prices are not available, fair values are based on judgments regarding future expected loss experience, current economic condition risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Impact of Inflation and Changing Prices

The financial statements and notes thereto presented elsewhere herein have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of operations; unlike most industrial companies, nearly all of the Company's assets and liabilities are monetary. As a result, interest rates have a greater impact on performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Liquidity

The liquidity position of the Company is dependent primarily on successful management of the Bank's assets and liabilities so as to meet the needs of both deposit and credit customers. Liquidity needs arise principally to accommodate possible deposit outflows and to meet customers' requests for loans. Scheduled principal loan repayments, maturing investments, short-term liquid assets and deposit inflows, can satisfy such needs. The objective of liquidity management is to enable the Company to maintain sufficient liquidity to meet its obligations in a timely and cost-effective manner.

Management monitors current and projected cash flows, and adjusts positions as necessary to maintain adequate levels of liquidity. Under its liquidity risk management program, the Company regularly monitors correspondent bank funding exposure and credit exposure in accordance with guidelines issued by the banking regulatory authorities. Management uses a variety of potential funding sources and staggering maturities to reduce the risk of potential funding pressure. Management also maintains a detailed contingency funding plan designed to respond adequately to situations which could lead to stresses on liquidity. Management believes that the Company has the funding capacity to meet the liquidity needs arising from potential events. The Company maintains borrowing capacity through the Federal Home Loan Bank of Pittsburgh secured with loans and marketable securities.

The Company's primary sources of short-term liquidity consist of cash and cash equivalents and investment securities available-for-sale.

At September 30, 2019, the Company had \$153.5 million in cash and cash equivalents compared to \$30.8 million at September 30, 2018. In addition, our investment securities available-for-sale amounted to \$18.4 million at September 30, 2019 and \$24.3 million at September 30, 2018.

Deposits

Total deposits increased to \$953.8 million at September 30, 2019 from \$774.2 million at September 30, 2018. Deposit growth during the year is a result of business development efforts, expanded market presence, and the higher visibility of the Bank. Total interest-bearing deposits increased from \$732.5 million at September 30, 2018 to \$898.1 million at September 30, 2019, an increase of \$165.6 million or 22.6 percent. Interest-bearing demand, savings, money market and time deposits under \$100,000 increased \$124.0 million to a total of \$696.6 million at September 30, 2019 as compared to \$572.6 million at September 30, 2018. Time deposits \$100,000 and over increased \$41.7 million at September 30, 2019 as compared to September 30, 2018. Time deposits \$100,000 and over represented 21.1 percent of total deposits at September 30, 2019 compared to 20.7 percent at September 30, 2018. We had brokered deposits totaling \$73.1 million at September 30, 2019 compared to \$88.3 million at September 30, 2018.

The Company continues to place the main focus of its deposit gathering efforts in the maintenance, development, and expansion of its core deposit base. Management believes that the emphasis on serving the needs of our communities will provide a long-term relationship base that will allow the Company to efficiently compete for business in its market. The success of this strategy is reflected in the growth of the savings and money market balances during fiscal 2019.

The following table depicts the Company's deposits classified by interest rates with percentages to total deposits at September 30, 2019 and 2018:

| | September 30, 2019 | | September 30, 2018 | | Dollar Change |
|-------------------------------|-----------------------|------------|-----------------------|------------|------------------|
| | Amount | Percentage | Amount | Percentage | |
| <i>(In thousands)</i> | | | | | |
| Balances by types of deposit: | | | | | |
| Savings | \$ 41,875 | 4.4% | \$ 44,642 | 5.8% | \$ (2,767) |
| Money market accounts | 276,644 | 29.0 | 270,834 | 35.0 | 5,810 |
| Interest bearing demand | 302,039 | 31.7 | 184,073 | 23.8 | 117,966 |
| Non-interest bearing demand | 55,684 | 5.8 | 41,677 | 5.4 | 14,007 |
| | \$ 676,242 | 70.9 | \$ 541,226 | 70.0 | \$ 135,016 |
| Certificates of deposit | 277,569 | 29.1 | 232,937 | 30.0 | 44,632 |
| Total | \$ 953,811 | 100.0% | \$ 774,163 | 100.0% | \$ 179,648 |

At September 30, 2019, our certificates of deposit and other time deposits with a balance of \$100,000 or more amounted to \$201.6 million, of which \$147.9 million are scheduled to mature within twelve months. At September 30, 2019, the weighted average remaining maturity of our certificate of deposit accounts was 13.3 months. The following table presents the maturity of our certificates of deposit and other time deposits with balances of \$100,000 or more at September 30, 2019.

| | <u>Amount</u> |
|---------------------------------------|-----------------------|
| | <i>(In thousands)</i> |
| Maturity Period: | |
| Three months or less | \$ 58,142 |
| Over three months through six months | 33,700 |
| Over six months through twelve months | 56,022 |
| Over twelve months | 53,712 |
| Total | <u>\$ 201,576</u> |

Borrowings

Borrowings from the FHLB of Pittsburgh are available to supplement the Company's liquidity position and, to the extent that maturing deposits do not remain with the Company, management may replace such funds with advances. As of September 30, 2019, and 2018, the Company's outstanding balance of FHLB advances, totaled \$133.0 million and \$118.0 million, respectively. Of the \$133.0 million in advances as of September 30, 2019, \$28.0 million represents long-term, fixed-rate advances maturing in 2020 that have terms enabling the FHLB to call the borrowing at its option prior to maturity. At September 30, 2019, there were five short-term FHLB advances totaling \$105.0 million of fixed-rate borrowing with rollover of 90 days.

During fiscal 2019 the Company did not purchase any securities sold under agreements to repurchase as a short-term funding source. At September 30, 2018, the Company had \$2.5 million in securities sold under agreements to repurchase at a rate of 2.5 percent.

Cash Flows

The Consolidated Statements of Cash Flows present the changes in cash and cash equivalents resulting from the Company's operating, investing and financing activities. During the year ended September 30, 2019, cash and cash equivalents increased by \$122.7 million over the balance at September 30, 2018. Net cash of \$10.2 million was provided by operating activities in fiscal 2019 compared to net cash of \$9.1 million provided by operating activities in fiscal 2018. Net cash used in investing activities amounted to approximately \$103.1 million in fiscal 2019 compared to net cash used in investing activities of approximately \$76.4 million in fiscal 2018. Net cash of \$215.6 million was provided by financing activities in fiscal 2019 compared to net cash of \$19.0 million used in financing activities in fiscal 2018.

Off-Balance Sheet Arrangements

In the normal course of operations, the Company engages in a variety of financial transactions that, in accordance with U.S. GAAP, are not recorded in its financial statements. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments, lines of credit and letters of credit.

The contractual amounts of commitments to extend credit represent the amounts of potential accounting loss should the contract be fully drawn upon, the customer defaults and the value of any existing collateral becomes worthless. We use the same credit policies in making commitments and conditional obligations as we do for on-balance sheet instruments. Financial instruments whose contract amounts represent credit risk at September 30, 2019 and 2018 were as follows:

| | September 30, | |
|--|-----------------------|-------------------|
| | 2019 | 2018 |
| | <i>(In thousands)</i> | |
| Commitments to extend credit:⁽¹⁾ | | |
| Future loan commitments | \$ 40,976 | \$ 52,390 |
| Undisbursed construction loans | 27,645 | 25,128 |
| Undisbursed home equity lines of credit | 21,447 | 26,498 |
| Undisbursed commercial lines of credit | 88,164 | 71,391 |
| Overdraft protection lines | 1,363 | 1,312 |
| Standby letters of credit | 11,589 | 7,122 |
| Total commitments | \$ 191,184 | \$ 183,841 |

(1) Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments may require payment of a fee and generally have fixed expiration dates or other termination clauses.

We anticipate that we will continue to have sufficient funds and alternative funding sources to meet our current commitments.

Shareholders' Equity

Total shareholders' equity amounted to \$142.5 million, or 11.3 percent of total assets, at September 30, 2019, compared to \$110.8 million, or 10.7 percent of total assets at September 30, 2018. Book value per common share was \$18.35 at September 30, 2018, compared to \$16.84 at September 30, 2018. As previously disclosed in the Company's Form 8-K filed on October 9, 2018, the Company closed an underwritten public offering of shares of our common stock for gross proceeds of \$25.0 million and net proceeds of approximately \$23.3 million (after deducting the underwriting discount and other estimated offering expenses).

Capital

Malvern Bank's capital ratios as of September 30, 2019 and September 30, 2018 are as follows:

| | <u>Actual</u> | | <u>Required for Capital Adequacy Purposes</u> | | <u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u> | | <u>Excess Over Well-Capitalized Provision</u> | |
|--|---------------|--------------|---|--------------|---|--------------|---|--------------|
| | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> |
| As of September 30, 2019: | | | | | | | | |
| <i>(Dollars in thousands)</i> | | | | | | | | |
| Tier 1 leverage (core) capital (to adjusted tangible assets) | \$ 153,086 | 12.23% | \$ 50,055 | 4.00% | \$ 62,569 | 5.00% | \$ 90,517 | 7.23% |
| Common equity Tier 1 (to risk-weighted assets) | \$ 153,086 | 15.38 | 44,788 | 4.50 | 64,694 | 6.50 | 88,392 | 8.88 |
| Tier 1 risk-based capital (to risk-weighted assets) | \$ 153,086 | 15.38 | 59,717 | 6.00 | 79,623 | 8.00 | 73,463 | 7.38 |
| Total risk-based capital (to risk-weighted assets) | \$ 163,253 | 16.40 | 79,623 | 8.00 | 99,529 | 10.00 | 63,724 | 6.40 |
| As of September 30, 2018: | | | | | | | | |
| Tier 1 leverage (core) capital (to adjusted tangible assets) | \$ 131,746 | 12.71% | \$ 41,450 | 4.00% | \$ 51,812 | 5.00% | \$ 79,934 | 7.71% |
| Common equity Tier 1 (to risk-weighted assets) | \$ 131,746 | 15.09 | 39,293 | 4.50 | 56,756 | 6.50 | 74,990 | 8.59 |
| Tier 1 risk-based capital (to risk-weighted assets) | \$ 131,746 | 15.09 | 52,390 | 6.00 | 69,853 | 8.00 | 61,893 | 7.09 |
| Total risk-based capital (to risk-weighted assets) | \$ 140,833 | 16.13 | 69,853 | 8.00 | 87,317 | 10.00 | 53,516 | 6.13 |

Malvern Bancorp's capital ratios as of September 30, 2019 and September 30, 2018 are as follows:

| | <u>Actual</u> | | <u>Required for Capital Adequacy Purposes</u> | | <u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u> | | <u>Excess Over Well-Capitalized Provision</u> | |
|--|---------------|--------------|---|--------------|---|--------------|---|--------------|
| | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> |
| As of September 30, 2019: | | | | | | | | |
| <i>(Dollars in thousands)</i> | | | | | | | | |
| Tier 1 leverage (core) capital (to adjusted tangible assets) | \$ 142,508 | 11.38% | \$ 50,091 | 4.00% | \$ 62,614 | 5.00% | \$ 79,894 | 6.38% |
| Common equity Tier 1 (to risk-weighted assets) | \$ 142,508 | 14.30 | 44,838 | 4.50 | 64,766 | 6.50 | 77,741 | 7.80 |
| Tier 1 risk-based capital (to risk-weighted assets) | \$ 142,508 | 14.30 | 59,784 | 6.00 | 79,713 | 8.00 | 62,795 | 6.30 |
| Total risk-based capital (to risk-weighted assets) | \$ 177,293 | 17.79 | 79,713 | 8.00 | 99,641 | 10.00 | 77,652 | 7.79 |
| As of September 30, 2018: | | | | | | | | |
| Tier 1 leverage (core) capital (to adjusted tangible assets) | \$ 110,239 | 10.63% | \$ 41,491 | 4.00% | \$ 51,864 | 5.00% | \$ 58,375 | 5.63% |
| Common equity Tier 1 (to risk-weighted assets) | \$ 110,239 | 12.62 | 39,322 | 4.50 | 56,799 | 6.50 | 53,440 | 6.12 |
| Tier 1 risk-based capital (to risk-weighted assets) | \$ 110,239 | 12.62 | 52,430 | 6.00 | 69,906 | 8.00 | 40,333 | 4.62 |
| Total risk-based capital (to risk-weighted assets) | \$ 143,787 | 16.45 | 69,906 | 8.00 | 87,383 | 10.00 | 56,404 | 6.45 |

Looking Forward

One of the Company's primary objectives is to achieve balanced asset and revenue growth, and at the same time expand market presence and diversify its financial products. However, it is recognized that objectives, no matter how focused, are subject to factors beyond the control of the Company, which can impede its ability to achieve these goals. The following factors should be considered when evaluating the Company's ability to achieve its objectives:

The financial market place is rapidly changing. Banks are no longer the only place to obtain loans, nor the only place to keep financial assets. The banking industry has lost market share to other financial service providers. The future is predicated on the Company's ability to adapt its products, provide superior customer service and compete in an ever-changing marketplace. Net interest income, the primary source of earnings, is impacted favorably or unfavorably by changes in interest rates. Although the impact of interest rate fluctuations is mitigated by ALCO strategies, significant changes in interest rates can have a material adverse impact on profitability.

The ability of customers to repay their obligations is often impacted by changes in the regional and local economy. Although the Company sets aside loan loss provisions toward the allowance for loan losses when management determines such action to be appropriate, significant unfavorable changes in the economy could impact the assumptions used in the determination of the adequacy of the allowance.

Technological changes will have a material impact on how financial service companies compete for and deliver services. It is recognized that these changes will have a direct impact on how the marketplace is approached and ultimately on profitability. The Company has taken steps to improve its traditional delivery channels. However, continued success will likely be measured by the Company's ability to anticipate and react to future technological changes.

This “Looking Forward” discussion constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from those projected in the Company’s forward-looking statements due to numerous known and unknown risks and uncertainties, including the factors referred to above, on the first page of this Annual Report on Form 10-K and in other sections of this Annual Report on Form 10-K.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

This Item has been omitted based on the Company’s status as a smaller reporting company.

Item 8. Financial Statements and Supplementary Data.

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Malvern Bancorp, Inc. and Subsidiaries

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated statements of financial condition of Malvern Bancorp, Inc. and Subsidiaries (the "Company") as of September 30, 2019 and 2018, and the related consolidated statements of operations, comprehensive income, changes in shareholders' equity, and cash flows, for the years then ended, and the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of September 30, 2019, based on criteria established in *Internal Control - Integrated Framework: (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of September 30, 2019 and 2018, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2019, based on criteria established in *Internal Control - Integrated Framework: (2013)* issued by COSO.

Basis for Opinion

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Assessment of Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud and whether effective internal control over financial reporting was maintained in all material respects.

Our audit of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in

accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Baker Tilly Virchow Krause, LLP

We have served as the Company's auditor since 2018.

Allentown, Pennsylvania
December 16, 2019

Malvern Bancorp, Inc. and Subsidiaries

Consolidated Statements of Financial Condition

| | September 30, | |
|---|--|---------------------|
| | 2019 | 2018 |
| | <i>(Dollars in thousands, except share data)</i> | |
| Assets | | |
| Cash and due from depository institutions | \$ 1,400 | \$ 1,563 |
| Interest bearing deposits in depository institutions | 152,143 | 29,271 |
| Cash and Cash Equivalents | 153,543 | 30,834 |
| Investment securities available for sale, at fair value (amortized cost of \$18,522 and \$24,804 at September 30, 2019 and 2018, respectively) | 18,411 | 24,298 |
| Investment securities held to maturity, at cost (fair value of \$22,609 and \$28,968 at September 30, 2019 and 2018, respectively) | 22,485 | 30,092 |
| Restricted stock, at cost | 11,129 | 8,537 |
| Loans receivable, net of allowance for loan losses of \$10,095 and \$9,021 at September 30, 2019 and 2018, respectively | 1,007,714 | 902,136 |
| Other real estate owned | 5,796 | — |
| Accrued interest receivable | 4,253 | 3,800 |
| Property and equipment, net | 6,678 | 7,181 |
| Deferred income taxes, net | 2,840 | 3,195 |
| Bank-owned life insurance | 19,891 | 19,403 |
| Other assets | 12,482 | 4,475 |
| Total Assets | \$ 1,265,222 | \$ 1,033,951 |
| Liabilities and Shareholders' Equity | | |
| Liabilities | | |
| Deposits: | | |
| Deposits-noninterest-bearing | \$ 55,684 | \$ 41,677 |
| Deposits-interest-bearing | 898,127 | 732,486 |
| Total Deposits | 953,811 | 774,163 |
| FHLB advances | 133,000 | 118,000 |
| Other short-term borrowings | — | 2,500 |
| Subordinated debt | 24,619 | 24,461 |
| Advances from borrowers for taxes and insurance | 1,761 | 1,305 |
| Accrued interest payable | 978 | 784 |
| Other liabilities | 8,545 | 1,915 |
| Total Liabilities | 1,122,714 | 923,128 |
| Commitments and Contingencies | — | — |
| Shareholders' Equity | | |
| Preferred stock, \$0.01 par value, 10,000,000 shares authorized, none issued | — | — |
| Common stock, \$0.01 par value, 50,000,000 shares authorized, 7,782,258 and 7,765,395 shares issued and outstanding, respectively, at September 30, 2019 and 6,580,879 shares at September 30, 2018 | 78 | 66 |
| Additional paid-in-capital | 84,783 | 61,099 |
| Retained earnings | 59,744 | 50,412 |
| Unearned Employee Stock Ownership Plan (ESOP) shares | (1,192) | (1,338) |
| Accumulated other comprehensive (loss) income | (569) | 584 |
| Treasury stock, at cost: 16,863 shares at September 30, 2019 | (336) | — |
| Total Shareholders' Equity | 142,508 | 110,823 |
| Total Liabilities and Shareholders' Equity | \$ 1,265,222 | \$ 1,033,951 |

See notes to consolidated financial statements.

Malvern Bancorp, Inc. and Subsidiaries

Consolidated Statements of Operations

| | Year Ended September 30, | |
|--|--------------------------|------------------|
| | 2019 | 2018 |
| <i>(Dollars in thousands, except share data)</i> | | |
| Interest and Dividend Income | | |
| Loans, including fees | \$ 43,574 | \$ 36,862 |
| Investment securities, taxable | 982 | 1,094 |
| Investment securities, tax-exempt | 207 | 251 |
| Dividends, restricted stock | 627 | 467 |
| Interest-bearing cash accounts | 2,265 | 1,356 |
| Total Interest and Dividend Income | 47,655 | 40,030 |
| Interest Expense | | |
| Deposits | 14,348 | 9,200 |
| Short-term borrowings | 7 | 68 |
| Long-term borrowings | 2,693 | 2,200 |
| Subordinated debt | 1,532 | 1,527 |
| Total Interest Expense | 18,580 | 12,995 |
| Net Interest Income | 29,075 | 27,035 |
| Provision for Loan Losses | 2,379 | 954 |
| Net Interest Income after Provision for Loan Losses | 26,696 | 26,081 |
| Other Income | | |
| Service charges and other fees | 1,796 | 1,268 |
| Rental income | 243 | 268 |
| Net gains on sale of investments | 28 | — |
| Net gains on sale of real estate | — | 1,186 |
| Net gains on sale of loans | 37 | 102 |
| Earnings on bank-owned life insurance | 488 | 480 |
| Total Other Income | 2,592 | 3,304 |
| Other Expense | | |
| Salaries and employee benefits | 8,541 | 8,193 |
| Occupancy expense | 2,256 | 2,295 |
| Federal deposit insurance premium | 221 | 298 |
| Advertising | 107 | 152 |
| Data processing | 1,024 | 1,098 |
| Professional fees | 1,799 | 2,891 |
| Other real estate owned expense, net | 192 | — |
| Pennsylvania shares tax | 431 | — |
| Other operating expenses | 2,916 | 2,876 |
| Total Other Expenses | 17,487 | 17,803 |
| Income before income tax expense | 11,801 | 11,582 |
| Income tax expense | 2,469 | 4,276 |
| Net Income | \$ 9,332 | \$ 7,306 |
| Earnings Per Common Share: | | |
| Basic | \$ 1.22 | \$ 1.13 |
| Diluted | \$ 1.22 | \$ 1.13 |
| Weighted Average Common Shares Outstanding | | |
| Basic | 7,638,866 | 6,456,154 |
| Diluted | 7,639,166 | 6,459,510 |

See notes to consolidated financial statements.

Malvern Bancorp, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

| | Year Ended September 30, | |
|--|--------------------------|-----------------|
| | 2019 | 2018 |
| <i>(In thousands)</i> | | |
| Net Income | \$ 9,332 | \$ 7,306 |
| Other Comprehensive (Loss) Income, Net of Tax: | | |
| Unrealized holding gains (losses) on available-for-sale securities | 419 | (229) |
| Tax effect | (88) | 48 |
| Net of tax amount | 331 | (181) |
| Reclassification adjustment for net gains arising during the period ⁽¹⁾ | (28) | — |
| Tax effect | 6 | — |
| Net of tax amount | (22) | — |
| Amortization of unrealized holding losses on securities transferred from available-for-sale to held-to-maturity ⁽²⁾ | 4 | 6 |
| Tax effect | (1) | (1) |
| Net of tax amount | 3 | 5 |
| Fair value adjustment on derivatives | (1,855) | 868 |
| Tax effect | 390 | (203) |
| Net of tax amount | (1,465) | 665 |
| Total other comprehensive (loss) income | (1,153) | 489 |
| Total comprehensive income | \$ 8,179 | \$ 7,795 |

(1) Amounts are included in net gains on sale of investments on the Consolidated Statements of Operations in total other income.

(2) Amounts are included in interest and dividends on investment securities on the Consolidated Statements of Operations.

See notes to consolidated financial statements.

Malvern Bancorp, Inc. and Subsidiaries

Consolidated Statements of Changes in Shareholders' Equity Years Ended September 30, 2019 and 2018

| | Common Stock | Additional Paid-In Capital | Retained Earnings | Unearned ESOP Shares | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total Shareholders' Equity |
|--|-----------------|----------------------------------|----------------------|----------------------------|--|-------------------|----------------------------------|
| <i>(In thousands, except share data)</i> | | | | | | | |
| Balance, October 1, 2017 | \$ 66 | \$ 60,736 | \$ 43,139 | \$ (1,483) | \$ 62 | — | \$ 102,520 |
| Net Income | — | — | 7,306 | — | — | — | 7,306 |
| Reclassification of certain tax effects from accumulated other comprehensive income | — | — | (33) | — | 33 | — | — |
| Other comprehensive income | — | — | — | — | 489 | — | 489 |
| Committed to be released ESOP shares (14,400 shares) | — | 221 | — | 145 | — | — | 366 |
| Stock based compensation | — | 142 | — | — | — | — | 142 |
| Balance, September 30, 2018 | \$ 66 | \$ 61,099 | \$ 50,412 | \$ (1,338) | \$ 584 | — | \$ 110,823 |
| Net Income | — | — | 9,332 | — | — | — | 9,332 |
| Other comprehensive loss | — | — | — | — | (1,153) | — | (1,153) |
| Treasury stock activity | — | — | — | — | — | (336) | (336) |
| Stock issuance (net issuance of proceeds of \$25,000) | 12 | 23,332 | — | — | — | — | 23,344 |
| Committed to be released ESOP shares (14,400 shares) | — | 143 | — | 146 | — | — | 289 |
| Stock based compensation | — | 209 | — | — | — | — | 209 |
| Balance, September 30, 2019 | \$ 78 | \$ 84,783 | \$ 59,744 | \$ (1,192) | \$ (569) | \$ (336) | \$ 142,508 |

See notes to consolidated financial statements.

Malvern Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

| | Year Ended September 30, | |
|---|--------------------------|------------------|
| | 2019 | 2018 |
| | (In thousands) | |
| Cash Flows from Operating Activities | | |
| Net income | \$ 9,332 | \$ 7,306 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation expense | 761 | 758 |
| Provision for loan losses | 2,379 | 954 |
| Deferred income taxes expense | 231 | 3,353 |
| ESOP expense | 289 | 366 |
| Stock based compensation | 209 | 142 |
| Amortization of premiums and discounts on investment securities, net | 275 | 360 |
| Amortization (accretion) of loan origination fees and costs | 183 | (77) |
| Amortization of mortgage service rights | 45 | 45 |
| Amortization of subordinated debt issuance costs | 158 | 158 |
| Net gain on sale of investment securities available for sale | (28) | — |
| Net gain on sale of real estate | — | (1,186) |
| Net gain on sale of secondary market loans | (37) | (102) |
| Proceeds on sale of secondary market loans | 2,867 | 9,189 |
| Originations of secondary market loans | (2,830) | (9,087) |
| Earnings on bank-owned life insurance | (488) | (480) |
| Increase in accrued interest receivable | (453) | (661) |
| Increase in accrued interest payable | 194 | 90 |
| Increase (decrease) in other liabilities | 6,630 | (1,631) |
| Increase in other assets | (9,476) | (439) |
| Net Cash Provided by Operating Activities | 10,241 | 9,058 |
| Cash Flows from Investing Activities | | |
| Investment securities available-for-sale: | | |
| Purchases | (17,890) | (30,140) |
| Sales | 2,055 | — |
| Maturities, calls and principal repayments | 22,092 | 20,123 |
| Investment securities held-to-maturity: | | |
| Maturities, calls and principal repayments | 7,385 | 4,545 |
| Proceeds from sale of loans | 384 | — |
| Net increase in loans | (114,320) | (68,682) |
| Net increase in restricted stock | (2,592) | (2,979) |
| Proceeds from sale of real estate | — | 1,315 |
| Purchases of property and equipment | (258) | (561) |
| Net Cash Used in Investing Activities | (103,144) | (76,379) |
| Cash Flows from Financing Activities | | |
| Net increase (decrease) in deposits | 179,648 | (16,233) |
| Proceeds for long-term borrowings | 70,000 | 140,000 |
| Repayment of long-term borrowings | (55,000) | (140,000) |
| Repayment of other borrowed money | (2,500) | (2,500) |
| Increase (decrease) in advances from borrowers for taxes and insurance | 456 | (248) |
| Net proceeds from issuance of common stock | 23,344 | — |
| Acquisition of treasury stock | (336) | — |
| Net Cash Provided by (Used in) Financing Activities | 215,612 | (18,981) |
| Net Increase (Decrease) in Cash and Cash Equivalents | 122,709 | (86,302) |
| Cash and Cash Equivalent - Beginning | 30,834 | 117,136 |
| Cash and Cash Equivalent - Ending | \$ 153,543 | \$ 30,834 |
| Supplementary Cash Flows Information | | |
| Interest paid | \$ 18,386 | \$ 12,904 |
| Non-cash transfer to other real estate owned | \$ 5,796 | \$ — |
| Non-cash transfer of loans to loans held for sale | \$ 367 | \$ — |
| Income taxes paid | \$ 1,367 | \$ 2,630 |

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Organizational Structure and Nature of Operations

Malvern Bancorp, Inc. (the “Company” or “Malvern Bancorp”), a Pennsylvania corporation, is a registered bank holding company under the Bank Holding Company Act of 1956, as amended (the “Holding Company Act”). Malvern Bancorp is the holding company for Malvern Bank, National Association (“Malvern Bank” or the “Bank”), a national bank that was originally organized in 1887 as a federally-chartered savings bank. Malvern Bank now serves as one of the oldest banks headquartered on the Philadelphia Main Line. For more than a century, the Bank has been committed to helping people build prosperous communities as a trusted financial partner, forging lasting relationships through teamwork, respect and integrity. Effective February 12, 2018, the Bank converted from a federal savings bank charter to a national bank charter and Malvern Bancorp converted from a savings and loan holding company to a bank holding company.

The Bank conducts business from its headquarters in Paoli, Pennsylvania, a suburb of Philadelphia, and through its twelve other banking locations in Chester, Delaware and Bucks counties, Pennsylvania, Palm Beach, Florida, and Morristown, New Jersey, its New Jersey regional headquarters. The Bank also maintains a representative office in Wellington, Florida. The Bank’s primary market niche is providing personalized service to its client base.

The Bank’s principal business consists of attracting deposits from businesses and the general public 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.

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 (including from the Federal Home Loan Bank of Pittsburgh (the “FHLB”)), 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.

The Bank owns 100 percent of Malvern Insurance Associates, LLC (“Malvern Associates”), a Pennsylvania limited liability company. Malvern Associates is a licensed insurance broker under Pennsylvania and New Jersey law.

The Bank owns a 10 percent non-controlling interest in Bell Rock Capital, LLC (“Bell Rock”), a Delaware limited liability company and investment advisor registered with the SEC, and headquartered in Rehoboth Beach, Delaware.

Certain mortgage-backed securities of the Bank are held through Delaware statutory trusts, 5 percent of which are owned by the Bank and 95 percent of which are owned by Coastal Asset Management Co., a Delaware corporation which is wholly owned by the Bank.

The Bank owns a 3.39 percent interest in Bankers Settlement Services Capital Region, LLC, a Pennsylvania limited liability company which acts as a title insurance agent or agency.

The Bank owns 100 percent of Joliet 55 LLC., a New Jersey limited liability company which holds an other real estate owned (“OREO”) asset.

The banking industry is highly regulated. The Bank is supervised by the Office of the Comptroller of the Currency (the “OCC”), and the Company is supervised by the Board of Governors of the Federal Reserve Board (the “FRB”).

In accordance with the subsequent events topic of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (the “Codification” or the “ASC”), the Company evaluates events and transactions that occur after the statement of financial condition date and through the date these consolidated financial statements are being issued for potential recognition and disclosure in the consolidated financial statements. The effect of all subsequent events that provide additional evidence of conditions that existed at the statement of financial condition date are recognized in the audited consolidated financial statements as of September 30, 2019.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The consolidated financial statements at and for the years ended September 30, 2019 and 2018 include the accounts of Malvern Bancorp, Inc. and its subsidiaries. All significant intercompany transactions and balances have been eliminated.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of deferred tax assets.

Significant Group Concentrations of Credit Risk

Most of the Company's activities are with customers located within Chester County, Pennsylvania. In addition to Chester County, our lending efforts are focused in neighboring Bucks County, Montgomery County and Delaware County, which are also in southeastern Pennsylvania, New Jersey and the New York metropolitan marketplace. Note 6 discusses the types of investment securities that the Company invests in. Note 7 discusses the types of lending that the Company engages in. The Company does not have any significant concentrations to any one industry or customer. Although the Company has a diversified portfolio, its debtor's ability to honor their contracts is influenced by, among other factors, the region's economy.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from depository institutions and interest bearing deposits.

The Company maintains cash deposits in other depository institutions that occasionally exceed the amount of deposit insurance available. Management periodically assesses the financial condition of these institutions and believes that the risk of any possible credit loss is minimal.

The Company is required to maintain average reserve balances in vault cash with the Federal Reserve Bank based upon outstanding balances of deposit transaction accounts. Based upon the Company's outstanding transaction deposit balances, the Bank maintained a deposit account with the Federal Reserve Bank of Philadelphia in the amount of zero at September 30, 2019 and 2018.

Investment Securities

Held-to-maturity ("HTM") are securities that includes debt securities that the Company has the positive intent and the ability to hold to maturity. These securities are reported at amortized cost and adjusted for unamortized premiums and discounts. Securities held for trading are securities that are bought and held principally for the purpose of selling in the near term; these securities are reported at fair value, with unrealized gains and losses reported in current earnings. At September 30, 2019 and 2018, the Company had no investment securities classified as trading. Debt securities that will be held for indefinite periods of time and equity securities, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity and changes in the availability of and the yield of alternative investments, are classified as available for sale. Realized gains and losses are recorded on the trade date and are determined using the specific identification method. Securities held as available for sale are reported at fair value, with unrealized gains and losses, net of tax, reported as a component of accumulated other comprehensive income ("AOCI"). Management determines the appropriate classification of investment securities at the time of purchase.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (Continued)

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.

Loans Receivable

The Company, through the Bank, grants mortgage, construction, commercial and consumer loans to customers. Substantially all of our loans are to individuals, businesses and real estate developers in Chester County, Pennsylvania and neighboring areas in southern Pennsylvania, New Jersey and the New York metropolitan marketplace, Delaware and Florida markets. The ability of the Company's debtors to honor their contracts is dependent upon, among other factors, the real estate and general economic conditions in this area.

Loans receivable that management has the intent and ability to hold until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees and costs. Interest income is accrued on the unpaid principal balance. Loan origination fees and costs are deferred and recognized as an adjustment of the yield (interest income) of the related loans using the interest method. The Company is amortizing these amounts over the contractual lives of the loans.

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

For all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collection of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans, including impaired loans, generally is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

In addition to originating loans, the Company purchases consumer and mortgage loans from brokers in our market area. Such purchases are reviewed for compliance with our underwriting criteria before they are purchased, and are generally purchased without recourse to the seller. Premiums and discounts on purchased loans are amortized as adjustments to interest income using the effective yield method.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (Continued)

Reserves for unfunded lending commitments represent management's estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities on the consolidated statements of financial condition.

Allowance for Loan Losses

The allowance for credit losses consists of the allowance for loan losses. The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the consolidated statement of financial condition date and is recorded as a reduction to loans. The allowance for loan losses ("ALLL", "allowance") is increased by the provision for loan losses and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment or collateral recovery of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than when they become 120 days past due on a contractual basis or earlier in the event of the borrower's bankruptcy or if there is an amount deemed uncollectible. Because all identified losses are generally charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

The allowance for credit losses is maintained at a level considered adequate to provide for losses that can be reasonably estimated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, the composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, a specific reserve is recognized when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class that are not considered impaired.

These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these classes of loans, as adjusted for qualitative factors. These qualitative risk factors include:

1. Lending policies and procedures, including underwriting standards and collection, charge-off, and recovery practices.
2. National, regional, and local economic and business conditions as well as the condition of various market segments, including the value of underlying collateral for collateral dependent loans.
3. The nature and volume of the loan portfolio and terms of loans.
4. The experience, ability, and depth of lending management and staff.
5. The volume and severity of past due, classified and nonaccrual loans as well as any other loan modifications.
6. The quality of the Company's loan review system, and the degree of oversight by the Company's Board of Directors.
7. The existence and effect of any concentrations of credit and changes in the level of such concentrations.
8. Value of underlying collateral.
9. A single calculation figure which is subsequently applied to the loan portfolio by loan type (Commercial, Residential and Consumer) based upon the percent of each to total loans. It is derived from a review of a peer group consisting of ten banks with similar asset size within the same general geographic area of the Bank.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (Continued)

The qualitative factors are applied to the historical loss rates for each class of loan. In addition, while not reported as a separate factor, changes in the value of underlying collateral (for regional property values) for collateral dependent loans is considered and addressed within the economic trends factor. A quarterly calculation is made adjusting the reserve allocation for each factor within a risk weighted range as it relates to each particular loan type, collateral type and risk rating within each segment. Data is gathered and evaluated through internal, regulatory, and government sources quarterly for each factor.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

In addition, the allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial and consumer loans. Credit quality risk ratings include categories of "pass," "special mention," "substandard" and "doubtful." Assets classified as "Pass" are those protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral. Assets which do not currently expose the insured institution to sufficient risk to warrant classification as substandard or doubtful but possess certain identified weaknesses are required to be designated "special mention." If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. An asset is considered "substandard" if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. "Substandard" assets include those characterized by the "distinct possibility" that the insured institution will sustain "some loss" if the deficiencies are not corrected. Assets classified as "doubtful" have all of the weaknesses inherent in those classified "substandard" with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable."

Residential Lending. Residential mortgage originations are secured primarily by properties located in the Company's primary market area and surrounding areas. We currently originate fixed-rate, fully amortizing mortgage loans with maturities of 10 to 30 years. We also offer adjustable rate mortgage ("ARM") loans where the interest rate either adjusts on an annual basis or is fixed for the initial one, three or seven years and then adjusts annually.

We underwrite one- to four-family residential mortgage loans with loan-to-value ratios of up to 95 percent, provided that the borrower obtains private mortgage insurance on loans that exceed 80 percent of the appraised value or sales price, whichever is less, of the secured property. We also require that title insurance, hazard insurance and, if appropriate, flood insurance be maintained on all properties securing real estate loans. We require that a licensed appraiser from our list of approved appraisers perform and submit to us an appraisal on all properties secured by a first mortgage on one- to four-family first mortgage loans.

In underwriting one- to four-family residential mortgage loans, the Company evaluates both the borrower's ability to make monthly payments and the value of the property securing the loan. Most properties securing real estate loans made by the Company are appraised by independent fee appraisers reviewed and approved by the Bank's third-party appraisal management companies. The Company generally requires borrowers to obtain an attorney's title opinion or title insurance, and fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. Real estate loans originated by the Company generally contain a "due on sale" clause allowing the Company to declare the unpaid principal balance due and payable upon the sale of the security property. The Company has not engaged in sub-prime residential mortgage loan originations. Our single-family residential mortgage loans generally are underwritten on terms and documentation conforming to guidelines issued by Freddie Mac and Fannie Mae.

Construction and Development Lending. We originate construction loans for residential and, to a lesser extent, commercial uses within our market area. We generally limit construction loans to builders and developers with whom we have an established relationship, or who are otherwise known to officers of the Bank. Our construction and development loans currently in the portfolio typically have variable rates of interest tied to the prime rate which improves the interest rate sensitivity of our loan portfolio.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (Continued)

Construction and development loans generally are considered to involve a higher level of risk than one-to four-family residential lending, due to the concentration of principal in a limited number of loans and borrowers and the effect of economic conditions on developers, builders and projects. Additional risk is also associated with construction lending because of the inherent difficulty in estimating both a property's value at completion and the estimated cost (including interest) to complete a project. The nature of these loans is such that they are more difficult to evaluate and monitor. In addition, speculative construction loans to a builder are not pre-sold and thus pose a greater potential risk than construction loans to individuals on their personal residences. In order to mitigate some of the risks inherent in construction lending, we inspect properties under construction, review construction progress prior to advancing funds, work with builders with whom we have established relationships, require annual updating of tax returns and other financial data of developers and obtain personal guarantees from the principals.

Commercial Lending. Commercial and multi-family real estate loans generally present a higher level of risk than loans secured by one- to four-family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effect of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by commercial and multi-family real estate is typically dependent upon the successful operation of the related real estate project. If the cash flow from the project is reduced (for example, if leases are not obtained or renewed, or a bankruptcy court modifies a lease term, or a major tenant is unable to fulfill its lease obligations), the borrower's ability to repay the loan may be impaired.

Most of the Company's commercial business loans have been extended to finance local and regional businesses and include short-term loans to finance machinery and equipment purchases, inventory and accounts receivable. The commercial business loans which we originate may be either a revolving line of credit or for a fixed term of generally 10 years or less. Interest rates are adjustable, indexed to a published prime rate of interest, or fixed. Generally, equipment, machinery, real property or other corporate assets secure such loans. Personal guarantees from the business principals are generally obtained as additional collateral.

Consumer Lending. The Company currently originates most of its consumer loans in its primary market area and surrounding areas. The Company originates consumer loans on both a direct and indirect basis. Consumer loans generally have higher interest rates and shorter terms than residential mortgage loans; however, they have additional credit risk due to the type of collateral securing the loan or in some case the absence of collateral. We are continuing to evaluate and monitor the credit conditions of our consumer loan borrowers and the real estate values of the properties securing our second mortgage loans as part of our on-going efforts to assess the overall credit quality of the portfolio in connection with our review of the allowance for loan losses.

Consumer loans may entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans which are unsecured or are secured by rapidly depreciable assets, such as automobiles or recreational equipment. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

Once all factor adjustments are applied, general reserve allocations for each segment are calculated, summarized and reported on the ALLL summary. ALLL final schedules, calculations and the resulting evaluation process are reviewed quarterly.

In addition, Federal bank regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (Continued)

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, cash flow, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed.

A specific reserve is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of substantially all of the Company's impaired loans are measured based on the estimated fair value of the loan's collateral.

For commercial loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For commercial and industrial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable aging or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

Troubled Debt Restructurings

Loans whose terms are modified are classified as troubled debt restructurings if the Company grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring may be modified by means of extending the maturity date of the loan, reducing the interest rate on the loan to a rate which is below market, a combination of rate adjustments and maturity extensions, or by other means including covenant modifications, forbearances or other concessions. However, the Company generally only restructures loans by modifying the payment structure to interest only or by reducing the actual interest rate.

We do not accrue interest on loans that were non-accrual prior to the troubled debt restructuring until they have performed in accordance with their restructured terms for a period of at least six months. We continue to accrue interest on troubled debt restructurings which were performing in accordance with their terms prior to the restructure and continue to perform in accordance with their restructured terms. Management evaluates the ALLL with respect to TDRs under the same policy and guidelines as all other performing loans are evaluated with respect to the ALLL.

Loan Servicing

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Capitalized servicing rights are reported in other assets and are amortized into other expense in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Company later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income. The Company also sells loans in the secondary market with servicing released.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (Continued)

Other Real Estate Owned

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of the previously established carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other expenses from other real estate owned.

Restricted Stock

Restricted stock represents required investments in the common stock of a correspondent bank and is carried at cost. As of September 30, 2019 and 2018, restricted stock consists of the common stock of the Federal Reserve Bank, FHLB and Atlantic Community Bankers Bank (“ACBB”).

Management’s evaluation and determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of an investment’s cost is influenced by criteria such as (1) the significance of the decline in net assets of the Federal Reserve Bank, FHLB and ACBB as compared to the capital stock amount for the Federal Reserve Bank, FHLB and ACBB and the length of time this situation has persisted, (2) commitments by the Federal Reserve Bank, FHLB and ACBB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the Federal Reserve Bank, FHLB and ACBB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the Federal Reserve Bank, FHLB and ACBB.

During the years ended September 30, 2019 and 2018, there were net repurchases of restricted stock of \$2.6 million and \$3.0 million, respectively. Also, as of September 30, 2019 and 2018, the number of restricted shares was 137,148 and 108,151, respectively. There were approximately \$627,000 and \$467,000 of dividends on restricted stock received or recognized in income for fiscal years 2019 and 2018, respectively.

Property and Equipment

Property and equipment is carried at cost. Depreciation is computed using the straight-line and accelerated methods over estimated useful lives ranging from 3 to 39 years beginning when assets are placed in service. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any gain or loss is reflected in income for the period. The cost of maintenance and repairs is charged to income as incurred.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Bank-Owned Life Insurance

The Company invests in bank owned life insurance (“BOLI”) as a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance by the Bank on a chosen group of employees. The Bank is the owner and beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies. Earnings from the increase in cash surrender value of the policies are included in other income on the statements of operations.

Employee Benefit Plans

The Bank’s 401(k) plan allows eligible participants to set aside a certain percentage of their salaries before taxes. The Company may elect to match employee contributions up to a specified percentage of their respective salaries in an amount determined annually by the Board of Directors. The Company’s matching contribution related to the plan resulted in expenses of \$135,000 and \$121,000 for fiscal 2019 and 2018, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (Continued)

The Company also maintains an unfunded Supplemental Executive and a Director Retirement Plan (the "Plans"). The accrued amount for the Plans included in other liabilities was \$875,000 and \$970,000 at September 30, 2019 and 2018, respectively. Distributions from the Plan for each of the fiscal years 2019 and 2018 were approximately \$100,000 and \$93,000, respectively. The expense associated with the Plans for the years ended September 30, 2019 and 2018 was \$4,000 and \$5,000, respectively.

Derivatives and Hedging

The Company records cash flow hedges at the inception of the derivative contract based on the Company's intentions and belief as to likely effectiveness as a hedge. The Company documents the strategy for entering into the transactions and the method of assessing ongoing effectiveness. Cash flow hedges represent a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability. For a cash flow hedge that is effective, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. The changes in the fair value of derivatives that are not highly effective in hedging the changes in fair value or expected cash flows of the hedged item are recognized immediately in current earnings. Changes in the fair value of derivatives that do not qualify for hedge accounting are reported currently in earnings, as noninterest income.

Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Net cash settlements on derivatives that do not qualify for hedge accounting are reported in noninterest income. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged. To determine fair value, the Company uses third party pricing models that incorporate assumptions about market conditions and risks that are current at the reporting date. The Company does not use derivative instruments for speculative purposes.

The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in fair values or cash flows of the hedged items. The Company discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as noninterest income. When a cash flow hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income are amortized into earnings over the same periods which the hedged transactions will affect earnings.

The Company recognized \$795,000 of net swap fees through the Bank's commercial loan hedging program during fiscal 2019.

Advertising Costs

The Company follows the policy of charging the costs of advertising to expense as incurred. Advertising expense was \$107,000 and \$152,000 in fiscal 2019 and 2018, respectively.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. These calculations are based on many complex factors including estimates of the timing of reversals of temporary differences, the interpretation of federal income tax laws and a determination of the differences between the tax and the financial reporting basis of assets and liabilities. Actual results could differ significantly from the estimates and interpretations used in determining the current and deferred income tax assets and liabilities.

A valuation allowance is required to be recognized if it is "more likely than not" that a portion of the deferred tax assets will not be realized. The Company's policy is to evaluate the deferred tax asset on a quarterly basis and record a valuation allowance for our deferred tax asset if we do not have sufficient positive evidence indicating that

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (Continued)

it is more likely than not that some or all of the deferred tax asset will be realized. The Company's policy is to account for interest and penalties as components of income tax expense.

Commitments and Contingencies

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the statement of financial condition when they are funded.

Segment Information

The Company has one reportable segment, "Community Banking." All of the Company's activities are interrelated, and each activity is dependent and assessed based on how each of the activities of the Company supports the others. For example, lending is dependent upon the ability of the Company to fund itself with deposits and other borrowings and manage interest rate and credit risk. Accordingly, all significant operating decisions are based upon analysis of the Company as one segment or unit.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale investment securities, are reported as a separate component of the shareholders' equity section of the statement of financial condition, such items, along with net income, are components of comprehensive income.

For securities transferred from available for sale to held to maturity, the Company records the amortization and/or accretion of unrealized holding losses on such investment securities, in accumulated other comprehensive (loss) income.

The Company also records changes in the fair value of interest rate derivatives used in its cash flow hedging activities, net of deferred income tax, in accumulated other comprehensive (loss) income.

Reclassifications

Certain reclassifications have been made to the previous year's consolidated financial statements to conform to the current year's presentation. These reclassifications had no effect on the Company's results of operations.

Revenue Recognition

ASC 606, *Revenue from Contracts with Customers* ("ASC 606"), establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts to provide goods or services to customers. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it expects to be entitled to receive in exchange for those goods or services recognized as performance obligations are satisfied.

The majority of our revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as our loans, investment securities, derivatives as well as revenue related to BOLI, sales of investment securities, rental income, and gain on sale of loans. Revenue-generating activities that are within the scope of ASC 606, which are presented in our income statements as components of other income include certain fees such as credit card fee income, DDA service and fee income, and debit card fees.

Loans Held-For-Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value on the consolidated statements of financial condition. Gains and losses on loan sales (sales proceeds minus carrying value) are recorded in noninterest income, and direct loan origination costs and fees are deferred at origination of the loan and are recognized in other income upon sale of the loan. Servicing is retained at the Bank for loans sold in the secondary market and are placed as a mortgage servicing asset on the consolidated statement of financial condition. There were no loans classified as held for sale as of September 30, 2019 and September 30, 2018.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (Continued)

Treasury stock

The Company records common stock purchased for treasury at cost. At the date of subsequent reissue, the treasury stock account is reduced by the cost of such stock on the first-in, first-out basis.

Recently Issued Accounting Pronouncements

Receivables. In March 2017, the FASB issued Accounting Standards Update (“ASU”) No. 2017-08, *Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*. This ASU shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. Today, entities generally amortize the premium over the contractual life of the security. The new guidance does not change the accounting for purchased callable debt securities held at a discount; the discount continues to be amortized to maturity. ASU No. 2017-08 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. The guidance calls for a modified retrospective transition approach under which a cumulative-effect adjustment will be made to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company adopted this standard effective October 1, 2019. Adoption of this ASU did not have a material impact on the consolidated earnings, financial position or cash flows of the Company.

Derivatives. In October 2018, the FASB issued ASU No. 2018-16, *Derivatives and Hedging - Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes (Topic 815)*. This ASU applies to all entities that elect to apply hedge accounting to benchmark interest rate hedges under Topic 815. It permits the use of the OIS rate based on SOFR as a U.S. benchmark interest rate for hedge accounting purposes in addition to the existing applicable rates. The guidance is required to be adopted concurrently with ASU 2017-12, on a prospective basis for qualifying new or redesignated hedging relationships entered into on or after adoption. The Company early adopted this standard effective October 1, 2018. Adoption of this ASU did not have a material impact on the consolidated earnings, financial position or cash flows of the Company.

Collaborative Arrangements. In November 2018, the FASB issued ASU 2018-18, *Collaborative Arrangements (Topic 808)*. This ASU clarifies the interaction between Topic 808, *Collaborative Arrangements*, and Topic 606, *Revenue from Contracts with Customers*. This ASU is effective for fiscal years beginning after December 15, 2019 and is not expected to have a material impact on the consolidated earnings, financial position or cash flows of the Company.

Fair Value. In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement* which modifies the disclosures on fair value measurements by removing the requirement to disclose the amount and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, the policy for timing of such transfers and the valuation process for Level 3 fair value measurements. This ASU also expands the disclosure requirements for Level 3 fair value measurements and is effective for fiscal years beginning after December 15, 2019, with early adoption permitted. The adoption of this ASU is not expected to have a material impact on the consolidated earnings, financial position or cash flows of the Company.

Credit Losses. In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This ASU requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied currently will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. Additionally, this ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. In April 2019, the FASB issued ASU 2019-04, *Codification Improvements*, which provides guidance on accounting for credit losses on accrued interest receivable balances and guidance on including recoveries when estimating the allowance. In May 2019, the FASB issued ASU 2019-05, *Targeted Transition Relief*, which allows entities with an option to elect fair value for certain instruments upon adoption of Topic 326. This ASU will be effective for interim and annual periods

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (Continued)

beginning after December 15, 2019, with early adoption permitted. The Bank has a software system in place to assist with the calculation of Current Expected Credit Losses (“CECL”). The Company formed a cross functional implementation team to review the requirements of ASU 2016-13 and contracted with a third-party provider to assist in the development and implementation of the revised credit loss methodology. The impact on the consolidated earnings, financial position and cash flows of the Company, upon adoption of this ASU are currently unknown. On October 16, 2019, the FASB approved its August 2019 proposal to delay effective date for adopting credit losses CECL standard for certain small reporting companies and private companies/ not-for-profit organizations to January 2023. In November 2019, the FASB issued ASU No. 2019-10, *Financial Instruments-Credit Losses (Topic 326), Derivatives and hedging (Topic 815), and Leases (Topic 842)* making this ASU effective for interim and annual periods beginning after December 15, 2022. As such the Company would be required to implement the ASU on October 1, 2023.

Leases. In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* to increase transparency and comparability among organizations recognizing lease assets and lease liabilities on the balance sheet. This ASU will require lessees to recognize a right-of-use (ROU) asset for its right to use the underlying asset and a lease liability for the corresponding lease obligation for leases with terms of more than twelve months. Accounting by lessors will remain largely unchanged from current U.S. GAAP. This ASU also requires expanded quantitative and qualitative disclosures for both lessees and lessors. In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842): Targeted Improvements*, which provides entities with an additional (and optional) transition method in which the entity applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The Company plans to apply this optional transition method upon adoption. In December 2018, the FASB issued ASU 2018-20, *Leases (Topic 842): Narrow Scope Improvements for Lessors*, which clarifies the treatment of sales taxes and other taxes collected from lessees, lessor costs paid directly by lessees, and recognition of variable payments for contracts with lease and non-lease components. The Company adopted the guidance in these ASUs on October 1, 2019 and will not restate comparative periods. As a result, the Company recorded ROU assets and related lease liabilities of approximately \$3.3 million.

Note 3 – Non-Interest Income

On October 1, 2018, the Company adopted the amendments of ASU 2014-09 - *Revenue from Contracts with Customers (Topic 606)* and all subsequent ASUs that modified Topic 606. A significant amount of the Company’s revenues is derived from net interest income on financial assets and liabilities, which are excluded from the scope of the amended guidance. Some sources of revenue included within non-interest income fall within the scope of Topic 606, while other sources do not. The Company recognizes revenue when the performance obligations related to the transfer of goods or services under the terms of the contract are satisfied. Some obligations are satisfied at a point in time while others are satisfied over a period of time. Revenue is recognized as the amount of consideration to which the Company expects to be entitled in exchange for transferring goods or services to a customer. When consideration includes a variable component, the amount of consideration attributable to variability is included in the transaction price only to the extent it is probable that significant revenue recognized will not be reversed when uncertainty associated with the variable consideration is subsequently resolved. The Company’s contracts generally do not contain terms that require significant judgement to determine the variability impacting the transaction price. The Company has included the following table regarding the Company’s non-interest income for the periods presented.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3 – Non-Interest Income (Continued)

| <i>(In thousands)</i> | Year Ended September 30, | |
|--|--------------------------|-----------------|
| | 2019 | 2018 |
| Rental income | \$ 243 | \$ 268 |
| Net gains on sales of investments | 28 | — |
| Net gains on sale of real estate | — | 1,186 |
| Net gains on sale of loans | 37 | 102 |
| Earnings on bank-owned life insurance | 488 | 480 |
| Non-interest income within the scope of other GAAP topics | 796 | 2,036 |
| ATM fees | 6 | 10 |
| Credit card fee income | 24 | 23 |
| DDA fee income | 132 | 134 |
| DDA service fees | 75 | 69 |
| Debit card fees | 251 | 238 |
| Other loan fee income | 1,036 | 550 |
| Other fee income | 238 | 237 |
| Other non-interest income | 34 | 7 |
| Non-interest income from contracts with customers | \$ 1,796 | \$ 1,268 |
| Total Non-interest Income | \$ 2,592 | \$ 3,304 |

The increase in other loan fee income during the fiscal year ended September 30, 2019 is primarily due to the recognition of net swap fees through the Bank's commercial loan hedging program during fiscal 2019.

Note 4 – Earnings Per Share

Basic earnings per common share is computed based on the weighted average number of shares outstanding reduced by unearned Employee Stock Ownership Plan ("ESOP") shares. Diluted earnings per share is computed based on the weighted average number of shares outstanding and common stock equivalents ("CSEs") that would arise from the exercise of dilutive securities reduced by unearned ESOP shares. For the fiscal year ended September 30, 2019, the Company issued stock options to purchase 7,000 shares of common stock, as well as 12,674 restricted shares, which are considered CSEs. For the fiscal year ended September 30, 2018, the Company issued stock options to purchase 6,996 shares of common stock, as well as 6,400 restricted shares, which are considered CSEs.

The following table sets forth the composition of the weighted average shares (denominator) used in the earnings per share computations.

| <i>(In thousands, except share data)</i> | Year Ended September 30, | |
|---|--------------------------|-----------|
| | 2019 | 2018 |
| Net Income | \$ 9,332 | \$ 7,306 |
| Weighted average shares outstanding | 7,746,409 | 6,578,097 |
| Average unearned ESOP shares | (107,543) | (121,943) |
| Basic weighted average shares outstanding | 7,638,866 | 6,456,154 |
| Plus: effect of dilutive options and restricted stock | 300 | 3,356 |
| Diluted weighted average common shares outstanding | 7,639,166 | 6,459,510 |
| Earnings per share: | | |
| Basic | \$ 1.22 | \$ 1.13 |
| Diluted | \$ 1.22 | \$ 1.13 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 – Employee Stock Ownership Plan

The Company established an ESOP for substantially all of its full-time employees. As of September 30, 2019, the current ESOP trustee is Pentegra. Shares of the Company’s common stock purchased by the ESOP are held until released for allocation to participants. Shares released are allocated to each eligible participant based on the ratio of each such participant’s base compensation to the total base compensation of all eligible plan participants. As the unearned shares are committed to be released and allocated among participants, the Company recognizes compensation expense equal to the fair value of the ESOP shares during the periods in which they become committed to be released. To the extent that the fair value of the ESOP shares released differs from the cost of such shares, the difference is charged or credited to additional paid-in capital. During the period from May 20, 2008 to September 30, 2008, the ESOP purchased 241,178 shares of common stock for approximately \$2.6 million, at an average price of \$10.86 per share, which was funded by a loan from Malvern Federal Bancorp, Inc. (the Company’s predecessor). The ESOP loan is being repaid principally from the Bank’s contributions to the ESOP. The loan, which bears an interest rate of 5 percent, is being repaid in quarterly installments through 2026. Shares are released to participants proportionately as the loan is repaid. During each of the years ended September 30, 2019 and 2018, there were 14,400 shares committed to be released. At September 30, 2019, there were 100,365 unallocated shares and 158,853 allocated shares held by the ESOP. The unallocated shares had an aggregate fair value of approximately \$2.2 million at September 30, 2019.

Note 6 - Investment Securities

The Company’s investment securities are classified as available-for-sale or held-to-maturity at September 30, 2019 and 2018. Investment securities available-for-sale are reported at fair value with unrealized gains or losses included in equity, net of tax. Accordingly, the carrying value of such securities reflects their fair value at the balance sheet date. Fair value is based upon either quoted market prices, or in certain cases where there is limited activity in the market for a particular instrument, assumptions are made to determine their fair value.

Transfers of debt securities from the available-for-sale category to the held-to-maturity category are made at fair value at the date of transfer. The unrealized holding gain or loss at the date of transfer remains in accumulated other comprehensive income and in the carrying value of the held-to-maturity investment security. Premiums or discounts on investment securities are amortized or accreted using the effective interest method over the life of the security as an adjustment of yield. Unrealized holding gains or losses that remain in accumulated other comprehensive income are amortized or accreted over the remaining life of the security as an adjustment of yield, offsetting the related amortization of the premium or accretion of the discount.

The following tables present information related to the Company’s investment securities at September 30, 2019 and 2018.

| | September 30, 2019 | | | |
|--|-----------------------|------------------------------|-------------------------------|---------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | <i>(In thousands)</i> | | | |
| Investment Securities Available-for-Sale: | | | | |
| U.S. government agencies | \$ 3,000 | \$ — | \$ — | \$ 3,000 |
| State and municipal obligations | 4,715 | 17 | — | 4,732 |
| Single issuer trust preferred security | 1,000 | — | (77) | 923 |
| Corporate debt securities | 9,557 | 181 | (232) | 9,506 |
| Mutual fund | 250 | — | — | 250 |
| Total | 18,522 | 198 | (309) | 18,411 |
| Investment Securities Held-to-Maturity: | | | | |
| U.S. government agencies | \$ 1,000 | \$ — | \$ — | \$ 1,000 |
| State and municipal obligations | 4,515 | 75 | — | 4,590 |
| Corporate debt securities | 3,608 | 182 | — | 3,790 |
| Mortgage-backed securities: | | | | |
| Collateralized mortgage obligations, fixed-rate | 13,362 | 3 | (136) | 13,229 |
| Total | \$ 22,485 | \$ 260 | \$ (136) | \$ 22,609 |
| Total investment securities | \$ 41,007 | \$ 458 | \$ (445) | \$ 41,020 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Investment Securities (Continued)

| | September 30, 2018 | | | |
|--|-----------------------|------------------------------|-------------------------------|---------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | <i>(In thousands)</i> | | | |
| Investment Securities Available-for-Sale: | | | | |
| U.S. Treasury notes | \$ 9,996 | \$ — | \$ (10) | \$ 9,986 |
| State and municipal obligations | 6,953 | — | (66) | 6,887 |
| Single issuer trust preferred security | 1,000 | — | (79) | 921 |
| Corporate debt securities | 6,605 | — | (351) | 6,254 |
| Mutual fund | 250 | — | — | 250 |
| Total | 24,804 | — | (506) | 24,298 |
| Investment Securities Held-to-Maturity: | | | | |
| U.S. government agencies | \$ 1,999 | \$ — | \$ (20) | \$ 1,979 |
| State and municipal obligations | 8,181 | — | (66) | 8,115 |
| Corporate debt securities | 3,715 | — | (49) | 3,666 |
| Mortgage-backed securities: | | | | |
| Collateralized mortgage obligations, fixed-rate | 16,197 | — | (989) | 15,208 |
| Total | \$ 30,092 | \$ — | \$ (1,124) | \$ 28,968 |
| Total investment securities | \$ 54,896 | \$ — | \$ (1,630) | \$ 53,266 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Investment Securities (Continued)

For fiscal 2019, proceeds of available-for-sale investment securities sold amounted to approximately \$2.1 million. Gross realized gains on investment securities sold amounted to approximately \$28,000. For fiscal 2018, no available-for-sale investment securities were sold.

The varying amount of sales from the available-for-sale portfolio over the past few years, 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 following tables indicate gross unrealized losses not recognized in income and fair value, aggregated by investment category and the length of time individual securities have been in a continuous unrealized loss position at September 30, 2019 and 2018.

| | September 30, 2019 | | | | | |
|--|-----------------------|-------------------|---------------------|-------------------|------------|-------------------|
| | Less than 12 Months | | More than 12 Months | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair value | Unrealized Losses |
| | <i>(In thousands)</i> | | | | | |
| Investment Securities Available-for-Sale: | | | | | | |
| Single issuer trust preferred security | — | — | 923 | (77) | 923 | (77) |
| Corporate debt securities | — | — | 3,268 | (232) | 3,268 | (232) |
| Total | \$ — | \$ — | \$ 4,191 | \$ (309) | \$ 4,191 | \$ (309) |
| Investment Securities Held-to-Maturity: | | | | | | |
| Mortgage-backed securities: | | | | | | |
| CMO, fixed-rate | 1,315 | (4) | 10,894 | (132) | 12,209 | (136) |
| Total | 1,315 | (4) | 10,894 | (132) | 12,209 | (136) |
| Total investment securities | \$ 1,315 | \$ (4) | \$ 15,085 | \$ (441) | \$ 16,400 | \$ (445) |

| | September 30, 2018 | | | | | |
|--|-----------------------|-------------------|---------------------|-------------------|------------|-------------------|
| | Less than 12 Months | | More than 12 Months | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair value | Unrealized Losses |
| | <i>(In thousands)</i> | | | | | |
| Investment Securities Available-for-Sale: | | | | | | |
| U.S. Treasury notes | \$ 9,986 | \$ (10) | \$ — | \$ — | \$ 9,986 | \$ (10) |
| State and municipal obligations | 5,433 | (56) | 1,000 | (10) | 6,433 | (66) |
| Single issuer trust preferred security | — | — | 921 | (79) | 921 | (79) |
| Corporate debt securities | — | — | 6,254 | (351) | 6,254 | (351) |
| Total | \$ 15,419 | \$ (66) | \$ 8,175 | \$ (440) | \$ 23,594 | \$ (506) |
| Investment Securities Held-to-Maturity: | | | | | | |
| U.S. government agencies | — | — | 1,979 | (20) | 1,979 | (20) |
| State and municipal obligations | 8,115 | (66) | — | — | 8,115 | (66) |
| Corporate securities | 3,666 | (49) | — | — | 3,666 | (49) |
| Mortgage-backed securities: | | | | | | |
| CMO, fixed-rate | 127 | (6) | 15,081 | (983) | 15,208 | (989) |
| Total | 11,908 | (121) | 17,060 | (1,003) | 28,968 | (1,124) |
| Total investment securities | \$ 27,327 | \$ (187) | \$ 25,235 | \$ (1,443) | \$ 52,562 | \$ (1,630) |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Investment Securities (Continued)

As of September 30, 2019, the estimated fair value of the securities disclosed above was primarily dependent upon the movement in market interest rates, particularly given the 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, 2019, the Company held two corporate securities, thirty-four mortgage-backed securities, and one single issuer trust preferred security which were in an unrealized loss position. As of September 30, 2018, the Company held one U.S. government Treasury note, two U.S. government agency securities, seventeen municipal bonds, four corporate securities, thirty-seven 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 not 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, 2019 represents other-than-temporary impairment.

Investment securities having a carrying value of approximately \$6.4 million and \$17.9 million at September 30, 2019 and September 30, 2018, respectively, were pledged to secure public deposits. Pledged investment securities having a carrying value of \$4.0 million at September 30, 2019 were pledged to secure hedges. There were no pledged investment securities pledged to secure hedges at September 30, 2018. In addition, no investment securities were pledged to secure short-term borrowings at September 30, 2019. Investment securities having a carrying value of \$3.1 million were pledged to secure short-term borrowings at September 30, 2018.

The following table presents information for investment securities at September 30, 2019, based on scheduled maturities. Actual maturities can be expected to differ from scheduled maturities due to prepayment or early call options of the issuer.

| | September 30, 2019 | |
|--|---------------------------|-------------------------|
| | Amortized Cost | Fair Value |
| <i>(In thousands)</i> | | |
| Investment Securities Available-for-Sale: | | |
| Due in one year or less | \$ 1,538 | \$ 1,544 |
| Due after one year through five years | 9,010 | 9,044 |
| Due after five years through ten years | 7,974 | 7,823 |
| Due after ten years | — | — |
| Total | <u>\$ 18,522</u> | <u>\$ 18,411</u> |
| Investment Securities Held-to-Maturity: | | |
| Due in one year or less | \$ 1,000 | \$ 1,000 |
| Due after one year through five years | — | — |
| Due after five years through ten years | 5,436 | 5,691 |
| Due after ten years | 2,687 | 2,689 |
| Mortgage-backed securities: | | |
| Collateralized mortgage obligations, fixed-rate | 13,362 | 13,229 |
| Total | <u>\$ 22,485</u> | <u>\$ 22,609</u> |
| Total investment securities | <u>\$ 41,007</u> | <u>\$ 41,020</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Loans Receivable and Related Allowance for Loan Losses

Loans receivable in the Company's portfolio consisted of the following at the dates indicated:

| | September 30, | |
|---|-----------------------|-------------------|
| | 2019 | 2018 |
| | <i>(In thousands)</i> | |
| Residential mortgage | \$ 220,011 | \$ 197,219 |
| Construction and Development: | | |
| Residential and commercial | 40,346 | 37,433 |
| Land | 3,420 | 9,221 |
| Total Construction and Development | 43,766 | 46,654 |
| Commercial: | | |
| Commercial real estate | 543,452 | 493,929 |
| Farmland | 7,563 | 12,066 |
| Multi-family | 62,884 | 45,102 |
| Commercial and industrial | 99,747 | 73,895 |
| Other | 4,450 | 6,164 |
| Total Commercial | 718,096 | 631,156 |
| Consumer: | | |
| Home equity lines of credit | 19,506 | 14,884 |
| Second mortgages | 13,737 | 18,363 |
| Other | 2,030 | 2,315 |
| Total Consumer | 35,273 | 35,562 |
| Total loans | 1,017,146 | 910,591 |
| Deferred loan fees and cost, net | 663 | 566 |
| Allowance for loan losses | (10,095) | (9,021) |
| Total loans receivable, net | \$ 1,007,714 | \$ 902,136 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Loans Receivable and Related Allowance for Loan Losses (Continued)

The following table summarizes the primary classes of the allowance for loan losses, segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of and for the years ended September 30, 2019 and 2018.

| | Year Ended September 30, 2019 | | | | | | | | | | | | Total |
|---|-------------------------------|----------------------------|-----------------|------------------------|-----------------|------------------|---------------------------|-----------------|-----------------------------|------------------|-----------------|---------------|---------------------|
| | Construction and Development | | | Commercial | | | | | Consumer | | | | |
| | Residential Mortgage | Residential and Commercial | Land | Commercial Real Estate | Farmland | Multi-family | Commercial and Industrial | Other | Home Equity Lines of Credit | Second Mortgages | Other | Unallocated | |
| | <i>(In thousands)</i> | | | | | | | | | | | | |
| Allowance for loan losses: | | | | | | | | | | | | | |
| Beginning balance | \$ 1,062 | \$ 393 | \$ 49 | \$ 5,031 | \$ 66 | \$ 232 | \$ 443 | \$ 24 | \$ 82 | \$ 326 | \$ 51 | \$ 1,262 | \$ 9,021 |
| Charge-offs | (17) | — | — | (1,418) | — | — | — | — | — | (45) | (37) | — | (1,517) |
| Recoveries | 79 | — | — | 23 | — | — | 4 | — | 1 | 94 | 11 | — | 212 |
| Provisions | 240 | 130 | (29) | 2,267 | (17) | 137 | 168 | (3) | 39 | (108) | (2) | (443) | 2,379 |
| Ending Balance | <u>\$ 1,364</u> | <u>\$ 523</u> | <u>\$ 20</u> | <u>\$ 5,903</u> | <u>\$ 49</u> | <u>\$ 369</u> | <u>\$ 615</u> | <u>\$ 21</u> | <u>\$ 122</u> | <u>\$ 267</u> | <u>\$ 23</u> | <u>\$ 819</u> | <u>\$ 10,095</u> |
| Ending balance: individually evaluated for impairment | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 57</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 100</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 157</u> |
| Ending balance: collectively evaluated for impairment | <u>\$ 1,364</u> | <u>\$ 523</u> | <u>\$ 20</u> | <u>\$ 5,846</u> | <u>\$ 49</u> | <u>\$ 369</u> | <u>\$ 615</u> | <u>\$ 21</u> | <u>\$ 122</u> | <u>\$ 167</u> | <u>\$ 23</u> | <u>\$ 819</u> | <u>\$ 9,938</u> |
| Loans receivable: | | | | | | | | | | | | | |
| Ending balance | <u>\$ 220,011</u> | <u>\$ 40,346</u> | <u>\$ 3,420</u> | <u>\$ 543,452</u> | <u>\$ 7,563</u> | <u>\$ 62,884</u> | <u>\$ 99,747</u> | <u>\$ 4,450</u> | <u>\$ 19,506</u> | <u>\$ 13,737</u> | <u>\$ 2,030</u> | <u>\$ —</u> | <u>\$ 1,017,146</u> |
| Ending balance: individually evaluated for impairment | <u>\$ 3,526</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 9,707</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 30</u> | <u>\$ 728</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 13,991</u> |
| Ending balance: collectively evaluated for impairment | <u>\$ 216,485</u> | <u>\$ 40,346</u> | <u>\$ 3,420</u> | <u>\$ 533,745</u> | <u>\$ 7,563</u> | <u>\$ 62,884</u> | <u>\$ 99,747</u> | <u>\$ 4,450</u> | <u>\$ 19,476</u> | <u>\$ 13,009</u> | <u>\$ 2,030</u> | <u>\$ —</u> | <u>\$ 1,003,155</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Loans Receivable and Related Allowance for Loan Losses (Continued)

| Year Ended September 30, 2018 | | | | | | | | | | | | | | |
|---|------------------------------|----------------------------|-----------------|------------------------|------------------|------------------|---------------------------|-----------------|-----------------------------|------------------|-----------------|-----------------|-------------------|-------|
| | Construction and Development | | | Commercial | | | | | Consumer | | | | Unallocated | Total |
| | Residential Mortgage | Residential and Commercial | Land | Commercial Real Estate | Farmland | Multi-family | Commercial and Industrial | Other | Home Equity Lines of Credit | Second Mortgages | Other | | | |
| <i>(In thousands)</i> | | | | | | | | | | | | | | |
| Allowance for loan losses: | | | | | | | | | | | | | | |
| Beginning balance | \$ 1,004 | \$ 523 | \$ 132 | \$ 3,581 | \$ 9 | \$ 224 | \$ 520 | \$ 21 | \$ 90 | \$ 402 | \$ 27 | \$ 1,872 | \$ 8,405 | |
| Charge-offs | (60) | — | — | (276) | — | — | (45) | — | — | (88) | (2) | — | (471) | |
| Recoveries | 58 | — | — | 11 | — | — | 4 | — | 1 | 52 | 7 | — | 133 | |
| Provisions | 60 | (130) | (83) | 1,715 | 57 | 8 | (36) | 3 | (9) | (40) | 19 | (610) | 954 | |
| Ending Balance | <u>\$ 1,062</u> | <u>\$ 393</u> | <u>\$ 49</u> | <u>\$ 5,031</u> | <u>\$ 66</u> | <u>\$ 232</u> | <u>\$ 443</u> | <u>\$ 24</u> | <u>\$ 82</u> | <u>\$ 326</u> | <u>\$ 51</u> | <u>\$ 1,262</u> | <u>\$ 9,021</u> | |
| Ending balance: individually evaluated for impairment | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 1,448</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 103</u> | <u>\$ 26</u> | <u>\$ —</u> | <u>\$ 1,577</u> | |
| Ending balance: collectively evaluated for impairment | <u>\$ 1,062</u> | <u>\$ 393</u> | <u>\$ 49</u> | <u>\$ 3,583</u> | <u>\$ 66</u> | <u>\$ 232</u> | <u>\$ 443</u> | <u>\$ 24</u> | <u>\$ 82</u> | <u>\$ 223</u> | <u>\$ 25</u> | <u>\$ 1,262</u> | <u>\$ 7,444</u> | |
| Loans receivable: | | | | | | | | | | | | | | |
| Ending balance | <u>\$ 197,219</u> | <u>\$ 37,433</u> | <u>\$ 9,221</u> | <u>\$ 493,929</u> | <u>\$ 12,066</u> | <u>\$ 45,102</u> | <u>\$ 73,895</u> | <u>\$ 6,164</u> | <u>\$ 14,884</u> | <u>\$ 18,363</u> | <u>\$ 2,315</u> | <u>\$ —</u> | <u>\$ 910,591</u> | |
| Ending balance: individually evaluated for impairment | <u>\$ 3,148</u> | <u>\$ —</u> | <u>\$ 76</u> | <u>\$ 17,409</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 34</u> | <u>\$ 635</u> | <u>\$ 26</u> | <u>\$ —</u> | <u>\$ 21,328</u> | |
| Ending balance: collectively evaluated for impairment | <u>\$ 194,071</u> | <u>\$ 37,433</u> | <u>\$ 9,145</u> | <u>\$ 476,520</u> | <u>\$ 12,066</u> | <u>\$ 45,102</u> | <u>\$ 73,895</u> | <u>\$ 6,164</u> | <u>\$ 14,850</u> | <u>\$ 17,728</u> | <u>\$ 2,289</u> | <u>\$ —</u> | <u>\$ 889,263</u> | |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Loans Receivable and Related Allowance for Loan Losses (Continued)

In assessing the adequacy of the ALLL, it is recognized that the process, methodology and underlying assumptions require a significant degree of judgment. The estimation of credit losses is not precise; the range of factors considered is wide and is significantly dependent upon management's judgment, including the outlook and potential changes in the economic environment. At present, components of the commercial loan segments of the portfolio are new originations and the associated volumes continue to see increased growth. At the same time, historical loss levels have decreased as factors in assessing the portfolio. Any unallocated portion of the allowance reflects management's estimate of probable inherent but undetected losses within the portfolio due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition, the difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors.

The following table presents impaired loans in portfolio by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of September 30, 2019 and 2018.

| | <u>Impaired Loans With Specific Allowance</u> | | <u>Impaired Loans With No Specific Allowance</u> | <u>Total Impaired Loans</u> | |
|--------------------------------------|---|------------------------------|--|--------------------------------|---|
| | <u>Recorded Investment</u> | <u>Related Allowance</u> | <u>Recorded Investment</u> | <u>Recorded Investment</u> | <u>Unpaid Principal Balance</u> |
| <i>(In thousands)</i> | | | | | |
| September 30, 2019: | | | | | |
| Residential mortgage | \$ — | \$ — | \$ 3,526 | \$ 3,526 | \$ 3,713 |
| Commercial: | | | | | |
| Commercial real estate | 9,176 | 57 | 531 | 9,707 | 9,707 |
| Consumer: | | | | | |
| Home equity lines of credit | — | — | 30 | 30 | 32 |
| Second mortgages | 123 | 100 | 605 | 728 | 790 |
| Total impaired loans | <u>\$ 9,299</u> | <u>\$ 157</u> | <u>\$ 4,692</u> | <u>\$ 13,991</u> | <u>\$ 14,242</u> |
| September 30, 2018: | | | | | |
| Residential mortgage | \$ — | \$ — | \$ 3,148 | \$ 3,148 | \$ 3,337 |
| Construction and Development: | | | | | |
| Land | — | — | 76 | 76 | 76 |
| Commercial: | | | | | |
| Commercial real estate | 16,343 | 1,448 | 1,066 | 17,409 | 17,685 |
| Consumer: | | | | | |
| Home equity lines of credit | — | — | 34 | 34 | 34 |
| Second mortgages | 120 | 103 | 515 | 635 | 730 |
| Other | 26 | 26 | — | 26 | 26 |
| Total impaired loans | <u>\$ 16,489</u> | <u>\$ 1,577</u> | <u>\$ 4,839</u> | <u>\$ 21,328</u> | <u>\$ 21,888</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Loans Receivable and Related Allowance for Loan Losses (Continued)

The following table presents the average recorded investment in impaired loans in portfolio and related interest income recognized year ended September 30, 2019 and 2018.

| | Average Impaired Loans | Interest Income Recognized on Impaired Loans |
|---------------------------------------|------------------------------|--|
| <i>(In thousands)</i> | | |
| Year Ended September 30, 2019: | | |
| Residential mortgages | \$ 3,575 | \$ 89 |
| Construction and Development: | | |
| Land | 46 | 2 |
| Commercial: | | |
| Commercial real estate | 11,251 | 304 |
| Consumer: | | |
| Home equity lines of credit | 35 | — |
| Second mortgages | 670 | 9 |
| Other | 7 | — |
| Total | \$ 15,584 | \$ 404 |
| Year Ended September 30, 2018: | | |
| Residential mortgages | \$ 1,833 | \$ 56 |
| Construction and Development: | | |
| Land | 65 | 5 |
| Commercial: | | |
| Commercial real estate | 6,510 | 245 |
| Commercial and industrial | 138 | — |
| Consumer: | | |
| Home equity lines of credit | 14 | — |
| Second mortgages | 458 | 8 |
| Other | 1 | — |
| Total | \$ 9,019 | \$ 314 |

No additional funds are committed to be advanced in connection with impaired loans.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Loans Receivable and Related Allowance for Loan Losses (Continued)

The following table presents the classes of the loan portfolio summarized by loans considered to be rated as pass and the categories of special mention, substandard and doubtful within the Company's internal risk rating system as of September 30, 2019 and 2018.

| | September 30, 2019 | | | | |
|--------------------------------------|-----------------------|--------------------|------------------|-------------|---------------------|
| | Pass | Special Mention | Substandard | Doubtful | Total |
| | <i>(In thousands)</i> | | | | |
| Residential mortgage | \$ 216,376 | \$ — | \$ 3,635 | \$ — | \$ 220,011 |
| Construction and Development: | | | | | |
| Residential and commercial | 40,346 | — | — | — | 40,346 |
| Land | 3,420 | — | — | — | 3,420 |
| Commercial: | | | | | |
| Commercial real estate | 518,848 | 14,601 | 10,003 | — | 543,452 |
| Farmland | 7,563 | — | — | — | 7,563 |
| Multi-family | 62,483 | 401 | — | — | 62,884 |
| Commercial and industrial | 99,613 | — | 134 | — | 99,747 |
| Other | 4,450 | — | — | — | 4,450 |
| Consumer: | | | | | |
| Home equity lines of credit | 19,385 | — | 121 | — | 19,506 |
| Second mortgages | 12,727 | 85 | 925 | — | 13,737 |
| Other | 2,030 | — | — | — | 2,030 |
| Total | <u>\$ 987,241</u> | <u>\$ 15,087</u> | <u>\$ 14,818</u> | <u>\$ —</u> | <u>\$ 1,017,146</u> |

| | September 30, 2018 | | | | |
|--------------------------------------|-----------------------|--------------------|------------------|-------------|-------------------|
| | Pass | Special Mention | Substandard | Doubtful | Total |
| | <i>(In thousands)</i> | | | | |
| Residential mortgage | \$ 193,584 | \$ — | \$ 3,635 | \$ — | \$ 197,219 |
| Construction and Development: | | | | | |
| Residential and commercial | 37,433 | — | — | — | 37,433 |
| Land | 9,146 | — | 75 | — | 9,221 |
| Commercial: | | | | | |
| Commercial real estate | 474,232 | 949 | 18,748 | — | 493,929 |
| Farmland | 12,066 | — | — | — | 12,066 |
| Multi-family | 45,102 | — | — | — | 45,102 |
| Commercial and industrial | 73,738 | — | 157 | — | 73,895 |
| Other | 6,164 | — | — | — | 6,164 |
| Consumer: | | | | | |
| Home equity lines of credit | 14,707 | — | 177 | — | 14,884 |
| Second mortgages | 17,402 | 103 | 858 | — | 18,363 |
| Other | 2,289 | — | 26 | — | 2,315 |
| Total | <u>\$ 885,863</u> | <u>\$ 1,052</u> | <u>\$ 23,676</u> | <u>\$ —</u> | <u>\$ 910,591</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Loans Receivable and Related Allowance for Loan Losses (Continued)

The following table presents loans on which we are no longer accruing interest by portfolio class at the dates indicated.

| | September 30, | |
|--------------------------------|-----------------------|-----------------|
| | 2019 | 2018 |
| | <i>(In thousands)</i> | |
| Residential mortgage | \$ 1,532 | \$ 1,817 |
| Commercial: | | |
| Commercial real estate | — | 520 |
| Consumer: | | |
| Home equity lines of credit | — | 34 |
| Second mortgages | 259 | 290 |
| Other | 30 | 26 |
| Total non-accrual loans | <u>\$ 1,821</u> | <u>\$ 2,687</u> |

Under the Bank's loan policy, once a loan has been placed on non-accrual status, we do not resume interest accruals until the loan has been brought current and has maintained a current payment status for not less than six consecutive months. The decrease in non-accrual loans was primarily due to the sale of one commercial real estate with an aggregate balance of approximately \$367,000 during the fourth fiscal quarter of 2019. In addition, four residential loans and one consumer loan with aggregate balances of approximately \$420,000 and \$44,000, respectively, returned to accrual status during the fourth fiscal quarter of 2019. Interest income that would have been recognized on nonaccrual loans had they been current in accordance with their original terms was approximately \$39,000 and \$28,000 for fiscal 2019 and 2018, respectively. At September 30, 2019 and 2018 there were approximately \$502,000 and \$374,000, respectively, loans past due 90 days or more and still accruing interest.

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by whether a loan payment is "current," that is, it is received from a borrower by the scheduled due date, or the length of time a scheduled payment is past due. The following table presents the classes of the loan portfolio summarized by the aging categories as of September 30, 2019 and 2018.

| | Current | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Total Loans Receivable | Accruing 90 Days or More Past Due |
|--------------------------------------|-----------------------|---------------------------|---------------------------|-----------------------------------|-----------------|---------------------------|--|
| | <i>(In thousands)</i> | | | | | | |
| September 30, 2019: | | | | | | | |
| Residential mortgage | \$ 219,062 | \$ 62 | \$ 381 | \$ 506 | \$ 949 | \$ 220,011 | \$ 207 |
| Construction and Development: | | | | | | | |
| Residential and commercial | 40,346 | — | — | — | — | 40,346 | — |
| Land | 3,420 | — | — | — | — | 3,420 | — |
| Commercial: | | | | | | | |
| Commercial real estate | 543,157 | — | — | 295 | 295 | 543,452 | 295 |
| Farmland | 7,563 | — | — | — | — | 7,563 | — |
| Multi-family | 62,884 | — | — | — | — | 62,884 | — |
| Commercial and industrial | 99,247 | 500 | — | — | 500 | 99,747 | — |
| Other | 4,450 | — | — | — | — | 4,450 | — |
| Consumer: | | | | | | | |
| Home equity lines of credit | 19,506 | — | — | — | — | 19,506 | — |
| Second mortgages | 13,102 | 379 | 112 | 144 | 635 | 13,737 | — |
| Other | 2,030 | — | — | — | — | 2,030 | — |
| Total | <u>\$ 1,014,767</u> | <u>\$ 941</u> | <u>\$ 493</u> | <u>\$ 945</u> | <u>\$ 2,379</u> | <u>\$ 1,017,146</u> | <u>\$ 502</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Loans Receivable and Related Allowance for Loan Losses (Continued)

| | <u>Current</u> | <u>30-59 Days Past Due</u> | <u>60-89 Days Past Due</u> | <u>90 Days or More Past Due</u> | <u>Total Past Due</u> | <u>Total Loans Receivable</u> | <u>Accruing 90 Days or More Past Due</u> |
|--------------------------------------|-------------------|------------------------------------|------------------------------------|---|-----------------------|-----------------------------------|--|
| <i>(In thousands)</i> | | | | | | | |
| September 30, 2018: | | | | | | | |
| Residential mortgage | \$ 193,727 | \$ 450 | \$ 1,016 | \$ 2,026 | \$ 3,492 | \$ 197,219 | \$ 339 |
| Construction and Development: | | | | | | | |
| Residential and commercial | 37,433 | — | — | — | — | 37,433 | — |
| Land | 9,221 | — | — | — | — | 9,221 | — |
| Commercial: | | | | | | | |
| Commercial real estate | 485,886 | 449 | 7,019 | 575 | 8,043 | 493,929 | — |
| Farmland | 12,066 | — | — | — | — | 12,066 | — |
| Multi-family | 45,102 | — | — | — | — | 45,102 | — |
| Commercial and industrial | 73,895 | — | — | — | — | 73,895 | — |
| Other | 6,164 | — | — | — | — | 6,164 | — |
| Consumer: | | | | | | | |
| Home equity lines of credit | 14,815 | — | — | 69 | 69 | 14,884 | 35 |
| Second mortgages | 17,928 | 121 | 103 | 211 | 435 | 18,363 | — |
| Other | 2,282 | 7 | 1 | 25 | 33 | 2,315 | — |
| Total | <u>\$ 898,519</u> | <u>\$ 1,027</u> | <u>\$ 8,139</u> | <u>\$ 2,906</u> | <u>\$ 12,072</u> | <u>\$ 910,591</u> | <u>\$ 374</u> |

Restructured loans deemed to be trouble debt restructures (“TDRs”) are typically the result of extension of the loan maturity date or a reduction of the interest rate of the loan to a rate that is below market, a combination of rate and maturity extension, or by other means including covenant modifications, forbearance and other concessions. However, the Company generally only restructures loans by modifying the payment structure to require payments of interest only for a specified period or by reducing the actual interest rate. Once a loan becomes a TDR, it will continue to be reported as a TDR during the term of the restructure.

The Company had twenty-four and eighteen loans classified as TDRs with an aggregate outstanding balance of \$13.3 million and \$18.9 million at September 30, 2019 and 2018, respectively. At September 30, 2019, these loans were also classified as impaired. Twenty of the TDR loans continue to perform under the restructured terms through September 30, 2019 and we continued to accrue interest on such loan through such date.

The decrease in TDRs at September 30, 2019 compared to September 30, 2018 was primarily due to the transfer of one commercial real estate loan with an aggregate outstanding balance of approximately \$7.0 million to OREO in the first fiscal quarter of 2019 partially offset by seven residential loans and two consumer loans with an aggregate outstanding balance of approximately \$1.6 million and \$92,000, respectively, moving to TDR status during fiscal 2019.

Loans that have been classified as TDRs have modified payment terms and in some cases interest rate from the original agreements and allowed the borrowers, who were experiencing financial difficulty, including but not limited to making interest only payments for a period of time in order to relieve some of their overall cash flow burden. Some loan modifications classified as TDRs may not ultimately result in the full collection of principal and interest, as modified, and result in potential incremental losses. These potential incremental losses have been factored into our overall estimate of the allowance for loan losses. The level of any defaults will likely be affected by future economic conditions. A default on a troubled debt restructured loan for purposes of this disclosure occurs when the borrower is 90 days past due or a foreclosure or repossession of the applicable collateral has occurred.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Loans Receivable and Related Allowance for Loan Losses (Continued)

TDRs may arise in which, due to financial difficulties experienced by the borrower, the Company obtains through physical possession one or more collateral assets in satisfaction of all or part of an existing credit. Once possession is obtained, the Company reclassifies the appropriate portion of the remaining balance of the credit from loans to OREO, which is included within other assets in the Consolidated Statements of Financial Condition. For any residential real estate property collateralizing a consumer mortgage loan, the Company is considered to possess the related collateral only if legal title is obtained upon completion of foreclosure, or the borrower conveys all interest in the residential real estate property to the Company through completion of a deed in lieu of foreclosure or similar legal agreement. Excluding OREO, the Company had \$111,000 and \$1.4 million of residential real estate properties in the process of foreclosure at September 30, 2019 and 2018, respectively.

| | Total Troubled Debt Restructurings | | Troubled Debt Restructured Loans That Have Defaulted on Modified Terms Within The Past 12 Months | |
|--------------------------------------|---|----------------------------|---|----------------------------|
| | Number of Loans | Recorded Investment | Number of Loans | Recorded Investment |
| <i>(In thousands)</i> | | | | |
| At September 30, 2019: | | | | |
| Residential mortgage | 17 | \$ 3,372 | 4 | \$ 1,090 |
| Commercial: | | | | |
| Commercial real estate | 3 | 9,707 | — | — |
| Consumer | | | | |
| Second mortgages | 4 | 181 | — | — |
| Total | <u>24</u> | <u>\$ 13,260</u> | <u>4</u> | <u>\$ 1,090</u> |
| At September 30, 2018: | | | | |
| Residential mortgage | 10 | \$ 1,816 | 3 | \$ 289 |
| Construction and Development: | | | | |
| Land | 1 | 76 | — | — |
| Commercial: | | | | |
| Commercial real estate | 4 | 16,889 | — | — |
| Consumer | | | | |
| Second mortgages | 3 | 148 | — | — |
| Total | <u>18</u> | <u>\$ 18,929</u> | <u>3</u> | <u>\$ 289</u> |

The following table reports the performing status of all TDR loans. The performing status is determined by the loan's compliance with the modified terms.

| | September 30, | | | |
|--------------------------------------|----------------------|-----------------------|-------------------|-----------------------|
| | 2019 | | 2018 | |
| | Performing | Non-Performing | Performing | Non-Performing |
| <i>(In thousands)</i> | | | | |
| Residential mortgage | \$ 2,282 | \$ 1,090 | \$ 1,527 | \$ 289 |
| Construction and Development: | | | | |
| Land | — | — | 76 | — |
| Commercial: | | | | |
| Commercial real estate | 9,707 | — | 16,889 | — |
| Consumer | | | | |
| Second mortgages | 181 | — | 148 | — |
| Total | <u>\$ 12,170</u> | <u>\$ 1,090</u> | <u>\$ 18,640</u> | <u>\$ 289</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Loans Receivable and Related Allowance for Loan Losses (Continued)

The following table shows the new TDRs for the twelve months ended September 30, 2019 and 2018.

| | September 30, | | | | | |
|---|--------------------|--|---|--------------------|--|------------------|
| | 2019 | | | 2018 | | |
| | Number of Loans | Restructured During Period | | Number of Loans | Restructured During Period | |
| Pre- Modifications Outstanding Recorded Investments | | Post- Modifications Outstanding Recorded Investments | Pre- Modifications Outstanding Recorded Investments | | Post- Modifications Outstanding Recorded Investments | |
| <i>(In thousands)</i> | | | | | | |
| Troubled Debt Restructurings: | | | | | | |
| Residential mortgage | 7 | \$ 1,664 | \$ 1,586 | 4 | \$ 389 | \$ 386 |
| Commercial: | | | | | | |
| Commercial real estate | — | — | — | 2 | 16,417 | 16,343 |
| Consumer: | | | | | | |
| Second mortgages | 2 | 97 | 92 | — | — | — |
| Total | <u>9</u> | <u>\$ 1,761</u> | <u>\$ 1,678</u> | <u>6</u> | <u>\$ 16,806</u> | <u>\$ 16,729</u> |

The following table sets forth the aggregate dollar amount of loans to principal officers, directors and their affiliates in the normal course of business of the Company.

| | Year Ended September 30, | |
|------------------------------|--------------------------|-----------------|
| | 2019 | 2018 |
| <i>(In thousands)</i> | | |
| Balance at beginning of year | \$ 8,691 | \$ 12,335 |
| New loans | 10,191 | 9,018 |
| Repayments | (6,404) | (12,662) |
| Balance at end of year | <u>\$ 12,478</u> | <u>\$ 8,691</u> |

At September 30, 2019 and 2018, the Company was servicing loans for the benefit of others in the amounts of \$24.3 million and \$29.3 million, respectively. A summary of mortgage servicing rights included in other assets and the activity therein follows for the periods indicated:

| | September 30, | |
|------------------------------|---------------|---------------|
| | 2019 | 2018 |
| <i>(In thousands)</i> | | |
| Balance at beginning of year | \$ 223 | \$ 268 |
| Amortization | (45) | (45) |
| Balance at end of year | <u>\$ 178</u> | <u>\$ 223</u> |

For the fiscal year ended September 30, 2019 and 2018, the fair value of servicing rights was determined using a base discount rate between 11 percent and 12 percent. The fair market value is evaluated by a third-party vendor on a quarterly basis for impairment purposes only. For the fiscal year ended September 30, 2019, we sold \$2.9 million of long-term, fixed-rate residential mortgage loans with servicing released. This transaction resulted in a gain of \$37,000. For the year ended September 30, 2019, the Company only sold loans with servicing released. For the fiscal year ended September 30, 2018, we sold \$9.2 million of long-term, fixed-rate residential mortgage loans with servicing released. This transaction resulted in a gain of \$102,000. For the year ended September 30, 2018, the Company only sold loans with servicing released.

No valuation allowance on servicing rights has been recorded at September 30, 2019 or 2018.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8 - Property and Equipment

Property and equipment, net consisted of the following at September 30, 2019 and 2018:

| | <u>Estimated Useful Life (years)</u> | <u>September 30,</u> | |
|-----------------------------------|--|-----------------------|-----------------|
| | | <u>2019</u> | <u>2018</u> |
| | | <i>(In thousands)</i> | |
| Land | — | \$ 711 | \$ 711 |
| Building and improvements | 10-39 | 11,742 | 11,533 |
| Construction in process | — | 16 | 117 |
| Furniture, fixtures and equipment | 3-7 | 5,709 | 5,560 |
| | | <u>18,178</u> | <u>17,921</u> |
| Accumulated depreciation | | (11,500) | (10,740) |
| | | <u>\$ 6,678</u> | <u>\$ 7,181</u> |

Depreciation expense was approximately \$761,000 and \$758,000 for the years ended September 30, 2019 and 2018, respectively.

Note 9 - Deposits

Deposits classified by interest rates with percentages to total deposits at September 30, 2019 and 2018 consisted of the following:

| | <u>September 30,</u> | | | |
|-------------------------------|-----------------------|--|-------------------|--|
| | <u>2019</u> | | <u>2018</u> | |
| | <u>Amount</u> | <u>Percent of Total Deposits</u> | <u>Amount</u> | <u>Percent of Total Deposits</u> |
| | <i>(In thousands)</i> | | | |
| Balances by types of deposit: | | | | |
| Savings | \$ 41,875 | 4.39% | \$ 44,642 | 5.77% |
| Money market accounts | 276,644 | 29.00 | 270,834 | 34.98 |
| Interest bearing demand | 302,039 | 31.67 | 184,073 | 23.78 |
| Non-interest bearing demand | 55,684 | 5.84 | 41,677 | 5.38 |
| | <u>676,242</u> | <u>70.90</u> | <u>541,226</u> | <u>69.91</u> |
| Certificates of deposit | 277,569 | 29.10 | 232,937 | 30.09 |
| Total | <u>\$ 953,811</u> | <u>100.00%</u> | <u>\$ 774,163</u> | <u>100.00%</u> |

The total amount of certificates of deposit of \$250,000 and greater at September 30, 2019 and 2018 was \$63.5 million and \$37.7 million, respectively. We had brokered deposits totaling \$73.1 million and \$88.3 million at September 30, 2019 and 2018, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 9 - Deposits (Continued)

Interest expense on deposits consisted of the following for the years:

| | September 30, | |
|-------------------------|-----------------------|-----------------|
| | 2019 | 2018 |
| | <i>(In thousands)</i> | |
| Savings accounts | \$ 49 | \$ 36 |
| Money market accounts | 4,352 | 3,271 |
| Interest bearing demand | 4,221 | 1,742 |
| Certificates of deposit | 5,726 | 4,151 |
| Total deposits | \$ 14,348 | \$ 9,200 |

The following is a schedule of certificates of deposit maturities.

| | September 30, 2019 |
|---|-----------------------|
| | <i>(In thousands)</i> |
| <u>Maturing in the Fiscal Year Ending September 30,</u> | |
| 2020 | \$ 191,619 |
| 2021 | 54,875 |
| 2022 | 8,341 |
| 2023 | 5,713 |
| 2024 | 10,026 |
| Thereafter | 6,995 |
| | <u>\$ 277,569</u> |

Deposits from related parties held by the Company at September 30, 2019 and 2018 amounted to \$10.4 million and \$10.1 million, respectively.

Note 10 - Borrowings

Under terms of its collateral agreement with the FHLB, the Company maintains otherwise unencumbered qualifying assets in an amount at least equal to its borrowings.

Under an agreement with the FHLB, the Company has a line of credit available in the amount of \$150.0 million, of which none was outstanding at September 30, 2019 or 2018. The interest rate on the line of credit at September 30, 2019 and 2018 was 2.08 percent and 2.38 percent, respectively.

The summary of long-term borrowings as of September 30, 2019 and 2018 are as follows:

| | September 30, | | | |
|-----------------------------|-----------------------|-----------------------------|-------------------|-----------------------------|
| | 2019 | | 2018 | |
| | Amount | Weighted Average Rate | Amount | Weighted Average Rate |
| | <i>(In thousands)</i> | | | |
| <u>Due by September 30:</u> | | | | |
| 2019 | — | — | 90,000 | 1.41 |
| 2020 | 93,000 | 1.78 | 28,000 | 2.82 |
| 2021 | 20,000 | 1.79 | — | — |
| 2022 | 20,000 | 1.78 | — | — |
| Total FHLB Advances | \$ 133,000 | 1.14% | \$ 118,000 | 1.58% |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10 - Borrowings (Continued)

At September 30, 2019, the Company had \$133.0 million in outstanding long-term fixed rate FHLB advances and \$282.7 million in potential FHLB advances available to us, which is based on the amount of FHLB stock held or levels of other assets, including U.S. government securities, and certain mortgage loans which are available for collateral.

During fiscal 2019, the Company did not purchase any securities sold under agreements to repurchase as a short-term funding source. During fiscal 2018, the Company had purchased securities sold under agreements to repurchase as a short-term funding source. At September 30, 2018, the Company had \$2.5 million in securities sold under agreements to repurchase at a rate of 2.5 percent.

Note 11 - Derivatives

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. Specifically, 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's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income (loss) and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. At September 30, 2019, such derivatives were used to hedge the variable cash flows associated with FHLB advances.

Amounts reported in accumulated other comprehensive (loss) income related to derivatives will be reclassified to interest expense as interest payments are made on the Company's variable-rate debt. During the next twelve months, the Company estimates approximately \$187,000 to be reclassified to earnings in interest expense. The Company is hedging its exposure to the variability in future cash flows for forecasted transactions over a maximum period of twenty months (excluding forecasted transactions related to the payment of variable interest on existing financial instruments).

The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions. These derivatives are not designated as hedges and are not speculative. Rather, these derivatives result from a service the Company provides to certain customers, which the Company implemented during the first quarter of fiscal 2019. As the interest rate swaps associated with this program do not meet the hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Derivatives (Continued)

The tables below present the fair value of the Company's derivative financial instruments as well as their classification on the Consolidated Statements of Financial Condition as of September 30, 2019 and 2018:

| | September 30, 2019 | | | | | |
|---|-----------------------|---------------|--|-----------------------|---------------|--|
| | Asset derivatives | | | Liability derivatives | | |
| | Notional Amount | Fair Value | Statement of Financial Condition Location | Notional Amount | Fair Value | Statement of Financial Condition Location |
| | <i>(In thousands)</i> | | | | | |
| Derivatives designated as a hedging instrument: | | | | | | |
| Interest rate swap agreement | \$ 35,000 | \$ 126 | Other assets | \$ 30,000 | \$ 736 | Other liabilities |
| Derivatives not designated as a hedging instrument: | | | | | | |
| Interest rate swap agreement | \$ 29,916 | \$ 5,019 | Other assets | \$ 29,916 | \$ 5,018 | Other liabilities |

| | September 30, 2018 | | | | | |
|---|-----------------------|---------------|--|-----------------------|---------------|--|
| | Asset derivatives | | | Liability derivatives | | |
| | Notional Amount | Fair Value | Statement of Financial Condition Location | Notional Amount | Fair Value | Statement of Financial Condition Location |
| | <i>(In thousands)</i> | | | | | |
| Derivatives designated as a hedging instrument: | | | | | | |
| Interest rate swap agreement | \$ 65,000 | \$ 1,245 | Other assets | \$ — | \$ — | |

Offsetting of Derivative Assets as of September 30, 2019

| | <i>(In thousands)</i> | | | | | |
|-------------|---|--|--|--------------------------|--------------------------------|---------------|
| | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Statement of Financial Condition | Net Amounts of Assets presented in the Statement of Financial Condition | Financial Instruments | Cash Collateral Received | Net Amount |
| Derivatives | \$ 5,145 | \$ — | \$ 5,145 | \$ 173 | \$ — | \$ 4,972 |

Offsetting of Derivative Liabilities as of September 30, 2019

| | <i>(In thousands)</i> | | | | | |
|-------------|--|--|---|--------------------------|------------------------------|---------------|
| | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Statement of Financial Condition | Net Amounts of Liabilities presented in the Statement of Financial Condition | Financial Instruments | Cash Collateral Posted | Net Amount |
| Derivatives | \$ 5,754 | \$ — | \$ 5,754 | \$ 767 | \$ 2,754 | \$ 2,233 |

Offsetting of Derivative Assets as of September 30, 2018

| | <i>(In thousands)</i> | | | | | |
|-------------|---|--|--|--------------------------|--------------------------------|---------------|
| | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Statement of Financial Condition | Net Amounts of Assets presented in the Statement of Financial Condition | Financial Instruments | Cash Collateral Received | Net Amount |
| Derivatives | \$ 1,245 | \$ — | \$ 1,245 | \$ 1,245 | \$ — | \$ — |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Derivatives (Continued)

Offsetting of Derivative Liabilities as of September 30, 2018

(In thousands)

| | <u>Gross Amounts of Recognized Liabilities</u> | <u>Gross Amounts Offset in the Statement of Financial Condition</u> | <u>Net Amounts of Liabilities presented in the Statement of Financial Condition</u> | <u>Gross Amounts Not Offset in the Statements of Financial Condition</u> | | |
|-------------|--|---|---|--|---------------------------------------|-----------------------|
| | | | | <u>Financial Instruments</u> | <u>Cash Collateral Posted</u> | <u>Net Amount</u> |
| Derivatives | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — |

The tables below present the net gains (losses) recorded in accumulated other comprehensive (loss) income and the Consolidated Statements of Operations relating to the cash flow derivative instruments for the years ended September 30, 2019 and 2018.

| | <u>For the Year Ended September 30, 2019</u> | |
|-------------------------------|---|---|
| | <u>Amount of Loss Recognized in OCI on Derivative</u> | <u>Amount of Gain Reclassified from OCI to Interest Expense</u> |
| | <i>(In thousands)</i> | |
| Interest rate swap agreements | \$ (1,557) | \$ 298 |
| Total derivatives | <u>\$ (1,557)</u> | <u>\$ 298</u> |

| | <u>For the Year Ended September 30, 2018</u> | |
|-------------------------------|---|---|
| | <u>Amount of Gain Recognized in OCI on Derivative</u> | <u>Amount of Gain Reclassified from OCI to Interest Expense</u> |
| | <i>(In thousands)</i> | |
| Interest rate swap agreements | \$ 1,003 | \$ 134 |
| Total derivatives | <u>\$ 1,003</u> | <u>\$ 134</u> |

The tables below present the effect of the Company's derivative financial instruments on the Consolidated Statements of Operations for the years ended September 30, 2019 and 2018.

| | <u>For the Year Ended September 30, 2019</u> | |
|---|--|---|
| | <u>Consolidated Statements of Operations</u> | <u>Amount of Gain Recognized in Income on derivatives</u> |
| | <i>(In thousands)</i> | |
| Derivatives not designated as a hedging instrument: | | |
| Interest rate swap agreement | Other income | \$ 1 |
| Total | | <u>\$ 1</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Derivatives (Continued)

| | <u>For the Year Ended September 30, 2018</u> | |
|---|--|--|
| | <u>Consolidated Statements of Operations</u> | <u>Amount of Gain (Loss) Recognized in Income on derivatives</u> |
| | <i>(In thousands)</i> | |
| Derivatives not designated as a hedging instrument: | | |
| Interest rate swap agreement | | \$ — |
| Total | | \$ — |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Derivatives (Continued)

The Company has agreements with each of its derivative counterparties that contain a provision where if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations.

At September 30, 2019 and September 30, 2018, the fair value of derivatives was in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements. There were no adjustments for nonperformance risk at September 30, 2019 and September 30, 2018. At September 30, 2019 and September 30, 2018, the Company has minimum collateral posting thresholds with certain of its derivative counterparties and has posted collateral of \$6.4 million and zero, respectively, against its obligations under these agreements. If the Company had breached any of these provisions at September 30, 2019, it could have been required to settle its obligations under the agreements at the termination value and would have been required to pay any additional amounts due in excess of amounts previously posted as collateral with the respective counterparty.

Note 12 - Fair Value Measurements

The Company follows FASB ASC Topic 820 “Fair Value Measurement,” to record fair value adjustments to certain assets and to determine fair value disclosures for the Company’s financial instruments. 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.

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.

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.

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 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, could significantly affect the results of current or future valuations.

The Company monitors and evaluates available data to perform fair value measurements on an ongoing basis and recognizes transfers among the levels of the fair value hierarchy as of the date event or a change in circumstances that affects the valuation method chosen. There were no changes in valuation technique or transfers between levels as of and for the years ended September 30, 2019 and 2018.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Fair Value Measurements (Continued)

The tables below present the balances of assets measured at fair value on a recurring basis at September 30, 2019 and 2018:

| | September 30, 2019 | | | |
|---|--------------------|-------------|------------------|---------------|
| | Total | Level 1 | Level 2 | Level 3 |
| <i>(In thousands)</i> | | | | |
| Assets: | | | | |
| Investment securities available-for-sale: | | | | |
| Debt securities: | | | | |
| U.S. government agencies | \$ 3,000 | \$ — | \$ 3,000 | \$ — |
| State and municipal obligations | 4,732 | — | 4,732 | — |
| Single issuer trust preferred security | 923 | — | 923 | — |
| Corporate debt securities | 9,506 | — | 9,506 | — |
| Mutual funds | 250 | — | — | 250 |
| Total investment securities available-for-sale | \$ 18,411 | \$ — | \$ 18,161 | \$ 250 |
| Derivative instruments | \$ 5,145 | \$ — | \$ 5,145 | \$ — |
| Liabilities: | | | | |
| Derivative instruments | \$ 5,754 | \$ — | \$ 5,754 | \$ — |

| | September 30, 2018 | | | |
|---|--------------------|-----------------|------------------|---------------|
| | Total | Level 1 | Level 2 | Level 3 |
| <i>(In thousands)</i> | | | | |
| Assets: | | | | |
| Investment securities available-for-sale: | | | | |
| Debt securities: | | | | |
| U.S. treasury notes | \$ 9,986 | \$ 9,986 | \$ — | \$ — |
| State and municipal obligations | 6,887 | — | 6,887 | — |
| Single issuer trust preferred security | 921 | — | 921 | — |
| Corporate debt securities | 6,254 | — | 6,254 | — |
| Mutual funds | 250 | — | — | 250 |
| Total investment securities available-for-sale | \$ 24,298 | \$ 9,986 | \$ 14,062 | \$ 250 |
| Derivative instruments | \$ 1,245 | \$ — | \$ 1,245 | \$ — |

For assets measured at fair value on a nonrecurring basis in fiscal 2019 and fiscal 2018 that were still held at the end of the period, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related individual assets or portfolios at September 30, 2019 and 2018:

| | September 30, 2019 | | | |
|-------------------------------|--------------------|-------------|-------------|------------------|
| | Total | Level 1 | Level 2 | Level 3 |
| <i>(In thousands)</i> | | | | |
| Other real estate owned | \$ 5,796 | \$ — | \$ — | \$ 5,796 |
| Impaired loans ⁽¹⁾ | 9,142 | — | — | 9,142 |
| Total | \$ 14,938 | \$ — | \$ — | \$ 14,938 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Fair Value Measurements (Continued)

| September 30, 2019 | | | | |
|-------------------------|-------------------------------------|-------------------------------|---------------------------|-----------------------------|
| | Fair Value at September 30, 2019 | Valuation Technique | Unobservable Input | Range/(Weighted Average) |
| <i>(In thousands)</i> | | | | |
| Other real estate owned | \$ 5,796 | Appraisal of Collateral(2) | Collateral discount(3) | 0%/(0%) |
| Impaired loans(1) | 9,142 | Appraisal of Collateral(2) | Collateral discount(3) | 12%/(12%) |
| Total | \$ 14,938 | | | |

- (1) Consisted of four loans with an aggregate balance of \$9.3 million and with \$157,000 in specific loan loss allowance.
(2) Fair value is generally determined through independent appraisals of the underlying collateral primarily using comparable sales.
(3) Appraisals may be adjusted by management for qualitative factors such as time, changes in economic conditions and estimated liquidation expense.

| September 30, 2018 | | | | |
|-----------------------|-----------|---------|---------|-----------|
| | Total | Level 1 | Level 2 | Level 3 |
| <i>(In thousands)</i> | | | | |
| Impaired loans(1) | \$ 15,611 | \$ — | \$ — | \$ 15,611 |
| Total | \$ 15,611 | \$ — | \$ — | \$ 15,611 |

| September 30, 2018 | | | | |
|-----------------------|-------------------------------------|-------------------------------|----------------------------|-----------------------------|
| | Fair Value at September 30, 2018 | Valuation Technique | Unobservable Input | Range/(Weighted Average) |
| <i>(In thousands)</i> | | | | |
| Impaired loans(1) | \$ 15,611 | Appraisal of collateral(2) | Collateral discounts(3) | 8%-12%/(7.9%) |
| Total | \$ 15,611 | | | |

- (1) At September 30, 2018, consisted of eight loans with an aggregate balance of \$16.5 million and with \$1.6 million in specific loan loss allowance.
(2) Fair value is generally determined through independent appraisals of the underlying collateral primarily using comparable sales.
(3) Appraisals may be adjusted by management for qualitative factors such as time, changes in economic conditions and estimated liquidation expense

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of FASB ASC 825. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methods. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company would realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. FASB ASC 825 excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The fair value estimates presented herein are based on pertinent information available to management as of September 30, 2019 and 2018. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since September 30, 2019 and 2018 and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

The following assumptions were used to estimate the fair value of the Company's financial instruments:

Cash and Cash Equivalents—These assets are carried at historical cost. The carrying amount is a reasonable estimate of fair value because of the relatively short time between the origination of the instrument and its expected realization.

Investment Securities—Investment and mortgage-backed securities available for sale (carried at fair value) are measured at fair value on a recurring basis. Fair value measurements for these securities are typically obtained from independent pricing services that we have engaged for this purpose. When available, we, or our independent pricing

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Fair Value Measurements (Continued)

service, use quoted market prices to measure fair value. If market prices are not available, fair value measurement is based upon models that incorporate available trade, bid and other market information and for structured securities, cash flow and, when available, loan performance data. Because many fixed income securities do not trade on a daily basis, our independent pricing service's applications apply available information through processes such as benchmark curves, benchmarking of like securities, sector groupings and matrix pricing to prepare evaluations. For each asset class, pricing applications and models are based on information from market sources and integrate relevant credit information. All of our securities available for sale are valued using either of the foregoing methodologies to determine fair value adjustments recorded to our financial statements.

Loans Receivable—We do not record loans at fair value on a recurring basis. As such, valuation techniques discussed herein for loans are primarily for estimating fair value for FASB ASC 825 disclosure purposes. However, from time to time, we record nonrecurring fair value adjustments to loans to reflect partial write-downs for impairment or the full charge-off of the loan carrying value. The valuation of impaired loans is discussed below. The fair value estimate for FASB ASC 825 purposes differentiates loans based on their financial characteristics, such as product classification, loan category, pricing features and remaining maturity. Prepayment and credit loss estimates are evaluated by loan type and rate. The fair value of loans is estimated by discounting contractual cash flows using discount rates based on current industry pricing, adjusted for prepayment and credit loss estimates.

Impaired Loans—Impaired loans are valued utilizing independent appraisals that rely upon quoted market prices for similar assets in active markets. These appraisals include adjustments to comparable assets based on the appraisers' market knowledge and experience. The appraisals are adjusted downward by management, as necessary, for changes in relevant valuation factors subsequent to the appraisal date and are considered level 3 inputs.

Accrued Interest Receivable—This asset is carried at historical cost. The carrying amount is a reasonable estimate of fair value because of the relatively short time between the origination of the instrument and its expected realization.

Restricted Stock—Although restricted stock is an equity interest in the Federal Reserve Bank, FHLB and ACBB, it is carried at cost because it does not have a readily determinable fair value as its ownership is restricted and it lacks a market. The estimated fair value approximates the carrying amount.

Other Real Estate Owned—Assets acquired through foreclosure or deed in lieu of foreclosure are recorded at estimated fair value less estimated selling costs when acquired, thus establishing a new cost basis. Fair value is generally based on independent appraisals. These appraisals include adjustments to comparable assets based on the appraisers' market knowledge and experience, and are considered level 3 inputs. When an asset is acquired, the excess of the loan balance over fair value, less estimated selling costs, is charged to the allowance for loan losses. If the estimated fair value of the asset declines, a write-down is recorded through expense. The valuation of foreclosed assets is subjective in nature and may be adjusted in the future because of, among other factors, changes in the economic conditions.

Deposits—Deposit liabilities are carried at cost. As such, valuation techniques discussed herein for deposits are primarily for estimating fair value for FASB ASC 825 disclosure purposes. The fair value of deposits is discounted based on rates available for time deposits of similar maturities. Fair value approximates book value for Savings accounts, Checking and NOW accounts, and Money Market accounts.

Borrowings—Advances from the FHLB are carried at amortized cost. However, we are required to estimate the fair value of long-term debt under FASB ASC 825. The fair value is based on the contractual cash flows discounted using rates currently offered for new notes with similar remaining maturities.

Subordinated Debt—The calculation of fair value in level 2 is based on observable market values where available.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Fair Value Measurements (Continued)

Derivatives—The fair value of derivatives are based on valuation models using observable market data as of the measurement date (level 2). Our derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, but could include interest rates, prices and indices to generate continuous yield or pricing curves, prepayment rate, and volatility factors to value the position. The majority of market inputs is actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services.

Accrued Interest Payable—This liability is carried at historical cost. The carrying amount is a reasonable estimate of fair value because of the relatively short time between the origination of the instrument and its expected realization.

Commitments to Extend Credit and Letters of Credit—The majority of the Company's commitments to extend credit and letters of credit carry current market interest rates if converted to loans and are not included in the table below. Because commitments to extend credit and letters of credit are generally unassignable by either the Bank or the borrower, they only have value to the Company and the borrower. The estimated fair value approximates the recorded deferred fee amounts, which are not significant.

Mortgage Servicing Rights—The fair value of mortgage servicing rights is based on observable market prices when available or the present value of expected future cash flows when not available. Assumptions, such as loan default rates, costs to service, and prepayment speeds significantly affect the estimate of future cash flows.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Fair Value Measurements (Continued)

The carrying amount and estimated fair value of the Company's financial instruments as of September 30, 2019 and 2018 were as follows:

| | <u>Carrying Amount</u> | <u>Fair Value</u> | <u>Level 1</u> <i>(In thousands)</i> | <u>Level 2</u> | <u>Level 3</u> |
|--|----------------------------|-------------------|---|----------------|----------------|
| September 30, 2019: | | | | | |
| Financial assets: | | | | | |
| Cash and cash equivalents | \$ 153,543 | \$ 153,543 | \$ 153,543 | \$ — | \$ — |
| Investment securities available-for-sale | 18,411 | 18,411 | — | 18,161 | 250 |
| Investment securities held-to-maturity | 22,485 | 22,609 | — | 22,609 | — |
| Loans receivable, net (including impaired loans) | 1,007,714 | 1,010,442 | — | — | 1,010,442 |
| Accrued interest receivable | 4,253 | 4,253 | — | 4,253 | — |
| Restricted stock | 11,129 | 11,129 | — | 11,129 | — |
| Mortgage servicing rights (included in Other Assets) | 178 | 178 | — | 178 | — |
| Derivatives (included in Other Assets) | 5,145 | 5,145 | — | 5,145 | — |
| Financial liabilities: | | | | | |
| Savings accounts | 41,875 | 41,875 | — | 41,875 | — |
| Checking and NOW accounts | 357,723 | 357,723 | — | 357,723 | — |
| Money market accounts | 276,644 | 276,644 | — | 276,644 | — |
| Certificates of deposit | 277,569 | 280,024 | — | 280,024 | — |
| Borrowings (excluding sub debt) | 133,000 | 133,545 | — | 133,545 | — |
| Subordinated debt | 24,619 | 24,471 | — | 24,471 | — |
| Derivatives (included in Other Liabilities) | 5,754 | 5,754 | — | 5,754 | — |
| Accrued interest payable | 978 | 978 | — | 978 | — |
| September 30, 2018: | | | | | |
| Financial assets: | | | | | |
| Cash and cash equivalents | \$ 30,834 | \$ 30,834 | \$ 30,834 | \$ — | \$ — |
| Investment securities available-for-sale | 24,298 | 24,298 | 9,986 | 14,062 | 250 |
| Investment securities held-to-maturity | 30,092 | 28,968 | — | 28,968 | — |
| Loans receivable, net (including impaired loans) | 902,136 | 893,520 | — | — | 893,520 |
| Accrued interest receivable | 3,800 | 3,800 | — | 3,800 | — |
| Restricted stock | 8,537 | 8,537 | — | 8,537 | — |
| Mortgage servicing rights (included in Other Assets) | 223 | 268 | — | 268 | — |
| Derivatives (included in Other Assets) | 1,245 | 1,245 | — | 1,245 | — |
| Financial liabilities: | | | | | |
| Savings accounts | 44,642 | 44,642 | — | 44,642 | — |
| Checking and NOW accounts | 225,750 | 225,750 | — | 225,750 | — |
| Money market accounts | 270,834 | 270,834 | — | 270,834 | — |
| Certificates of deposit | 232,937 | 234,398 | — | 234,398 | — |
| Borrowings (excluding sub debt) | 120,500 | 120,420 | — | 120,420 | — |
| Subordinated debt | 24,461 | 24,461 | — | 24,461 | — |
| Accrued interest payable | 784 | 784 | — | 784 | — |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 - Income Taxes

In accordance with ASC Topic 740, the Company evaluates on a quarterly basis, all evidence, both positive and negative, to determine whether, based on the weight of that evidence, a valuation allowance for DTAs is needed. In conducting this evaluation, management explores all possible sources of taxable income available under existing tax laws to realize the net deferred tax asset beginning with the most objectively verifiable evidence first, including available carry back claims and viable tax planning strategies. If needed, management will look to future taxable income as a potential source. Management reviews the Company's current financial position and its results of operations for the current and preceding years. That historical information is supplemented by all currently available information about future years. The Company understands that projections about future performance are subjective.

Deferred income taxes at September 30, 2019 and 2018 were as follows:

| | September 30, | |
|---|-----------------------|-----------------|
| | 2019 | 2018 |
| | <i>(In thousands)</i> | |
| Deferred Tax Assets: | | |
| Allowance for loan losses | \$ 2,431 | \$ 3,089 |
| Non-accrual interest | 84 | 39 |
| Supplement Employer Retirement Plan | 216 | 228 |
| Federal and State net operating loss | 56 | 141 |
| Unrealized loss on investments available-for-sale | 158 | 106 |
| Other | 45 | 77 |
| Total Deferred Tax Assets | 2,990 | 3,680 |
| Valuation allowance for DTA | — | — |
| Total Deferred Tax Assets, Net of Valuation Allowance | \$ 2,990 | \$ 3,680 |
| Deferred Tax Liabilities: | | |
| Unrealized gain on derivatives | — | (261) |
| Mortgage servicing rights | (46) | (52) |
| Depreciation | (87) | (86) |
| Other | (17) | (86) |
| Total Deferred Tax Liabilities | (150) | (485) |
| Deferred Tax Assets, Net | \$ 2,840 | \$ 3,195 |

Of these DTAs, the carryforward periods for certain tax attributes are as follows:

- The Company has recorded state net operating loss carryforwards of approximately \$3.0 million and \$7.0 million as of September 30, 2019 and 2018, respectively. These net operating losses will begin to expire in 2033.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 – Income Taxes (Continued)

Income tax expense for the years ended September 30, 2019 and 2018 was comprised of the following:

| | September 30, | |
|--|-----------------|-----------------|
| | 2019 | 2018 |
| <i>(In thousands)</i> | | |
| Federal: | | |
| Current | \$ 1,579 | \$ 1,039 |
| Deferred (\$2.0 million impact of change in tax law in 2018) | 570 | 3,765 |
| | <u>2,149</u> | <u>4,804</u> |
| State: | | |
| Current | 228 | (116) |
| Deferred | 92 | (412) |
| | <u>320</u> | <u>(528)</u> |
| Total income tax expense | <u>\$ 2,469</u> | <u>\$ 4,276</u> |

A reconciliation from the expected federal income tax expense computed at the statutory federal income tax rate to the actual income tax expense included in the consolidated statements of income for the years ended September 30, 2019 and 2018:

| | September 30, | | | |
|---------------------------------------|-----------------|--------------|-----------------|--------------|
| | 2019 | 2018 | | |
| <i>(In thousands)</i> | | | | |
| Tax at statutory rate | \$ 2,478 | 21.0% | \$ 2,809 | 24.3% |
| Adjustments resulting from: | | | | |
| State tax, net of federal benefit | 252 | 2.1 | (574) | (5.0) |
| Tax-exempt interest | (53) | (0.4) | (147) | (1.3) |
| Earnings on bank-owned life insurance | (103) | (0.9) | (116) | (1.0) |
| Other | (105) | (0.9) | 274 | 2.4 |
| Subtotal | <u>2,469</u> | <u>20.9%</u> | <u>2,246</u> | <u>19.4%</u> |
| Impact of change in tax law | — | — | 2,030 | 17.5 |
| Total | <u>\$ 2,469</u> | <u>20.9%</u> | <u>\$ 4,276</u> | <u>36.9%</u> |

It is the Company's policy to provide for uncertain tax positions and the related interest and penalties based upon management's assessment of whether a tax benefit is more likely than not to be sustained upon examination by tax authorities. As of September 30, 2019 and 2018, there were no material uncertain tax positions related to federal and state income tax matters. The Company is currently open to audit under the statute of limitation by the Internal Revenue Service and state taxing authorities for the years ended September 30, 2016 to September 30, 2019.

The Small Business Job Protection Act of 1996 provides for the repeal of the tax bad debt deduction computed under the percentage-of-taxable-income method. Upon repeal, the Company was required to recapture into income, over a six-year period, the portion of its tax bad debt reserves that exceeds its base year reserves (i.e., tax reserves for tax years beginning before 1988). The base year tax reserves, which may be subject to recapture if the Company ceases to qualify as a bank for federal income tax purposes, are restricted with respect to certain distributions and have been treated as a permanent tax difference.

The U.S. Tax Cuts and Jobs Act ("Tax Act") was enacted on December 22, 2017 and introduces significant changes to U.S. income tax law. The Company substantially completed its provisional analysis of the income tax effects of The Act and recorded an estimate of such effects on its Financial Statements for the period ended on September 30, 2018. The Company has updated any of its provisional amounts related to the Tax Act and accounting for this is now final.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 14 – Leases

Pursuant to the terms of non-cancelable operating lease agreements, pertaining to Company property, future minimum rent commitments are (In thousands):

| Years ending September 30: | |
|-----------------------------------|-----------------|
| 2020 | \$ 582 |
| 2021 | 504 |
| 2022 | 480 |
| 2023 | 471 |
| 2024 | 474 |
| Thereafter | 746 |
| | <u>\$ 3,257</u> |

The Company receives rents from the lease of office and residential space owned by the Company. Rental income is included in Other Income. Future minimum rental commitments under these leases are (In thousands):

| Years ending September 30: | |
|-----------------------------------|---------------|
| 2020 | \$ 125 |
| 2021 | 108 |
| 2022 | 76 |
| 2023 | — |
| 2024 | — |
| | <u>\$ 309</u> |

Note 15 - Commitments and Contingencies

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, unused lines of credit and standby letters of credit. Such commitments involve, to varying degrees, elements of credit, and interest rate risk in excess of the amount recognized in the statements of financial condition.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Letters of credit are conditional commitments issued by the Company guaranteeing payments of drafts in accordance with the terms of the letter of credit agreements. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Collateral may be required to support letters of credit based upon management's evaluation of the creditworthiness of each customer. The credit risk involved in issuing letters of credit is substantially the same as that involved in extending loan facilities to customers. Most letters of credit expire within one year. At September 30, 2019 and 2018, the uncollateralized portion of the letters of credit extended by the Company was approximately \$11.6 million and \$7.1 million, respectively. The current amount of the liability for guarantees under letters of credit was not material as of September 30, 2019 or 2018.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 15 – Commitments and Contingencies (Continued)

At September 30, 2019 and 2018, the following financial instruments were outstanding whose contract amounts represent credit risk:

| | September 30, | |
|--|-----------------------|-------------------|
| | 2019 | 2018 |
| | <i>(In thousands)</i> | |
| Commitments to extend credit: | | |
| Future loan commitments | \$ 40,976 | \$ 52,390 |
| Undisbursed construction loans | 27,645 | 25,128 |
| Undisbursed home equity lines of credit | 21,447 | 26,498 |
| Undisbursed commercial lines of credit | 27,782 | 36,288 |
| Undisbursed commercial unsecured lines of credit | 60,382 | 35,103 |
| Overdraft protection lines | 1,363 | 1,312 |
| Standby letters of credit | 11,589 | 7,122 |
| Total Commitments | \$ 191,184 | \$ 183,841 |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation. Collateral held varies but generally includes personal or commercial real estate.

Unfunded commitments under commercial lines of credit are collateralized except for the overdraft protection lines of credit and commercial unsecured lines of credit. The amount of collateral obtained is based on management's credit evaluation, and generally includes personal or commercial real estate.

Various legal claims arise from time to time in the normal course of business which, in the opinion of management, will have no material effect on the Company's consolidated financial statements.

Note 16 - Regulatory Matters

Shareholders' Equity

On March 14, 2019, the Company's Board of Directors approved a stock repurchase plan, under which the Company is authorized to repurchase up to 194,516 shares, or approximately 2.5 percent of the Company's current outstanding common stock. This authority extends through March 31, 2020 and may be exercised from time to time and in such amounts as market conditions warrant. The repurchases may be made on the open market, in block trades or otherwise. The program may be suspended or discontinued at any time. During the fiscal year ended September 30, 2019, the Company purchased 16,863 shares of its common stock in the open market under the repurchase plan at an average cost of \$19.95 per share.

Regulatory Capital Requirements

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

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 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 –

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 16 - Regulatory Matters (Continued)

predominantly composed of retained earnings and common stock instruments. For community banks such as Malvern Bank, a common equity Tier 1 capital ratio of 4.5 percent became effective on January 1, 2015. The new capital rules also increased the minimum Tier 1 capital ratio from 4.0 percent to 6.0 percent beginning on January 1, 2015. The rules also establish a capital conservation buffer of 2.5 percent above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital and would result in the following minimum ratios: (1) a common equity Tier 1 capital ratio of 7.0 percent, (2) a Tier 1 capital ratio of 8.5 percent, and (3) a total capital ratio of 10.5 percent. The new capital conservation buffer requirement was phased in beginning in January 2016 at 0.625 percent of risk-weighted assets and will increase by that amount each year until fully implemented in January 2019. An institution is also subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of tangible and core capital (as defined in the regulations) to total adjusted tangible assets (as defined) and of risk-based capital (as defined) to risk-weighted assets (as defined).

As of September 30, 2019, the Company's and the Bank's current capital levels exceed the required capital amounts to be considered "well capitalized" and we believe they also meet the fully-phased in minimum capital requirements, including the related capital conservation buffers, as required by the Basel III capital rules.

The following table summarizes the Company's compliance with applicable regulatory capital requirements as of September 30, 2019 and 2018:

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|--|----------------|--------|-------------------------------|-------|--|--------|
| | Capital Amount | Ratio | Capital Amount | Ratio | Capital Amount | Ratio |
| <i>(In thousands)</i> | | | | | | |
| As of September 30, 2019: | | | | | | |
| Tier 1 Leverage (Core) Capital (to average assets) | \$ 142,508 | 11.38% | \$ 50,091 | 4.00% | \$ 62,614 | 5.00% |
| Common Equity Tier 1 Capital (to risk-weighted assets) | 142,508 | 14.30% | 44,838 | 4.50% | 64,766 | 6.50% |
| Tier 1 Capital (to risk-weighted assets) | 142,508 | 14.30% | 59,784 | 6.00% | 79,713 | 8.00% |
| Total Risk-Based Capital (to risk-weighted assets) | 177,293 | 17.79% | 79,713 | 8.00% | 99,641 | 10.00% |
| As of September 30, 2018: | | | | | | |
| Tier 1 Leverage (Core) Capital (to average assets) | \$ 110,239 | 10.63% | \$ 41,491 | 4.00% | \$ 51,864 | 5.00% |
| Common Equity Tier 1 Capital (to risk-weighted assets) | 110,239 | 12.62% | 39,322 | 4.50% | 56,799 | 6.50% |
| Tier 1 Capital (to risk-weighted assets) | 110,239 | 12.62% | 52,430 | 6.00% | 69,906 | 8.00% |
| Total Risk-Based Capital (to risk-weighted assets) | 143,787 | 16.45% | 69,906 | 8.00% | 87,383 | 10.00% |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 16 - Regulatory Matters (Continued)

The following table summarizes the Bank's compliance with applicable regulatory capital requirements as of September 30, 2019 and 2018:

| <i>(In thousands)</i> | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|--|----------------|--------|-------------------------------|-------|--|--------|
| | Capital Amount | Ratio | Capital Amount | Ratio | Capital Amount | Ratio |
| As of September 30, 2019: | | | | | | |
| Tier 1 Leverage (Core) Capital (to average assets) | \$ 153,086 | 12.23% | \$ 50,055 | 4.00% | \$ 62,569 | 5.00% |
| Common Equity Tier 1 Capital (to risk-weighted assets) | 153,086 | 15.38% | 44,788 | 4.50% | 64,694 | 6.50% |
| Tier 1 Capital (to risk-weighted assets) | 153,086 | 15.38% | 59,717 | 6.00% | 79,623 | 8.00% |
| Total Risk-Based Capital (to risk-weighted assets) | 163,253 | 16.40% | 79,623 | 8.00% | 99,529 | 10.00% |
| As of September 30, 2018: | | | | | | |
| Tier 1 Leverage (Core) Capital (to average assets) | \$ 131,746 | 12.71% | \$ 41,450 | 4.00% | \$ 51,812 | 5.00% |
| Common Equity Tier 1 Capital (to risk-weighted assets) | 131,746 | 15.09% | 39,293 | 4.50% | 56,756 | 6.50% |
| Tier 1 Capital (to risk-weighted assets) | 131,746 | 15.09% | 52,390 | 6.00% | 69,853 | 8.00% |
| Total Risk-Based Capital (to risk-weighted assets) | 140,833 | 16.13% | 69,853 | 8.00% | 87,317 | 10.00% |

The following table presents a reconciliation of the Bank's equity determined using accounting principles generally accepted in the United States of America ("US GAAP") and its regulatory capital amounts as of September 30, 2019 and 2018:

| | September 30, | |
|---|-----------------------|-------------------|
| | 2019 | 2018 |
| | <i>(In thousands)</i> | |
| Bank GAAP equity | \$ 152,517 | \$ 132,330 |
| Net unrealized loss on securities available for sale, net of income taxes | 87 | 400 |
| Net unrealized loss (gain) on derivatives, net of income taxes | 482 | (984) |
| Tangible Capital, Core Capital and Tier 1 Capital | 153,086 | 131,746 |
| Allowance for loan losses | 10,167 | 9,087 |
| Total Risk-Based Capital | \$ 163,253 | \$ 140,833 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 17 – Comprehensive Income

The components of accumulated other comprehensive (loss) income included in shareholders' equity are as follows:

| | September 30, | |
|--|-----------------------|---------------|
| | 2019 | 2018 |
| | <i>(In thousands)</i> | |
| Net unrealized holding losses on available-for-sale securities | \$ (111) | \$ (506) |
| Tax effect | 24 | 106 |
| Net of tax amount | (87) | (400) |
| Fair value adjustment on derivatives | (610) | 1,245 |
| Tax effect | 128 | (261) |
| Net of tax amount | (482) | 984 |
| Total accumulated other comprehensive (loss) income | \$ (569) | \$ 584 |

Other comprehensive (loss) income and related tax effects are presented in the following table:

| | Year Ended September 30, | |
|--|--------------------------|---------------|
| | 2019 | 2018 |
| | <i>(In thousands)</i> | |
| Net unrealized holding gains (losses) on available-for-sale securities | \$ 419 | \$ (229) |
| Net realized gain on securities available-for-sale | (28) | — |
| Amortization of unrealized holding losses on securities available-for-sale transferred to held-to-maturity | 4 | 6 |
| Fair value adjustment on derivatives | (1,855) | 868 |
| Other comprehensive (loss) income before taxes | (1,460) | 645 |
| Tax effect | 307 | (156) |
| Total other comprehensive (loss) income | \$ (1,153) | \$ 489 |

Note 18 – Equity Based Incentive Compensation Plan

The Company maintains the Malvern Bancorp, Inc. 2014 Long-Term Incentive Compensation Plan (the “2014 Plan”), which permits the grant of long-term incentive and other stock and cash awards. The purpose of the 2014 Plan is to promote the success of the Company and the Bank by providing incentives to officers, employees and directors of the Company and the Bank that will link their personal interests to the financial success of the Company and to growth in shareholder value. The maximum total number of shares of the Company's common stock available for grants under the 2014 Plan is 400,000. As of September 30, 2019, there were 347,862 remaining shares available for future grants.

Restricted stock and option awards granted during fiscal 2019 vest in 20 percent increments beginning on the one- year anniversary of the grant date, and accelerate upon a change in control of the Company. The options generally expire ten years from the date of grant. All issuances are subject to forfeiture if the recipient leaves or is terminated prior to the awards vesting. Shares of restricted stock have the same dividend and voting rights as common stock while options do not.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18 - Equity Based Incentive Compensation Plan (Continued)

All awards are issued at fair value of the underlying shares at the grant date. The Company expenses the cost of the awards, which is determined to be the fair market value of the awards at the date of grant.

During fiscal 2019 and 2018, stock options covering a total 7,000 and 6,996 shares of common stock, respectively, were granted. During fiscal 2019 and 2018, stock options covering a total of 4,166 and 2,000 shares of common stock, respectively, were forfeited. Total compensation expense related to options granted under the 2014 Plan was approximately \$35,000 for fiscal 2019 and \$19,000 for fiscal 2018.

During fiscal 2019, 12,674 shares of restricted stock were awarded and 1,772 of those shares were forfeited. During fiscal 2018, 6,400 shares of restricted stock were awarded and 700 of those shares were forfeited. The compensation expense related to restricted stock awards was approximately \$174,000 for fiscal 2019 and \$123,000 for fiscal 2018.

Stock-based compensation expense for the cost of the awards granted is based on the grant-date fair value. For stock option awards, the fair value is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options granted but are not considered by the model. Accordingly, while management believes that the Black-Scholes option-pricing model provides a reasonable estimate of fair value, the model does not necessarily provide the best single measure of fair value for the Company's employee stock options.

Stock Options

The assumptions used in determining the fair value of stock option grants for the year ended September 30, 2019 are as follows:

| | | |
|---------------------------------------|----|-----------|
| Weighted average fair value of awards | \$ | 5.72 |
| Risk-free rate | | 2.50% |
| Dividend yield | | —% |
| Volatility | | 20.39% |
| Expected life | | 6.5 years |

The assumptions used in determining the fair value of stock option grants for the year ended September 30, 2018 are as follows:

| | | |
|---------------------------------------|----|-----------|
| Weighted average fair value of awards | \$ | 7.86 |
| Risk-free rate | | 2.28% |
| Dividend yield | | —% |
| Volatility | | 24.10% |
| Expected life | | 6.5 years |

The following is a summary of currently outstanding options at September 30, 2019:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (In Years) | Aggregate Intrinsic Value |
|--------------------------------|---------|--|---|---------------------------------|
| Outstanding, beginning of year | 15,996 | \$ 22.34 | | \$ 41,490 |
| Granted | 7,000 | \$ 20.90 | | — |
| Exercised | — | — | | — |
| Forfeited/cancelled/expired | (4,166) | \$ 21.24 | | \$ 4,120 |
| Outstanding, end of year | 18,830 | \$ 22.05 | 8.231 | \$ 21,350 |
| Exercisable at end of year | 4,370 | \$ 21.02 | 7.421 | \$ 8,632 |
| Nonvested at end of year | 14,460 | \$ 22.36 | | |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18 - Equity Based Incentive Compensation Plan (Continued)

The following is a summary of currently outstanding options at September 30, 2018:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (In Years) | Aggregate Intrinsic Value |
|--------------------------------|---------|--|---|---------------------------------|
| Outstanding, beginning of year | 11,000 | \$ 19.19 | | \$ 83,170 |
| Granted | 6,996 | \$ 26.20 | | — |
| Exercised | — | — | | — |
| Forfeited/cancelled/expired | (2,000) | \$ 18.51 | | \$ 7,580 |
| Outstanding, end of year | 15,996 | \$ 22.34 | 8.635 | \$ 41,490 |
| Exercisable at end of year | 2,400 | \$ 18.51 | 7.995 | \$ 13,056 |
| Nonvested at end of year | 13,596 | \$ 23.02 | | |

As of September 30, 2019, there was \$80,000 of total unrecognized compensation cost related to non-vested options under the Plan. The cost is expected to be recognized over a weighted average period of 3.45 years.

Restricted Stock Awards

The table below summarizes the activity for the Company's restricted stock outstanding at September 30, 2019:

| | Shares | Weighted Average Fair Value |
|--------------------------------|---------|-----------------------------------|
| Outstanding, beginning of year | 14,340 | \$ 22.95 |
| Granted | 12,674 | 20.40 |
| Vested | (6,749) | 21.41 |
| Forfeited/cancelled/expired | (1,772) | 22.87 |
| Outstanding, end of year | 18,493 | \$ 21.78 |

The table below summarizes the activity for the Company's restricted stock outstanding at September 30, 2018:

| | Shares | Weighted Average Fair Value |
|--------------------------------|---------|-----------------------------------|
| Outstanding, beginning of year | 10,711 | \$ 20.36 |
| Granted | 6,400 | 26.20 |
| Vested | (2,071) | 20.22 |
| Forfeited/cancelled/expired | (700) | 21.00 |
| Outstanding, end of year | 14,340 | \$ 22.95 |

As of September 30, 2019, there was \$333,000 of total unrecognized compensation cost related to non-vested shares of restricted stock granted under the Plan. The cost is expected to be recognized over a weighted average period of 3.50 years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 19 – Subordinated Debt

On February 7, 2017, the Company issued \$25.0 million in aggregate principal amount of its 6.125 percent fixed-to-floating rate subordinated notes due 2027 (the “Notes”). The Notes have a stated maturity of February 15, 2027, are redeemable, in whole or in part, on or after February 15, 2022, and at any time upon the occurrences of certain events. The Notes bear interest at a fixed rate of 6.125 percent per year, from and including February 7, 2017 to, but excluding February 15, 2022. From and including February 15, 2022 to the maturity date or earlier redemption date, the interest rate will reset quarterly at a variable rate equal to the then current 3-month LIBOR plus 414.5 basis points. The Notes were structured to qualify as Tier 2 capital for regulatory purposes. The Company’s net subordinated debt totaled \$24.6 million (reported net of \$737,000 in debt issuance costs) at September 30, 2019.

The Company may not redeem the Notes prior to February 15, 2022, except that the Company may redeem the Notes at any time, at its option, in whole but not in part, subject to obtaining any required regulatory approvals, if (i) a change or prospective change in law occurs that could prevent the Company from deducting interest payable on the Notes for U.S. federal income tax purposes, (ii) a subsequent event occurs that precludes the Notes from being recognized as Tier 2 capital for regulatory capital purposes, or (iii) the Company is required to register as an investment company under the Investment Company Act of 1940, as amended, in each case, at a redemption price equal to 100 percent of the principal amount of the Notes plus any accrued and unpaid interest through, but excluding, the redemption date.

Note 20 – Condensed Financial Information - Parent Company Only

Condensed Statements of Financial Condition

| | September 30, | |
|---|-----------------------|-------------------|
| | 2019 | 2018 |
| | <i>(In thousands)</i> | |
| Assets | | |
| Cash and Cash Equivalents | \$ 12,438 | \$ 3,606 |
| Investment in subsidiaries | 152,517 | 132,330 |
| Loans receivable, net | 1,266 | 1,421 |
| Other assets | 1,116 | 657 |
| Total Assets | \$ 167,337 | \$ 138,014 |
| Liabilities | | |
| Subordinated debt | \$ 24,619 | \$ 24,461 |
| Other borrowings | — | 2,500 |
| Accrued interest payable | 196 | 196 |
| Accounts payable | 14 | 34 |
| Total Liabilities | 24,829 | 27,191 |
| Shareholders’ Equity | 142,508 | 110,823 |
| Total Liabilities and Shareholders’ Equity | \$ 167,337 | \$ 138,014 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 20 – Condensed Financial Information - Parent Company Only (Continued)

Condensed Statements of Operations

| | Year Ended September 30, | |
|--|--------------------------|-----------------|
| | 2019 | 2018 |
| | <i>(In thousands)</i> | |
| Income | | |
| Interest income | \$ 67 | \$ 74 |
| Total Interest Income | <u>67</u> | <u>74</u> |
| Expense | | |
| Long-term borrowings | 1,537 | 1,594 |
| Total Interest Expense | <u>1,537</u> | <u>1,594</u> |
| Other operating expenses | 582 | 382 |
| Total Other Expenses | <u>582</u> | <u>382</u> |
| Total Expense | <u>2,119</u> | <u>1,976</u> |
| Loss before Equity in Undistributed Net Income of Subsidiaries and Income Tax Expense | (2,052) | (1,902) |
| Equity in Undistributed Net Income of Subsidiaries | 10,911 | 8,748 |
| Income tax benefit | (473) | (460) |
| Net Income | <u>\$ 9,332</u> | <u>\$ 7,306</u> |

Condensed Statements of Comprehensive Income

| | Year Ended September 30, | |
|---|--------------------------|-----------------|
| | 2019 | 2018 |
| | <i>(In thousands)</i> | |
| Net Income | \$ 9,332 | \$ 7,306 |
| Other Comprehensive (Loss) Income, Net of Tax: | | |
| Unrealized holding gains (losses) on available-for-sale securities | 419 | (229) |
| Tax effect | (88) | 48 |
| Net of tax amount | <u>331</u> | <u>(181)</u> |
| Reclassification adjustment for net gains arising during the period ⁽¹⁾ | (28) | — |
| Tax effect | 6 | — |
| Net of tax amount | <u>(22)</u> | <u>—</u> |
| Accretion of unrealized holding losses on securities transferred from available-for-sale to held-to-maturity ⁽²⁾ | 4 | 6 |
| Tax effect | (1) | (1) |
| Net of tax amount | <u>3</u> | <u>5</u> |
| Fair value adjustment on derivatives | (1,855) | 868 |
| Tax effect | 390 | (203) |
| Net of tax amount | <u>(1,465)</u> | <u>665</u> |
| Total other comprehensive (loss) income | <u>(1,153)</u> | <u>489</u> |
| Total comprehensive income | <u>\$ 8,179</u> | <u>\$ 7,795</u> |

⁽¹⁾ Amounts are included in net gain on sales of investments on the Consolidated Statements of Operations in total other income.

⁽²⁾ Amounts are included in interest and dividends on investment securities on the Consolidated Statements of Operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 20 – Condensed Financial Information - Parent Company Only (Continued)

Condensed Statements of Cash Flows

| | Year Ended September 30, | |
|--|--------------------------|-----------------|
| | 2019 | 2018 |
| | <i>(In thousands)</i> | |
| Cash Flows from Operating Activities | | |
| Net income | \$ 9,332 | \$ 7,306 |
| Undistributed net income of subsidiaries | (10,911) | (8,748) |
| ESOP expense | 289 | 366 |
| Stock based compensation | 209 | 142 |
| Amortization of subordinated debt issuance costs | 158 | 158 |
| Increase in other assets | (888) | (418) |
| Decrease in other liabilities | (20) | (4) |
| Net Cash Used in Operating Activities | (1,831) | (1,198) |
| Cash Flows from Investing Activities | | |
| Net decrease in loans | 155 | 147 |
| Net Cash Provided by Investing Activities | 155 | 147 |
| Cash Flows from Financing Activities | | |
| Net proceeds from issuance of common stock | 23,344 | — |
| Cash contributed to the Bank | (10,000) | — |
| Acquisition of treasury stock | (336) | — |
| Repayment of other borrowed money | (2,500) | (2,500) |
| Net Cash Provided by (Used in) Financing Activities | 10,508 | (2,500) |
| Net Increase (Decrease) in Cash and Cash Equivalents | 8,832 | (3,551) |
| Cash and Cash Equivalents - Beginning | 3,606 | 7,157 |
| Cash and Cash Equivalents - Ending | \$ 12,438 | \$ 3,606 |
| Supplementary Cash Flows Information | | |
| Non-cash transfer of investment securities from Parent Company to Bank | \$ — | \$ — |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 21 – Quarterly Financial Information of Malvern Bancorp Inc. (Unaudited)

The following tables are a summary of certain quarterly financial data for the fiscal years ended September 30, 2019 and 2018.

| | 2019 | | | |
|--|--|-----------------|-----------------|-----------------|
| | 4th. Quarter | 3rd. Quarter | 2nd. Quarter | 1st. Quarter |
| | <i>(In thousands, except share data)</i> | | | |
| Total Interest and Dividend Income | \$ 12,686 | \$ 12,456 | \$ 11,601 | \$ 10,912 |
| Total Interest Expense | 5,268 | 4,995 | 4,352 | 3,965 |
| Net Interest Income | 7,418 | 7,461 | 7,249 | 6,947 |
| Provision for Loan Losses | — | 56 | 870 | 1,453 |
| Total Other Income | 551 | 454 | 441 | 1,146 |
| Total Other Expenses | 4,453 | 4,497 | 4,443 | 4,094 |
| Income before income tax expense | 3,516 | 3,362 | 2,377 | 2,546 |
| Income tax expense | 817 | 706 | 411 | 535 |
| Net Income | <u>\$ 2,699</u> | <u>\$ 2,656</u> | <u>\$ 1,966</u> | <u>\$ 2,011</u> |
| Earnings Per Common Share: | | | | |
| Basic | \$ 0.35 | \$ 0.35 | \$ 0.26 | \$ 0.27 |
| Diluted | \$ 0.35 | \$ 0.35 | \$ 0.26 | 0.27 |
| Weighted Average Common Shares Outstanding | | | | |
| Basic | 7,663,242 | 7,669,851 | 7,667,518 | 7,555,810 |
| Diluted | 7,663,593 | 7,670,106 | 7,667,518 | 7,555,969 |

| | 2018 | | | |
|--|--|-----------------|-----------------|---------------|
| | 4th. Quarter | 3rd. Quarter | 2nd. Quarter | 1st. Quarter |
| | <i>(In thousands, except share data)</i> | | | |
| Total Interest and Dividend Income | \$ 10,617 | \$ 10,198 | \$ 9,704 | \$ 9,511 |
| Total Interest Expense | 3,508 | 3,222 | 3,136 | 3,129 |
| Net Interest Income | 7,109 | 6,976 | 6,568 | 6,382 |
| Provision for Loan Losses | 125 | 589 | 240 | — |
| Total Other Income | 429 | 715 | 449 | 1,711 |
| Total Other Expenses | 4,437 | 4,790 | 4,105 | 4,471 |
| Income before income tax expense | 2,976 | 2,312 | 2,672 | 3,622 |
| Income tax expense | 334 | 69 | 654 | 3,219 |
| Net Income | <u>\$ 2,642</u> | <u>\$ 2,243</u> | <u>\$ 2,018</u> | <u>\$ 403</u> |
| Earnings Per Common Share: | | | | |
| Basic | \$ 0.41 | \$ 0.35 | \$ 0.31 | \$ 0.06 |
| Diluted | \$ 0.41 | \$ 0.35 | \$ 0.31 | 0.06 |
| Weighted Average Common Shares Outstanding | | | | |
| Basic | 6,464,326 | 6,453,031 | 6,448,691 | 6,445,264 |
| Diluted | 6,467,628 | 6,456,048 | 6,452,246 | 6,450,513 |

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

None

Item 9A. Controls and Procedures.

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of September 30, 2019. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of September 30, 2019.

Management’s Annual Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Securities and Exchange Act of 1934 Rules 13(a)-15(f). The Company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. An adequate system of internal control encompasses the processes and procedures that have been established by management to, among other things:

- Maintain records that accurately reflect the Company’s transactions;
- Prepare financial statements and footnote disclosures in accordance with GAAP that can be relied upon by external users; and
- Prevent and detect unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect of the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, the application of any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that compliance with the policies or procedures may deteriorate.

The Company’s management assessed the effectiveness of the Company’s internal control over financial reporting as of September 30, 2019. In making this assessment, the Company’s management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in Internal Control-Integrated Framework (2013).

As of September 30, 2019, based on management’s assessment, the Company’s internal control over financial reporting was effective.

The effectiveness of our internal control over financial reporting as of September 30, 2019, has been audited by Baker Tilly Virchow Krause, LLP, our independent registered public accounting firm as stated in their report which appears herein.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company’s internal control over financial reporting identified in connection with management’s evaluation that occurred during the three months ended September 30, 2019 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

Item 9B. Other Information.

None.

PART III.

Item 10. Directors, Executive Officers and Corporate Governance.

The information required by this Item with respect to our directors and certain corporate governance practices is contained in our Proxy Statement for our 2020 Annual Meeting of Shareholders (the “Proxy Statement”) to be filed with the SEC within 120 days after the end of the Company’s fiscal year ended September 30, 2019. Such information is incorporated herein by reference.

Item 11. Executive Compensation.

The information required by this Item is incorporated herein by reference to our Proxy Statement to be filed with the SEC within 120 days after the end of the Company's fiscal year ended September 30, 2019.

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

The information required by this Item regarding security ownership of certain beneficial owners and management is incorporated herein by reference to our Proxy Statement to be filed with the SEC within 120 days after the end of the Company fiscal year ended September 30, 2019. Information relating to securities authorized for issuance under the Company's equity compensation plans is included in Part II of this Annual Report on Form 10-K under "Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities."

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by this Item is incorporated herein by reference to our Proxy Statement to be filed with the SEC within 120 days after the end of the Company fiscal year ended September 30, 2019.

Item 14. Principal Accounting Fees and Services.

The information required by this Item is incorporated herein by reference to our Proxy Statement to be filed with the SEC within 120 days after the end of the Company fiscal year ended September 30, 2019.

PART IV.

Item 15. Exhibits and Financial Statement Schedules.

(a)(1)The following financial statements are incorporated by reference from Item 8 hereof:

Report of Independent Registered Public Accounting Firm

Consolidated Statements of Financial Condition

Consolidated Statements of Operations

Consolidated Statements of Comprehensive Income (Loss)

Consolidated Statements of Changes in Shareholders' Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

(2) All schedules are omitted because they are not required or applicable, or the required information is shown in the consolidated financial statements or the notes thereto.

(3) Exhibits

The following exhibits are filed as part of this Form 10-K and this list includes the Exhibit Index.

| <u>No.</u> | <u>Description</u> | <u>Location</u> |
|------------|---|-----------------|
| 3.1 | <u>Amended and Restated Articles of Incorporation of Malvern Bancorp, Inc.</u> | (1) |
| 3.2 | <u>Amended and Restated Bylaws of Malvern Bancorp, Inc.</u> | (2) |
| 4.0 | <u>Form of Stock Certificate of Malvern Bancorp, Inc.</u> | (3) |
| 4.1 | <u>Indenture, dated February 7, 2017, by and between Malvern Bancorp, Inc. and U.S. Bank National Association, as trustee</u> | (4) |
| 4.2 | <u>Forms of 6.125% Subordinated Note due 2027 (included as Exhibit A-1 and Exhibit A-2 to the Indenture referenced above)</u> | (5) |
| 10.1 | <u>Malvern Bancorp 2014 Long Term Incentive Plan*</u> | (6) |
| 10.2 | <u>Change of Control Agreement, dated May 23, 2016, with Joseph D. Gangemi*</u> | (7) |
| 10.3 | <u>Change of Control Agreement, dated May 23, 2016, with William Woolworth*</u> | (8) |
| 10.4 | <u>Amended and Restated Employment Agreement, dated May 25, 2017, among Malvern Bancorp, Inc., Malvern Bank and Anthony C. Weagley*</u> | (9) |
| 10.5 | <u>Amendment to Change in Control Agreement, dated May 25, 2017, between Joseph Gangemi and Malvern Bank, including his Non-Competition, Non-Solicitation, Confidentiality and Cooperation Agreement*</u> | (10) |
| 10.6 | <u>Employment Agreement, dated May 25, 2017, among Malvern Bancorp, Inc., Malvern Bank and William J. Boylan, including his Non-Competition, Non-Solicitation, Confidentiality and Cooperation Agreement*</u> | (11) |
| 10.7 | <u>Amendment to Employment Agreement, dated December 11, 2018, among Malvern Bancorp, Inc., Malvern Bank and Anthony C. Weagley</u> | (12) |
| 21.1 | <u>Subsidiaries of the Registrant</u> | Filed herewith |
| 23.0 | <u>Consent of Baker Tilly Virchow Krause, LLP.</u> | Filed herewith |
| 31.1 | <u>Rule 13(a)-14(a) Certification of the Chief Executive Officer</u> | Filed herewith |
| 31.2 | <u>Rule 13(a)-14(a) Certification of the Chief Financial Officer</u> | Filed herewith |
| 32.0 | <u>Section 1350 Certification</u> | Filed herewith |
| 101.INS | XBRL Instance Document. ** | Filed herewith |
| 101.SCH | XBRL Taxonomy Extension Schema Document.** | Filed herewith |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document.** | Filed herewith |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document.** | Filed herewith |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document.** | Filed herewith |
| 101.DEF | XBRL Taxonomy Extension Definitions Linkbase Document.** | Filed herewith |

* Denotes a management contract or compensatory plan or arrangement.

** Attached as Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statement of Financial Condition at September 30, 2019 and 2018, (ii) the Consolidated Statement of Operations for the years ended September 30, 2019 and 2018, (iii) the Consolidated Statement of Comprehensive Income (Loss) for the years ended September 30, 2019 and 2018, (iv) the Consolidated Statement of Changes in Shareholders' Equity for the years ended September 30, 2019 and 2018, (v) the Consolidated Statement of Cash Flows for the years ended September 30, 2019 and 2018 (vi) the Notes to Condensed Consolidated Financial Statements, tagged as detailed footnote tagging.

- (1) Incorporated by reference from Exhibit 3.1 to the Current Report on Form 8-K of Malvern Bancorp, Inc. filed with the SEC on February 17, 2017.
- (2) Incorporated by reference from Exhibit 3.2 to the Current Report on Form 8-K of Malvern Bancorp, Inc. filed with the SEC on February 17, 2017.
- (3) Incorporated by reference from Exhibit 4.0 to Malvern Bancorp, Inc.'s Registration Statement Form S-1, filed May 31, 2012 (SEC File No. 333-181798).
- (4) Incorporated by reference from Exhibit 4.1 to Malvern Bancorp, Inc.'s Current Report on Form 8-K, filed on February 8, 2017.
- (5) Incorporated by reference from Exhibit 10.1 to Malvern Bancorp, Inc.'s Current Report on Form 8-K, filed on February 8, 2017

- (6) Incorporated by reference from Appendix A of the definitive proxy statement filed by Malvern Bancorp, Inc. with the SEC on January 2, 2015.
- (7) Incorporated by reference from Exhibit 10.1 to Malvern Bancorp, Inc.'s Current Report on Form 8-K, filed on May 27, 2016.
- (8) Incorporated by reference from Exhibit 10.2 to Malvern Bancorp, Inc.'s Current Report on Form 8-K, filed on May 27, 2016.
- (9) Incorporated by reference from Exhibit 10.1 to Malvern Bancorp, Inc.'s Current Report on Form 8-K, filed on June 1, 2017.
- (10) Incorporated by reference from Exhibit 10.2 to Malvern Bancorp, Inc.'s Current Report on Form 8-K, filed on June 1, 2017.
- (11) Incorporated by reference from Exhibit 10.3 to Malvern Bancorp, Inc.'s Current Report on Form 8-K, filed on June 1, 2017.
- (12) Incorporated by reference from Exhibit 10.8 to Malvern Bancorp, Inc.'s Annual Report on Form 10-K, filed on December 14, 2018.

Item 16. Form 10-K Summary.

None

SIGNATURES

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

MALVERN BANCORP, INC.

December 16, 2019

By: /s/ Anthony C. Weagley
Anthony C. Weagley
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities described below on December 16, 2019, have signed this report below.

| | |
|---|---|
| <u>/s/ Anthony C. Weagley</u> Anthony C. Weagley | Director, President and Chief Executive Officer (principal executive officer) |
| <u>/s/ Howard Kent</u> Howard Kent | Chairman of the Board |
| <u>/s/ James Barrett</u> James Barrett | Director |
| <u>/s/ Cynthia Felzer Leitzell</u> Cynthia Felzer Leitzell | Director |
| <u>/s/ Norman Feinstein</u> Norman Feinstein | Director |
| <u>/s/ Andrew Fish</u> Andrew Fish | Director |
| <u>/s/ Stephen P. Scartozzi</u> Stephen P. Scartozzi | Director |
| <u>/s/ Julia Corelli</u> Julia Corelli | Director |
| <u>/s/ Joseph D. Gangemi</u> Joseph D. Gangemi | Senior Vice President and Chief Financial Officer (principal financial and accounting officer) |

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Section 2: EX-21.1 (EX-21.1)

Exhibit 21.1

MALVERN BANCORP, INC. SUBSIDIARIES OF THE REGISTRANT

| <u>Name</u> | <u>Jurisdiction of Incorporation</u> |
|--|--------------------------------------|
| Malvern Bank, National Association | United States |
| Malvern Insurance Associates, LLC (wholly-owned subsidiary of Malvern Bank, National Association) | Pennsylvania |

Coastal Asset Management Co.
(wholly-owned subsidiary of Malvern Bank, National Association)

Delaware

MFSB Mortgage Backed Security 2016-A Trust
(95% owned by Coastal Asset Management Co., and 5% owned by Malvern Bank, National Association)

Delaware

MFSB Mortgage Backed Security 2017-A Trust
(95% owned by Coastal Asset Management Co., and 5% owned by Malvern Bank, National Association)

Delaware

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Section 3: EX-23.0 (EX-23.0)

Exhibit 23.0

Consent of Independent Registered Public Accounting Firm

Malvern Bancorp, Inc. and Subsidiaries

We consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-184445 and 333-207214) and Form S-3 (Nos. 333-215220 and 333-219999) of Malvern Bancorp, Inc. and Subsidiaries of our report dated December 16, 2019, relating to the consolidated financial statements and the effectiveness of internal control over financial reporting as of and for the fiscal year ended September 30, 2019, which appear in this Annual Report on Form 10-K.

/s/ Baker Tilly Virchow Krause, LLP

Allentown, Pennsylvania
December 16, 2019

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Section 4: EX-31.1 (EX-31.1)

EXHIBIT 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Anthony C. Weagley, certify that:

1. I have reviewed this annual report on Form 10-K of Malvern Bancorp, Inc. (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and

- (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: December 16, 2019

/s/ Anthony C. Weagley

Anthony C. Weagley

President and Chief Executive Officer

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Section 5: EX-31.2 (EX-31.2)

EXHIBIT 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Joseph D. Gangemi certify that:

1. I have reviewed this annual report on Form 10-K of Malvern Bancorp, Inc. (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: December 16, 2019

/s/ Joseph D. Gangemi

Joseph D. Gangemi
Senior Vice President and Chief Financial Officer

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Section 6: EX-32.0 (EX-32.0)

EXHIBIT 32.0

SECTION 1350 CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER

Each of Anthony C. Weagley, President and Chief Executive Officer, and Joseph D. Gangemi, Senior Vice President and Chief Financial Officer, of Malvern Bancorp, Inc. (the "Company"), hereby certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that:

- (1) The Annual Report on Form 10-K of the Company for the fiscal year ended September 30, 2019 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C 78m(a) or 78o(d)); and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: December 16, 2019

By: /s/ Anthony C. Weagley

Anthony C. Weagley
President and Chief Executive Officer

Date: December 16, 2019

By: /s/ Joseph D. Gangemi

Joseph D. Gangemi
Senior Vice President and Chief Financial Officer

Note: A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act has been provided to Malvern Bancorp, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

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