

MALVERN BANCORP, INC.  
Form 10-K  
December 14, 2016

**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, 2016

**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:

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates was approximately \$92.7 million, based on the last sale price on NASDAQ Stock Market for the last business day of the Registrant's most recently completed second fiscal quarter.

The number of shares of the Issuer's common stock, par value \$0.01 per share, outstanding as of December 12, 2016 was 6,560,403.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive Proxy Statement for the 2017 Annual Meeting of Shareholders are incorporated by reference into Part III, Items 10-14 of this Form 10-K.

**MALVERN BANCORP, INC.**

**TABLE OF CONTENTS**

	Page
<b><u>PART I</u></b>	
Item 1. <u>Business</u>	1
Item 1A. <u>Risk Factors</u>	12
Item 1B. <u>Unresolved Staff Comments</u>	17
Item 2. <u>Properties</u>	17
Item 3. <u>Legal Proceedings</u>	17
Item 4. <u>Mine Safety Disclosures</u>	17
<b><u>PART II</u></b>	
Item 5. <u>Market for the Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities</u>	17
Item 6. <u>Selected Financial Data</u>	19
Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	21
Item 7A. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	49
Item 8. <u>Financial Statements and Supplementary Data</u>	50
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	106
Item 9A <u>Controls and Procedures</u>	106
Item 9B. <u>Other Information</u>	109

**PART III**

Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	109
Item 11. <u>Executive Compensation</u>	109
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</u>	109
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	110
Item 14. <u>Principal Accounting Fees and Services</u>	110

**PART IV**

Item 15. <u>Exhibits and Financial Statement Schedules</u>	110
Item 16. <u>Form 10-K Summary</u>	111

<u>SIGNATURES</u>	112
-------------------	-----

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

## **PART I.**

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

### **Item 1. Business**

#### **Historical Development of Business**

Malvern Bancorp, Inc., a Pennsylvania corporation (the “Company” or “Malvern Bancorp”), is the holding company for Malvern Federal Savings Bank (“Malvern Federal Savings” or the “Bank”) and owns all of the issued and outstanding shares of the common stock of the Bank. In connection with the “second-step” conversion and reorganization which we completed in October 2012, 3,636,875 shares of common stock, par value \$0.01 per share, of Malvern Bancorp were sold in a subscription offering to certain depositors of the Bank and other investors for \$10 per share, or \$36.4 million in the aggregate, and 2,921,598 shares of common stock were issued in exchange for the outstanding shares of common stock of the former federally chartered mid-tier holding company, Malvern Federal Bancorp, Inc. (the

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

The Bank has one subsidiary, Strategic Asset Management Group, Inc. (“SAMG”), a Pennsylvania corporation. SAMG holds a 50% ownership interest in Malvern Insurance Associates, LLC (“Malvern Insurance”), a Pennsylvania limited liability company. Malvern Insurance is a licensed insurance broker under Pennsylvania law.

During September 2014, the Bank and Malvern Bancorp dissolved two former investment subsidiaries, Malvern Federal Holdings, Inc. and Malvern Federal Investments, Inc., both of which were Delaware corporations that held and managed certain investment securities.

Malvern Federal Savings Bank is a federally chartered, FDIC-insured savings bank that was originally organized in 1887. The Bank conducts business from its headquarters in Paoli, Pennsylvania, a suburb of Philadelphia, as well as eight other financial centers located throughout Chester and Delaware Counties, Pennsylvania and a Private Banking Loan Production headquarters office in Morristown, New Jersey.

The Bank's principal business consists of attracting deposits from businesses and the general public primarily in Chester County, Pennsylvania and investing those deposits, together with borrowings and funds generated from operations, in one- to four-family residential real estate loans, construction and development loans, commercial and multi-family real estate loans, commercial business loans, home equity loans and lines of credit and other consumer loans, as well as investing in investment securities. In addition to Chester County, our lending efforts are focused in neighboring Bucks County, Montgomery County and Delaware County, which are also in southeastern Pennsylvania, New Jersey and the New York metropolitan marketplace. We also service client needs in the greater Philadelphia market area. Our primary market niche is providing personalized service to our client base.

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 both with servicing retained and released. The Bank's primary expenses are interest expense on deposits and borrowings, provisions for loan losses and general operating expenses.

## **SEC Reports and Corporate Governance**

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

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

## **Market Area and Competition**

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



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

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

### **Product and Services**

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

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

The Bank, through its partnership with Bell Rock Capital, offers through its private banking and wealth management division 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 401k services.

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

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

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

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

loans secured by first or second liens on residential real estate for primary or secondary residences.

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

The Bank's lending policies generally provide for lending inside of our primary market area. However, the Bank will make loans to persons outside of our primary trade area when we deem it prudent to do so. In an effort to promote a high degree of asset quality, the Bank focuses primarily upon offering secured loans. However, the Bank does make unsecured loans to borrowers with high net worth and income profiles. The Bank generally requires loan customers to maintain deposit accounts with the Bank. In addition, the Bank generally provides for a minimum required rate of interest in its variable rate loans. We believe that having senior management on-site allows for an enhanced local presence and rapid decision-making that attracts borrowers. The Bank's legal lending limit to any one borrower is 15% of the Bank's capital base (defined as tangible equity plus the allowance for loan losses) for most loans (\$13.6 million) and 25% of the capital base for loans secured by readily marketable collateral (\$22.6 million). At September 30, 2016, the Bank's largest committed relationship totaled \$10.0 million.

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

## **Supervision and Regulation**

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

On October 7, 2014, the Bank entered into a formal written agreement (the “Formal Agreement”) with the OCC. The Formal Agreement was terminated effective January 21, 2016. As a result of such termination, the Bank is no longer considered to be in “troubled condition.”

## **Dodd-Frank Act**

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

The following aspects of the 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. Smaller financial institutions, like the Bank, are subject to the supervision and enforcement of their primary federal banking regulator with respect to the federal consumer financial protection laws.

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

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

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

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

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

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

The following aspects of the Dodd-Frank Act are related to the operations of the Company:

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

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

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

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

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

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

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

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

Item 402 of Regulation S-K 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.

#### **Regulation of Malvern Bancorp, Inc.**

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

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

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

Under recently enacted legislation, savings and loan holding companies became subject to statutory capital requirements. However, in May 2015, amendments to the Federal Reserve Board’s small bank holding company policy statement (the “SBHC Policy”) became effective. The amendments made the SBHC Policy applicable to savings and loan holding companies such as Malvern Bancorp, and increased the asset threshold to qualify to be subject to the provisions of the SBHC Policy from \$500 million to \$1 billion. Savings and loan holding companies that have total assets of \$1 billion or less are subject to the SBHC Policy and are not required to comply with the regulatory capital requirements set forth in the table below. Such treatment continues until Malvern Bancorp’s total assets exceed \$1 billion or the Federal Reserve Board deems it to no longer be a small savings and loan holding company. However, if Malvern Bancorp had been subject to the requirements, it would have been in compliance with them as of September 30, 2016.

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

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

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

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

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



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

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

## **Volcker Rule Regulations**

Regulations adopted by the federal banking agencies to implement the provisions of the Dodd Frank Act commonly referred to as the Volcker Rule 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.

## **Regulation of Malvern Federal Savings Bank**

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

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

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

The Federal Deposit Insurance Corporation's risk-based premium system provides for quarterly assessments. Each insured institution is placed in one of four risk categories depending on supervisory and capital considerations. Within its risk category, an institution is assigned to an initial base assessment rate which is then adjusted to determine its

final assessment rate based on its brokered deposits, secured liabilities and unsecured debt. To implement the Dodd Frank Act, the Federal Deposit Insurance Corporation amended its deposit insurance regulations (1) to change the assessment base for insurance from domestic deposits to average assets minus average tangible equity and (2) to lower overall assessment rates. The revised assessments rates are between 2.5 to 9 basis points for banks in the lowest risk category and between 30 to 45 basis points for banks in the highest risk category.

In addition, all institutions with deposits insured by the FDIC are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation, 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% to 1.35% and requires the FDIC to offset the effect of this increase on insured institutions with assets of less than \$10 billion (small institutions). The FDIC has adopted a rule to accomplish this by imposing a surcharge on larger institutions commencing when the reserve ratio reaches 1.15% and ending when it reaches 1.35%. The reserve ratio reached 1.15% 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% and 1.35%. The credits will apply for each quarter the reserve ratio is above 1.38%, in amounts as determined by the FDIC.

**Regulatory Capital Requirements.** Federally insured savings institutions are required to maintain minimum levels of regulatory capital. The OCC has established capital standards consisting of a “tangible capital requirement,” a “leverage capital requirement” and “a risk-based capital requirement.” The OCC also is authorized to impose capital requirements in excess of these standards on individual institutions on a case-by-case basis.

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

Savings institutions such as Malvern Federal Savings Bank are currently required to satisfy the following capital requirements:

- Tangible capital requirement – “tangible” capital equal to at least 1.5% of adjusted total assets;

- Common equity Tier 1 capital requirement – generally consists of retained earnings and common stock instruments equal to at least 4.5% of “risk weighted” assets;

Tier 1 capital requirement – equal to at least 6.0%;

leverage capital requirement – “core” capital equal to at least 3.0% of adjusted total assets for the most highly rated institutions;

an additional “cushion” of at least 100 basis points of core capital for all but the most highly rated savings associations effectively increasing their minimum Tier 1 leverage ratio to 4.0% or more; and

risk-based capital requirement – “total” capital (a combination of core and “supplementary” capital) equal to at least 8.0% of “risk-weighted” assets.

Core capital generally consists of common stockholders' equity (including retained earnings). Tangible capital generally equals core capital minus intangible assets, with only a limited exception for purchased mortgage servicing rights. Malvern Federal Savings Bank had no intangible assets at September 30, 2016. Both core and tangible capital are further reduced by an amount equal to a savings institution's debt and equity investments in subsidiaries engaged in activities not permissible to national banks (other than subsidiaries engaged in activities undertaken as agent for customers or in mortgage banking activities and subsidiary depository institutions or their holding companies). These adjustments do not affect Malvern Federal Savings Bank's regulatory capital.

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

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

The table below sets forth Malvern Federal Savings Bank's capital position relative to the OCC's regulatory capital requirements at September 30, 2016. Malvern Bancorp is not subject to the regulatory capital ratios imposed by the Dodd-Frank Act on savings and loan holding companies because it was deemed to be a small savings and loan holding company as of September 30, 2016.

	Actual		Required for Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions		Excess Over Well-Capitalized Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)							
Tier 1 leverage capital (to adjusted tangible assets)	\$85,030	10.79%	\$31,533	4.00%	\$39,417	5.00%	\$45,613	5.79%
Common equity Tier 1 (to risk-weighted assets)	\$85,030	14.24	\$26,875	4.50	\$38,820	6.50	\$46,210	7.74
Tier 1 risk-based capital (to risk-weighted assets)	\$85,030	14.24	\$35,834	6.00	\$47,779	8.00	\$37,251	6.24
Total risk-based capital (to risk-weighted assets)	\$90,526	15.16	\$47,779	8.00	\$59,723	10.00	\$30,803	5.16

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

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

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

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

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

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

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

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

Currently, the OCC's QTL test requires that 65% of an institution's "portfolio assets" (as defined) consist of certain housing and consumer-related assets on a monthly average basis in nine out of every 12 months. To be a qualified



thrift lender under the IRS test, the savings institution must meet a “business operations test” and a “60 percent assets test,” each defined in the Internal Revenue Code.

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

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

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

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

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

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

At September 30, 2016, Malvern Federal Savings Bank met the requirements to be deemed a QTL.

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

In addition, Sections 22(g) and (h) of the Federal Reserve Act as made applicable to savings associations by Section 11 of the Home Owners' Loan Act, place restrictions on loans to executive officers, directors and principal shareholders of the savings association and its affiliates. Under Section 22(h), loans to a director, an executive officer and to a greater than 10% shareholder of a savings association, and certain affiliated interests of either, may not exceed, together with all other outstanding loans to such person and affiliated interests, the savings association's loans to one borrower limit (generally equal to 15% of the association's unimpaired capital and surplus). Section 22(h) also requires that loans to directors, executive officers and principal shareholders be made on terms substantially the same as offered in comparable transactions to other persons unless the loans are made pursuant to a benefit or compensation

program that (i) is widely available to employees of the association and (ii) does not give preference to any director, executive officer or principal shareholder, or certain affiliated interests of either, over other employees of the savings association. Section 22(h) also requires prior board approval for certain loans. In addition, the aggregate amount of extensions of credit by a savings association to all insiders cannot exceed the association's unimpaired capital and surplus. Furthermore, Section 22(g) places additional restrictions on loans to executive officers. Malvern Federal Savings Bank currently is subject to Sections 22(g) and (h) of the Federal Reserve Act and at September 30, 2016, was in compliance with the above restrictions.

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

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

**Federal Home Loan Bank System.** Malvern Federal Savings Bank is a member of the Federal Home Loan Bank of Pittsburgh, which is one of 12 regional Federal Home Loan Banks that administers the home financing credit function of savings institutions. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the board of directors of the FHLB. At September 30, 2016, Malvern Federal Savings Bank had \$118.0 million of FHLB advances outstanding and \$127.8 million available on its line of credit with the FHLB.

As a member, Malvern Federal Savings Bank is required to purchase and maintain stock in the FHLB of Pittsburgh in an amount equal to at least 1.0% of its aggregate unpaid residential mortgage loans or similar obligations at the beginning of each year. At September 30, 2016, Malvern Federal Savings Bank had \$5.4 million in FHLB stock, which was in compliance with this requirement.

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

**Federal Reserve System.** The Federal Reserve Board requires all depository institutions to maintain reserves against their transaction accounts (primarily NOW and Super NOW checking accounts) and non-personal time deposits. Because required reserves must be maintained in the form of vault cash or a noninterest-bearing account at a Federal Reserve Bank, the effect of this reserve requirement is to reduce an institution's earning assets. At September 30, 2016, Malvern Federal Savings Bank had met its reserve requirement.

## **Employees**

As of September 30, 2016, we had a total of 83 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.**

An investment in our common stock involves risks. Stockholders should carefully consider the risks described below, together with all other information contained in this Annual Report on Form 10-K, before making any purchase or sale decisions regarding our common stock. If any of the following risks actually occur, our business, financial condition or operating results may be harmed. In that case, the trading price of our common stock may decline, and stockholders may lose part or all of their investment in our common stock.

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

Our financial condition and results of operations are affected by the ability of our borrowers to repay their loans, and in a timely manner. Lending money is a significant part of the banking business. Borrowers, however, do not always repay their loans. The risk of non-payment is assessed through our underwriting and loan review procedures based on several factors including credit risks of a particular borrower, changes in economic conditions, the duration of the loan and in the case of a collateralized loan, uncertainties as to the future value of the collateral and other factors. Despite our efforts, we do and will experience loan losses, and our financial condition and results of operations will be adversely affected. Our non-performing assets were approximately \$2.3 million at September 30, 2016. Our allowance for loan losses was approximately \$5.4 million at September 30, 2016. Our loans between thirty and eighty-nine days delinquent totaled \$4.7 million at September 30, 2016.

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

Negative developments in the financial services industry since 2008 have resulted in uncertainty in the financial markets in general and a related general economic downturn globally. As a consequence of the most recent United States recession, business activities across a wide range of industries face serious difficulties due to the decline in the housing market and lack of consumer spending.

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

- we potentially face increased regulation of our industry and compliance with such regulation may increase our costs and limit our ability to pursue business opportunities;

- customer demand for loans secured by real estate could be reduced due to weaker economic conditions, an increase in unemployment, a decrease in real estate values or an increase in interest rates;

the process we use to estimate losses inherent in our credit exposure requires difficult, subjective and complex judgments, including forecasts of economic conditions and how these economic conditions might impair the ability of our borrowers to repay their loans; and

- the value of the portfolio of investment securities that we hold may be adversely affected.

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

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, 2016, the primary composition of our total loan portfolio was as follows:

- commercial real estate loans of \$231.4 million, or 40.0% of total loans;

- construction and development loans of \$28.6 million, or 4.9% of total loans;
- commercial and industrial loans of \$58.3 million, or 10.1% of total loans;
- residential real estate loans of \$209.2 million, or 36.2% of total loans and
- consumer loans of \$50.9 million, or 8.8% of total loans

Commercial real estate loans, which comprised 40.0% of our total loan portfolio as of September 30, 2016, 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, is improving, 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 be more difficult for commercial real estate borrowers to repay their loans in a timely manner 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 decrease the likelihood that a borrower may find permanent financing alternatives. Given the continued weaknesses in the commercial real estate market in general, there may be loans where the value of our collateral has been negatively impacted. 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 us.

**If our allowance for loan losses is not sufficient to cover actual loan losses, our earning 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 these 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 has adopted a new accounting standard that will be effective for the Company and the Bank after December 15, 2019. 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.

**Our deferred tax asset valuation allowance resulted in a one-time favorable impact to operations.**

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

During the fourth quarter of fiscal 2016, the Company reversed \$7.8 million representing the valuation allowance related to net deferred tax assets, which contributed to a net tax benefit for the quarter of \$6.0 million. The impact of the reversal and subsequent income tax benefit positively affected net income for the fourth quarter and full fiscal year 2016 results.

The reversal of the valuation allowance on net deferred tax assets was based on management's judgment that the net deferred tax asset will be realized by the Company. The Company has reported positive cumulative pre-tax earnings over the prior two year period ended September 30, 2016, representing eight quarters. These historical results in conjunction with management's expectations of future projected taxable income supported the Company's decision to reverse the valuation allowance on net deferred tax assets.

As for the remaining items related to the other temporary timing differences, the realization of a deferred tax asset requires us to exercise meaningful judgment and predict future occurrences, which is inherently uncertain. However, based on the types of some of the deferred assets, we reasonably estimate that the recovery period for these particular deferred assets to be ten years or less.

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

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

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

Substantially all of our loans are to individuals, businesses and real estate developers in Chester County, Pennsylvania and neighboring areas in southern Pennsylvania, New Jersey and the New York metropolitan marketplace. Our business depends significantly on general economic conditions in these market areas. These areas experienced deteriorating economic conditions during 2008 through 2015. A continued downturn in the local real estate market could harm our financial condition and results of operation in the following ways:

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

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

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

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

As of September 30, 2016, the fair value of our investment securities portfolio was approximately \$107.2 million. We have historically taken a conservative investment strategy, with concentrations of securities that are backed by government sponsored enterprises. Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. These factors include, but are not limited to, rating agency actions in respect of the securities, defaults by the issuer or with respect to the underlying securities, and changes in market interest rates and continued instability in the capital markets. Any of these factors, among others, could cause other-than-temporary impairments and realized and/or unrealized losses in future periods and declines in other comprehensive income, which could have a material adverse effect on us. The process for determining whether impairment of a security is other-than-temporary usually requires complex, subjective judgments about the future financial performance and liquidity of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security.

**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 loss of members of our senior management team, including those officers named in the summary compensation table of our proxy statement, 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.

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

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. Any of these events could have a material adverse effect on our financial condition and results of operations.

**Item 1B. Unresolved Staff Comments.**

Not applicable.

**Item 2. Properties.**

The Bank owns and maintains the premises in which the headquarters and six full-service financial centers are located, and leases a financial center in Glen Mills, Pennsylvania and in Villanova, Pennsylvania and a private banking office in Morristown, New Jersey. The location of each of the offices is as follows:

Paoli Headquarters	42 East Lancaster Avenue, Paoli, PA 19301
Paoli Financial Center	34 East Lancaster Avenue, Paoli, PA 19301
Malvern Financial Center	100 West King Street, Malvern, PA 19355
Exton Financial Center	109 North Pottstown Pike, Exton, PA 19341
Coventry Financial Center	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
Morristown Private Banking Office	163 Madison Avenue, 3 <sup>rd</sup> Floor, Morristown, NJ 07960

**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, 2016, the Company had 459 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, 2016, the closing sale price was \$16.40.

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, 2016 and 2015.

	Year Ended September 30,			
	2016		2015	
	High	Low	High	Low
First Quarter	\$17.70	\$15.31	\$12.17	\$11.10
Second Quarter	\$17.65	\$15.67	\$14.00	\$11.80
Third Quarter	\$16.50	\$15.40	\$15.25	\$13.24
Fourth Quarter	\$17.20	\$15.00	\$15.96	\$14.51

For the years ended September 30, 2016 and 2015, no cash dividends per share of common stock were declared by the Company.

**Stockholders Return Comparison**

Set forth on the following page is a line graph presentation comparing the cumulative stockholder return on the Company's common stock, on a dividend reinvested basis, against the cumulative total returns of the Standard & Poor's Composite, the SNL Mid-Atlantic Bank Index and the SNL Mid-Atlantic Thrift Index for the period from October 12, 2012 through September 30, 2016.

*Malvern Bancorp, Inc.*

Index	Period Ending				
	10/12/12	09/30/13	09/30/14	09/30/15	09/30/16
Malvern Bancorp, Inc.	100.00	115.82	103.55	142.27	149.09
S&P 500	100.00	120.23	143.96	143.08	165.15
SNL Mid-Atlantic U.S. Bank	100.00	130.00	149.06	152.69	161.22
SNL Mid-Atlantic U.S. Thrift	100.00	115.60	127.90	150.10	150.36



**Item 6. Selected Financial Data.**

The following tables set forth selected consolidated financial data as of the dates and for the periods presented. The selected consolidated statement of financial condition data as of September 30, 2016 and 2015 and the selected consolidated summary of operating data for the years ended September 30, 2016, 2015 and 2014 have been derived from our audited consolidated financial statements and related notes that we have included elsewhere in this Annual Report. The selected consolidated statement of financial condition data as of September 30, 2014, 2013 and 2012 and the selected consolidated summary of operating data for the years ended September 30, 2013 and 2012 have been derived from audited consolidated financial statements that are not presented in this Annual Report.

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

	At September 30,				
	2016	2015	2014	2013	2012
	(Dollars in thousands)				
<b>Summary of Operating Data:</b>					
Total interest and dividend income	\$25,244	\$20,462	\$20,167	\$22,301	\$25,775
Total interest expense	6,732	5,248	5,071	6,944	8,412
Net interest income	18,512	15,214	15,096	15,357	17,363
Provision for loan losses	947	90	263	11,235	810
Net interest income after provision for loan losses	17,565	15,124	14,833	4,122	16,553
Total other income	2,333	2,535	2,155	2,860	2,427
Total other expenses	13,922	13,961	16,644	19,775	16,393
Income tax (benefit) expense	(5,966 )	-	21	6,010	628
Net income (loss)	\$11,942	\$3,698	\$323	\$(18,803 )	\$1,959
Earnings (loss) per share <sup>(1)</sup>	\$1.86	\$0.58	\$0.05	\$(2.96 )	\$0.31
Dividends per share	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
<b>Statement of Financial Condition Data</b>					
Securities available for sale	\$66,387	\$128,354	\$100,943	\$124,667	\$80,508
Securities held to maturity	40,551	57,221	-	-	-
Loans held for sale	-	-	-	10,367	-
Loans receivable, net	574,160	391,307	386,074	401,857	457,001
Total assets	821,272	655,690	542,264	601,554	711,812
Deposits	602,046	465,522	412,953	484,596	540,988
FHLB borrowings	118,000	103,000	48,000	38,000	48,085
Shareholders’ equity	94,591	81,391	76,772	75,406	62,636

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Allowance for loan losses	5,434	4,667	4,589	5,090	7,581
Non-accrual loans in portfolio	1,617	1,399	2,391	1,901	9,749
Non-performing assets in portfolio	2,313	2,567	4,355	5,863	14,343
Performing troubled debt restructurings in portfolio	2,039	1,091	1,009	1,346	8,187
Non-performing assets and performing troubled debt restructurings in portfolio	4,352	3,658	5,364	7,209	22,530

Performance Ratios:

Return on average assets	1.59	%	0.60	%	0.06	%	(2.79	)%	0.30	%
Return on average equity	14.05		4.65		0.43		(20.24	)	3.15	
Interest rate spread <sup>(2)</sup>	2.53		2.48		2.59		2.25		2.66	
Net interest margin <sup>(3)</sup>	2.65		2.62		2.74		2.43		2.79	
Non-interest expenses to average total assets	1.85		2.25		2.84		2.93		2.50	
Efficiency ratio <sup>(4)</sup>	67.22		77.62		96.74		110.95		85.95	

Asset Quality Ratios:

Non-accrual loans as a percent of gross loans	0.28		0.35		0.62		0.47		2.11	
Non-performing assets as a percent of total assets	0.28		0.39		0.80		0.97		2.01	
Non-performing assets and performing troubled debt restructurings as a percent of total assets	0.53		0.56		0.99		1.20		3.17	
Allowance for loan losses as a percent of gross loans	0.94		1.18		1.18		1.26		1.64	
Allowance for loan losses as a percent of non-accrual loans	234.93		333.60		191.93		267.75		77.76	
Net charge-offs to average loans outstanding	0.04		0.00		0.19		3.07		0.69	

Capital Ratios<sup>(5)</sup>:

Total risk-based capital to risk weighted assets	15.16		16.99		20.75		18.97		14.22	
Tier 1 risk-based capital to risk weighted assets	14.24		15.90		19.50		17.72		12.96	
Tangible capital to tangible assets	N/A		N/A		12.09		10.91		7.70	
Tier 1 leverage (core) capital to adjustable tangible assets	10.79		10.80		12.09		10.91		7.70	
Shareholders' equity to total assets	11.52		12.41		14.16		12.54		8.80	

- (1) The calculation for the year ended September 2012 has been adjusted for the exchange and additional share issuance in the reorganization and offering completed on October 11, 2012.
- (2) Represents the difference between the weighted average yield on interest earning assets and the weighted average cost of interest bearing liabilities.
- (3) Net interest income divided by average interest earning assets.  
Efficiency ratio, which is a non-GAAP financial measure, is computed by dividing other expense, less non-core items, by net interest income on a tax equivalent basis plus other income, excluding net securities gains (losses).
- (4) Included in non-core items are costs which include expenses related to the Company's corporate restructuring initiatives. The Company believes these adjustments are necessary to provide the most accurate measure of core operating results as a means to evaluate comparative results. See table below for the calculation of the efficiency ratio.
- (5) Other than shareholders' equity to total assets, all capital ratios are for the Bank only.

The following table presents the calculation of efficiency ratio.

	At September 30,				
	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Other expense	\$ 13,922	\$ 13,961	\$ 16,644	\$ 19,775	\$ 16,393
Less: non-core items	111	439	-	-	-
Other expense, excluding non-core items	13,811	13,522	16,644	19,775	16,393
Net interest income (tax-equivalent basis)	18,777	15,400	15,152	15,442	17,396
Other income, excluding net investment securities gains	1,768	2,020	2,052	2,381	1,676
Total	20,545	17,420	17,204	17,823	19,072
Efficiency ratio	67.22 %	77.62 %	96.74 %	110.95 %	85.95 %

**Item 7. Management’s Discussion and Analysis (“MD&A”) of Financial Condition and Results of Operations.**

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

**CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS**

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

**Critical Accounting Policies and Estimates**

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

**Allowance for Loan Losses**

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

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

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

## Other Real Estate Owned

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

## Fair Value Measurements

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

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

- Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.
  
- Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
  
- Level 3 – Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company’s own estimates of assumptions that market participants would use in pricing the asset.

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

Fair value measurements for assets where there exists limited or no observable market data and, therefore, are based primarily upon the Company's or other third-party's estimates, are often calculated based on the characteristics of the asset, the economic and competitive environment and other such factors. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset. Additionally, there may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, that could significantly affect the results of current or future valuations. At September 30, 2016, the Company had \$8,000 of assets that were measured at fair value on a non-recurring basis using Level 3 measurements.

## **Income Taxes**

During the fourth quarter of fiscal 2016, the Company reversed approximately \$7.8 million representing the valuation allowance related to net deferred tax assets, which contributed to a net tax benefit for the year of \$6.0 million. The impact of the reversal and subsequent income tax benefit positively affected net income for the fourth quarter and full fiscal year 2016 results.

The reversal of the valuation allowance on net deferred tax assets was based on management's judgment that the net deferred tax asset will be realized by the Company. The Company has reported positive cumulative pre-tax earnings over the prior two year period ended September 30, 2016, representing eight quarters. These historical results in conjunction with management's expectations of future projected taxable income supported the Company's decision to reverse the valuation allowance on net deferred tax assets.

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

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

Our net deferred tax asset amounted to \$8.8 million and \$2.9 million at September 30, 2016 and at September 30, 2015, respectively. Our total deferred tax assets decreased to \$9.4 million at September 30, 2016 compared to \$11.4 million at September 30, 2015. The Company’s DTA allowance as of September 30, 2015 of \$8.0 million has decreased by \$8.0 million to \$61,000 at September 30, 2016.

### **Other-Than-Temporary Impairment of Securities**

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



## Derivatives

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

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

## Overview and Strategy

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

**Improving Core Earnings.** With interest rates falling to historically low levels, it has become increasingly difficult for financial institutions to maintain acceptable levels of net interest income. Until recently, with the Bank unable to grow its asset base and loan portfolio, increasing interest income has been a challenge. This lack of growth in the loan portfolio through fiscal year-end 2014, combined with higher deposit and borrowing costs, had contributed to a decline in the Banks' net interest margin. In an effort to achieve consistent sustainable earnings, i.e. improve the net interest margin, we have implemented specific product and pricing strategies designed to increase the yield on loans and reduce the cost of funding. In fiscal 2014, we resumed originating commercial real estate loans and commercial business loans, which have higher yields than single-family residential mortgage loans, on a relatively modest basis in accordance with our business plan and our strengthened loan underwriting and loan administration policies and procedures. We also have established a funding composition plan, which is designed to increase checking accounts, primarily non-interest bearing accounts, as well as savings and money market accounts. We are attempting to increase our core deposits, which we define as all deposit accounts other than certificates of deposit. At September 30, 2016, our core deposits amounted to 58.4% of total deposits (\$351.8 million), compared to 56.7% of total deposits (\$263.8 million) at September 30, 2015. We have continued our promotional efforts to increase core deposits. We review our deposit products on an ongoing basis and we are considering additional deposit products and are currently offering more flexible delivery options, such as mobile banking, as part of our efforts to increase core deposits. We expect to increase our commercial checking accounts and we plan to enhance our cross-marketing as part of our efforts to gain additional deposit relationships with our loan customers.

**Maintain Low Levels of Problem Assets.** We are continuing in our efforts to maintain low levels of problem assets. At September 30, 2016, our total non-performing assets in portfolio were \$2.3 million or 0.28% of total assets, reflecting a reduction of \$12.0 million, or 83.9%, compared to \$14.3 million of total non-performing assets at September 30, 2012 (when total non-performing assets amounted to 2.01% of total assets). The October 2013 bulk sale of problem loans resulted in a dramatic reduction of the Company's non-performing assets. The bulk sale was undertaken as an efficient mechanism for disposing of non-performing and underperforming assets and improving the Bank's credit quality in the process. As a result of the sale, the Company significantly reduced its exposure to sectors that experienced economic weakness and significant declines in collateral valuations and has substantially reduced the amount of non-accruing loans.

**Growing Our Loan Portfolio and Resuming Commercial Real Estate and Construction and Development Lending.** We have resumed, the origination of commercial real estate loans and construction and development loans in our market area. Such loans are being underwritten in accordance with our strengthened loan underwriting standards and our enhanced credit review and administration procedures. We continue to believe that we can be a

successful niche lender to small and mid-sized commercial borrowers and homebuilders in our market area. In light of the improvements in economic conditions and real estate values, we believe that the resumption of commercial real estate and construction and development lending in a planned, deliberative fashion with the loan underwriting and administrative enhancements that we have implemented in recent periods, together with modest loan growth, will increase our interest income and our returns in future periods.

**Increasing Market Share Penetration.** We operate in a competitive market area for banking products and services. In recent years, we have been working to increase our deposit share in Chester and Delaware counties and we increased our marketing and promotional efforts. During fiscal year 2016, we continued to execute on our business plans and have positioned the Company to take advantage of the growth activity we are achieving in our markets, which includes the opening of a full-service financial center in Villanova, Pennsylvania and a private banking / loan production office in Morristown, New Jersey. Our business plans call for us to achieve the transition to a commercial bank balance sheet. With entry into New Jersey lending market, we are working to solidify and expand the service relationship with our new customers. In our effort to increase market share as well as non-interest income, we plan to evaluate increasing our business in non-traditional products, such as wealth management.

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

## Introduction

The following introduction to Management's Discussion and Analysis highlights the principal factors that contributed to the Company's earnings performance for the year ended September 30, 2016.

The Company was proactive with its balance sheet strategies throughout fiscal 2016 in order to reduce exposure to interest rates through a reduction in higher cost funding and non-core balances in the deposit mix coupled with an improvement in the earning asset mix. The Company's progress in growing and improving its balance sheet earning asset mix has helped to expand its spread and margin.

The Company's net income in fiscal 2016 was \$11.9 million, or \$1.86 per fully diluted common share, compared to net income of \$3.7 million in fiscal 2015, or \$0.58 per fully diluted common share. In September 2016, the Company reversed approximately \$7.8 million representing the valuation allowance related to net deferred tax assets, which contributed to a net tax benefit of \$6.0 million. The impact of the reversal and subsequent income tax benefit positively affected net income for fiscal 2016. Excluding the net tax benefit of \$6.0 million, net income attributable to the Company would have been approximately \$6.0 million, or \$0.93 per fully diluted common share, for fiscal 2016. Besides the reversal of the valuation allowance, the growth in earnings performance in fiscal 2016 was primarily attributable to earnings from core operations. Earnings for fiscal 2016 and associated operating performance was characterized by solid revenue growth, loan generation and a continuation of our stable and favorable asset quality profile. Earnings were positively impacted by growth in net interest income, primarily from an increase in the average balance of earning assets of \$122.7 million, as well as an increase of eight basis points in the average yield. There was an increase of three basis points in the average rate paid on interest-bearing liabilities in fiscal 2016 compared to fiscal 2015.

For the year ended September 30, 2016, net interest income on a fully taxable equivalent basis amounted to \$18.8 million, compared to \$15.4 million for fiscal 2015. For fiscal 2016, interest income increased by \$4.9 million while interest expense increased by \$1.5 million from fiscal 2015. As noted above, in fiscal 2016 compared to fiscal 2015, the average balance of our average interest earning assets increased \$122.7 million while the net interest spread and margin increased on a tax-equivalent basis by five basis points and three basis points, respectively. For fiscal 2016, the Company's net interest margin increased to 2.65 percent as compared to 2.62 percent for fiscal 2015.

For the year ended September 30, 2016, total other income decreased \$202,000 as compared with the year ended September 30, 2015, from \$2.5 million to \$2.3 million. The decrease in fiscal 2016 was primarily a result of a \$66,000 decrease in service charges, a \$38,000 decrease in rental income, and a \$163,000 decrease in earnings on bank-owned insurance, partially offset by an increase of \$50,000 in net gains on sales of investment securities, an increase of \$14,000 in net gain on sale of loans and an increase in gain on disposal of fixed assets of \$1,000.

For the year ended September 30, 2016, total other expense decreased \$39,000, or 0.3 percent, compared to the year ended September 30, 2015. The decrease primarily reflected a \$205,000 decrease in federal deposit insurance, a \$108,000 decrease in advertising, a \$108,000 decrease in data processing expense and a \$200,000 decrease in other operating expenses. These decreases were partially offset by an increase in salaries and employee benefits of \$292,000, a \$105,000 increase in occupancy expense, a \$112,000 increase in professional fees and a \$73,000 change in other real estate owned (income) expense, net.

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

Total assets at September 30, 2016 were \$821.3 million, an increase of 25.3 percent from assets of \$655.7 million at September 30, 2015. The increase in assets primarily reflects the growth of \$182.9 million in our net loan portfolio, as well as an increase of \$56.5 million in cash and cash equivalents and a \$6.0 million increase in our deferred income taxes as a result of the reversal of the valuation allowance. These increases were partially offset by a decrease of \$78.6 million in our investment securities portfolio. The Company continued to expand its client base and loan production, deploying cash from increased deposit production into a more efficient earning asset mix. The growth in the earning asset portfolio was funded in part through deposit growth of \$136.5 million.

Our loan portfolio increased in fiscal 2016 as compared to fiscal 2015. Overall, the total portfolio increased year over year by approximately \$184.2 million or 46.7 percent from fiscal 2015. Demand for both commercial loans and real estate loans prevailed throughout the year in the Company's market in Pennsylvania and New Jersey, despite the economic climate at both the state and national levels. The increase in the total loan portfolio at September 30, 2016 compared to September 30, 2015, primarily reflected an increase of \$181.2 million in commercial loans and a \$20.8 million increase in construction and development loans. These increases were partially offset by a \$5.8 million decrease in residential mortgage loans and a \$12.0 million reduction in consumer loans at September 30, 2016 as compared to September 30, 2015. The Company is encouraged by loan demand and positive momentum is expected to continue in growing our loan portfolio in fiscal 2017. At September 30, 2016, the Company had \$107.9 million in overall undisbursed loan commitments, which includes largely unused commercial lines of credit, home equity lines of credit and available usage from active construction facilities. Included in the overall undisbursed commitments are the Company's "Approved, Accepted but Unfunded" pipeline, which includes approximately \$72.7 million in commercial real estate loans, \$13.8 million in commercial term loans and lines of credit, \$7.0 million in construction loans and \$4.0 million in residential mortgages expected to fund over the next 90 days.

Asset quality remains high and a primary focus of the Company. Even so, the stability of the economy and credit markets remains uncertain and as such, has had an impact on certain credits within our portfolio. At September 30, 2016, non-performing assets totaled \$2.3 million or 0.28 percent of total assets, a decline from \$2.6 million or 0.39 percent at September 30, 2015. The decrease was attributable to two commercial loans to one borrower with an outstanding balance of approximately \$492,000 at September 30, 2015 which were returned to accruing status during fiscal 2016, as well as \$117,000 in charge-offs, payments of \$212,000, offset in part by the addition of seven single residential loans (totaling approximately \$658,000), one commercial real estate loan (totaling approximately \$193,000) and six consumer loans (totaling approximately \$186,000) into non-accrual status. In addition, the Company reduced other real estate owned at September 30, 2016 to zero as compared to \$1.2 million at September 30, 2015. The decrease was attributable to three single residential loans and one commercial real estate loan sold during the fiscal 2016. The decrease in REO at September 30, 2016 compared to September 30, 2015, was due to \$1.2 million of sales of REO, at a net gain of \$19,000, as well as \$20,000 in reduction to fair value which are reflected in other REO expense during fiscal 2016.

At September 30, 2016, the level of the allowance was \$5.4 million compared to \$4.7 million at September 30, 2015. The allowance for loan losses as a percentage of total loans amounted to 0.94 percent at September 30, 2016 compared to 1.18 percent at September 30, 2015. We recorded \$947,000 and \$90,000, of provisions to the allowance for the years ended September 30, 2016 and 2015, respectively. The net charge-offs amounted to \$180,000 and

\$12,000 for the years ended September 30, 2016 and 2015, respectively. The allowance for loan losses as a percent of total non-performing loans amounted to 234.9 percent at September 30, 2016 and 333.6 percent at September 30, 2015. This increase in the ratio of the allowance for loan losses to total non-performing loans from September 30, 2015 to September 30, 2016 was due to the increase in the level of non-performing loans.

Deposits grew strongly during fiscal 2016, with total deposits of \$602.0 million at September 30, 2016, increasing \$136.5 million, or 29.3 percent, since September 30, 2015. Deposit growth is a result of business development efforts, our expanded market, and the higher visibility of the Bank, which have resulted in increased deposits and a broadened depositor base. Interest-bearing demand, savings, money market, and certificates of deposit less than \$100,000 increased \$75.7 million or 23.3 percent to a total of \$400.4 million at September 30, 2016 as compared to \$324.7 million at September 30, 2015. Time deposits \$100,000 and over increased \$53.3 million at September 30, 2016 as compared to September 30, 2015. Time deposits \$100,000 and over represented 27.8 percent of total deposits at September 30, 2016 compared to 24.5 percent at September 30, 2015.

Total shareholders' equity amounted to \$94.6 million, or 11.5 percent, of total assets at September 30, 2016 compared to \$81.4 million, or 12.4 percent, of total assets at September 30, 2015. Book value per common share (total common shareholders' equity divided by the number of shares outstanding) increased to \$14.42 at September 30, 2016, as compared with \$12.41 at September 30, 2015, primarily as a result of earnings of \$11.9 million in fiscal 2016.

At September 30, 2016, the Bank's common equity tier 1 ratio was 14.24 percent, tier 1 leverage ratio was 10.79 percent, tier 1 risk-based capital ratio was 14.24 percent and the total risk-based capital ratio was 15.16 percent. At September 30, 2015, the Bank's common equity tier 1 ratio was 15.90 percent, tier 1 leverage ratio was 10.80 percent, tier 1 risk-based capital ratio was 15.90 percent and the total risk-based capital ratio was 16.99 percent. At September 30, 2016, the Bank was in compliance with all applicable regulatory capital requirements.

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

### Results of Operations

Net income for the year ended September 30, 2016 was \$11.9 million as compared to \$3.7 million earned in fiscal 2015 and \$323,000 earned in fiscal 2014. Out net income for fiscal 2016 increased by 222.9 percent compared to fiscal 2015. For fiscal 2016, the fully diluted earnings per common share was \$1.86 as compared with \$0.58 per share in fiscal 2015 and \$0.05 per share in fiscal 2014.

For the year ended September 30, 2016, the Company's return on average shareholders' equity ("ROE") was 14.05 percent and its return on average assets ("ROA") was 1.59 percent. The comparable ratios for the year ended September 30, 2015, were ROE of 4.65 percent and ROA of 0.60 percent.

Earnings for fiscal 2016 benefitted from the reversal of the valuation allowance related to net deferred tax assets and the increase in net interest income. The decreases in non interest income, primarily in service charges and other fees, rental income and earnings on bank owned life insurance, which were partially offset by an increase in net gain on sale of investments and net gain on sale of loans. The decrease in non-interest expenses was due to decreases in FDIC insurance, advertising expenses, data processing expense and other operating expenses. These decreases were partially offset by increases in salaries and benefits, occupancy expenses, professional fees and OREO expenses.

### Use of Non-GAAP Disclosures

Reported amounts are presented in accordance with U.S. GAAP. The Company's management believes that the supplemental non-GAAP information contained herein, including the efficiency ratio, are utilized by regulators and market analysts to evaluate a company's financial condition and therefore, such information is useful to investors. These disclosures should not be viewed as a substitute for financial results determined in accordance with U.S.



GAAP, nor are they necessarily comparable to non-GAAP performance measures which may be presented by other companies.

### **Net Interest Income**

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

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

(Dollars in thousands)	Year Ended September 30, 2016			2015			2014		
	Amount	Increase (Decrease) from Prior Year	Percent Change	Amount	Increase (Decrease) from Prior Year	Percent Change	Amount	Increase (Decrease) from Prior Year	Percent Change
Interest income:									
Loans, including fees	\$21,216	\$4,724	28.64	\$16,492	\$(1,251)	(7.05)	\$17,743	\$(2,436)	(12.07)
Investment securities	3,830	57	1.51	3,773	1,470	63.83	2,303	252	12.29
Dividends, restricted stock	250	(61)	(19.61)	311	188	152.85	123	104	547.37
Interest-bearing cash accounts	213	141	195.83	72	18	33.33	54	(83)	(60.58)
Total interest income	25,509	4,861	23.54	20,648	425	2.10	20,223	(2,163)	(9.66)
Interest expense:									
Deposits	4,537	1,106	32.24	3,431	(538)	(13.56)	3,969	(1,310)	(24.82)
Borrowings	2,195	378	20.80	1,817	715	64.88	1,102	(563)	(33.81)
Total interest expense	6,732	1,484	28.28	5,248	177	3.49	5,071	(1,873)	(26.97)
Net interest income on a fully tax-equivalent basis	18,777	3,377	21.93	15,400	248	1.64	15,152	(290)	(1.88)
Tax-equivalent adjustment <sup>(1)</sup>	(265)	(79)	42.47	(186)	(130)	232.14	(56)	29	(34.12)
Net interest income, as reported under GAAP	\$18,512	\$3,298	21.68	\$15,214	\$118	0.78	\$15,096	\$(261)	(1.70)

<sup>(1)</sup> Computed using a federal income tax rate of 34 percent for Years ended September 30, 2016, 2015 and 2014.

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

Net interest income, on a tax-equivalent basis, for the year ended September 30, 2016 increased \$3.4 million, or 21.9 percent, to \$18.8 million, from \$15.4 million for fiscal 2015. The Company's net interest margin increased three basis points to 2.65 percent in fiscal 2016 from 2.62 percent for the fiscal year ended September 30, 2015. From fiscal 2014 to fiscal 2015, net interest income on a tax equivalent basis increased by \$248,000 and the net interest margin decreased by 12 basis points. During fiscal 2016, our net interest margin was impacted by increases in the yield on investments and interest-bearing cash accounts, as well as increase in the cost of deposits and decreases in the yield on loans and FHLB stock, as well as decrease in the cost of borrowings.

The change in net interest income during fiscal 2016 was attributable in part to the reduction in short-term interest rates that have remained at historic low levels throughout 2016 coupled with a sustained steepening of the interest rate yield curve. The Company experienced growth of \$7.5 million in non-interest bearing deposits during fiscal 2016 and \$75.7 million in interest-bearing demand, savings, money market and time deposits under \$100,000 during fiscal 2016 as customers' desire for safety and liquidity remained paramount in light of their overall investment concerns. During the twelve months ended September 30, 2016, the Company's net interest spread increased by five basis points reflecting an eight basis points increase in the average yield on interest-earning assets as well as a three basis point increase in the average interest rates paid on interest-bearing liabilities.

For the year ended September 30, 2016, average interest-earning assets increased by \$122.7 million to \$709.5 million, as compared with the year ended September 30, 2015. The fiscal 2016 change in average interest-earning asset volume was primarily due to increased loan volume. Average interest-bearing liabilities increased by \$123.7 million in fiscal 2016 compared to fiscal 2015, due primarily to an increase in average interest bearing deposits of \$99.7 million and a \$24.0 million increase in average borrowings.

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

The factors underlying the year-to-year changes in net interest income are reflected in the tables presented on pages 28 and 29, each of which have been presented on a tax-equivalent basis (assuming a 34 percent tax rate for fiscal 2016, 2015 and 2014). The table on page 31 (Average Statements of Condition with Interest and Average Rates) shows the Company's consolidated average balance of assets, liabilities and shareholders' equity, the amount of income produced from interest-earning assets and the amount of expense incurred from interest-bearing liabilities, and net interest income as a percentage of average interest-earning assets.

### Net Interest Margin

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

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

(In thousands)	Fiscal 2016/2015 Increase (Decrease) Due to Change in:			Fiscal 2015/2014 Increase (Decrease) Due to Change in:		
	Average Volume	Average Rate	Net Change	Average Volume	Average Rate	Net Change
Interest-earning assets:						
Loans, including fees	\$5,313	\$ (589 )	\$ 4,724	\$(1,005)	\$(246 )	\$(1,251 )
Investment securities	(202 )	259	57	802	668	1,470
Interest-bearing cash accounts	12	129	141	30	(12 )	18
Dividends, restricted stock	62	(123 )	(61 )	38	150	188
Total interest-earning assets	5,185	(324 )	4,861	(135 )	560	425
Interest-bearing liabilities:						
Money market deposits	246	357	603	20	87	107
Savings deposits	—	3	3	—	2	2
Certificates of deposit	432	12	444	(423 )	(222 )	(645 )

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Other interest-bearing deposits	3	53	56	—	(2 )	(2 )
Total interest-bearing deposits	681	425	1,106	(403 )	(135 )	(538 )
Borrowings	475	(97 )	378	1,141	(426 )	715
Total interest-bearing liabilities	1,156	328	1,484	738	(561 )	177
Change in net interest income	\$4,029	\$ (652 )	\$ 3,377	\$ (873 )	\$ 1,121	\$ 248

Interest income on a tax-equivalent basis for the year ended September 30, 2016 increased by approximately \$4.9 million or 23.5 percent as compared with the year ended September 30, 2015. This increase was due primarily to increases in the balances of the Company's loans.

The average balance of the Company's loan portfolio increased \$123.8 million in fiscal 2016 to \$508.0 million from \$384.1 million in fiscal 2015, primarily driven by an increase in commercial real estate loans.

The average loan portfolio represented approximately 71.6 percent of the Company's interest-earning assets (on average) during fiscal 2016 and 65.5 percent for fiscal 2015. Average investment securities decreased during fiscal 2016 by \$8.5 million compared to fiscal 2015. The average yield on interest-earning assets increased from 3.52 percent in fiscal 2015 to 3.60 percent in fiscal 2016.

Interest income (tax-equivalent) increased by \$425,000 from fiscal 2014 to fiscal 2015 primarily due to increases in the balances of the Company's investment securities portfolios offset in part by a decrease in loans and a decline in rates due to the actions taken by the Federal Reserve to maintain historically low market interest rates.

Interest expense for the year ended September 30, 2016 was principally impacted by both volume and rate mix related factors. The changes resulted in increased expense of \$1.5 million due to an increase in deposits and borrowings in fiscal 2016. Average interest-bearing liabilities increased \$123.7 million from fiscal 2015 to fiscal 2016. For the year ended September 30, 2015, interest expense increased \$177,000, or 3.5 percent as compared with fiscal 2014, principally reflecting an increase in borrowings partially offset by a decline in certificates of deposit. Average interest-bearing liabilities increased \$27.6 million from fiscal 2014 to fiscal 2015.

The Company's net interest spread on a tax-equivalent basis (i.e., the average yield on average interest-earning assets, calculated on a tax equivalent basis, minus the average rate paid on interest-bearing liabilities) increased five basis points to 2.53 percent in fiscal 2016 from 2.48 percent for the year ended September 30, 2015. The increase in fiscal 2016 reflected an increase of spreads between yields earned on investments and interest-bearing cash accounts and rates paid for supporting funds.

The net interest spread decreased 11 basis points in fiscal 2015 as compared with fiscal 2014, primarily as a result of a decline of spreads between yields earned on loans and investments and rates paid for supporting funds.

The cost of total average interest-bearing liabilities increased to 1.07 percent, an increase of three basis points, for the year ended September 30, 2016, from 1.04 percent for the year ended September 30, 2015, which followed a decrease of two basis points from 1.06 percent for the year ended September 30, 2014.

The following table, "Average Statements of Condition with Interest and Average Rates", on a tax-equivalent basis presents for the years ended September 30, 2016, 2015 and 2014, 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,								
	2016			2015			2014		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)								
<b>ASSETS</b>									
Interest earning assets:									
Loans receivable <sup>(1)</sup>	\$507,973	\$21,216	4.18%	\$384,125	\$16,492	4.29%	\$407,169	\$17,743	4.36%
Investment securities	149,812	3,830	2.56	158,282	3,773	2.38	117,366	2,303	1.96
Deposits in other banks	46,429	213	0.46	39,975	72	0.18	25,714	54	0.21
FHLB stock	5,243	250	4.77	4,369	311	7.12	3,342	123	3.68
Total interest earning assets <sup>(1)</sup>	709,457	25,509	3.60	586,751	20,648	3.52	553,591	20,223	3.65
Non-interest earning assets									
Cash and due from banks	15,585			7,003			1,356		
Bank owned life insurance	18,165			18,492			21,092		
Other assets	14,177			13,592			14,164		
Allowance for loan losses	(4,968 )			(4,610 )			(4,893 )		
Total non-interest earning assets	42,959			34,477			31,719		
Total assets	\$752,416			\$621,228			\$585,310		
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>									
Interest bearing liabilities:									
Money Market accounts	\$138,997	\$874	0.63%	\$72,467	\$271	0.37%	\$64,499	\$164	0.25%
Savings accounts	45,060	32	0.07	44,975	29	0.06	44,379	27	0.06
Certificate accounts	239,810	3,492	1.46	209,994	3,048	1.45	237,090	3,693	1.56
Other interest-bearing deposits	90,054	139	0.15	86,814	83	0.10	87,283	85	0.10
Total deposits	513,921	4,537	0.88	414,250	3,431	0.83	433,251	3,969	0.92
Borrowed funds	115,598	2,195	1.90	91,588	1,817	1.98	45,007	1,102	2.45
Total interest-bearing liabilities	629,519	6,732	1.07	505,838	5,248	1.04	478,258	5,071	1.06
Non-interest bearing liabilities									
Demand deposits	31,263			28,650			25,499		
Other liabilities	6,620			7,163			5,733		
Total non-interest-bearing liabilities	37,883			35,813			31,232		
Shareholders' equity	85,014			79,577			75,820		
Total liabilities and shareholders' equity	\$752,416			\$621,228			\$585,310		
Net interest income (tax-equivalent basis)		\$18,777			\$15,400			\$15,152	
Net interest spread			2.53%			2.48%			2.59%

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Net interest margin		2.65%		2.62%		2.74%
Tax-equivalent adjustment <sup>(2)</sup>	(265 )		(186 )		(56 )	
Net Interest income	\$18,512		\$15,214		\$15,096	

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

(2) The tax-equivalent adjustment was computed based on a statutory Federal income tax rate of 34 percent for fiscal years 2016, 2015 and 2014.

-31-



## Investment Portfolio

At September 30, 2016, the principal components of the investment portfolio were U.S. Government agency obligations, Federal agency obligations including mortgage-backed securities, obligations of U.S. states and political subdivision, corporate securities, trust preferred security and equity securities. At September 30, 2016, the total investment portfolio amounted to \$106.9 million, a decrease of \$78.6 million from September 30, 2015. The decrease in the investment portfolio was primarily the result of available-for-sale investment securities sold during fiscal 2016.

For the year ended September 30, 2016, the average volume of investment securities decreased by \$8.5 million to approximately \$149.8 million or 21.1 percent of average earning assets, from \$158.3 million on average, or 27.0 percent of average earning assets, in fiscal 2015.

During the year ended September 30, 2016, volume related factors decreased investment revenue by \$202,000, while rate related factors increased investment revenue by \$259,000. The tax-equivalent yield on investments increased by 18 basis points to 2.56 percent from a yield of 2.38 percent during the year ended September 30, 2015. The decrease in the investment portfolio was attributed to the sales, amortization, and calls recorded during fiscal 2016. The yield on the portfolio increased in fiscal 2016 compared to fiscal 2015 due primarily to higher rates earned on taxable securities.

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

As of September 30, 2016, the estimated fair value of the available-for-sale securities disclosed below was primarily dependent upon the movement in market interest rates, particularly given the negligible inherent credit risk associated with these securities. These investment securities are comprised of securities that are rated investment grade by at least one bond credit rating service. Although the fair value will fluctuate as the market interest rates move, management believes that these fair values will recover as the underlying portfolios mature and are reinvested in market rate yielding investments. As of September 30, 2016, the Company held two municipal bonds, nine corporate securities, 15 mortgage-backed securities and one single issuer trust preferred security which were in an unrealized loss position. The Company does not intend to sell and expects that it is not more likely than not that it will be required to sell these securities until such time as the value recovers or the securities mature. Management does not believe any individual unrealized loss as of September 30, 2016 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 2016, proceeds of investment securities sold amounted to approximately \$62.8 million. Gross realized gains on investment securities sold amounted to approximately \$595,000, while gross realized losses amounted to approximately \$30,000, for the period. For fiscal 2015, proceeds of investment securities sold amounted to approximately \$70.4 million. Gross realized gains on investment securities sold amounted to approximately \$610,000, while gross realized losses amounted to approximately \$95,000, for the period. For fiscal 2014, proceeds of investment securities sold amounted to approximately \$16.8 million. Gross realized gains on investment securities sold amounted to approximately \$118,000, while gross realized losses amounted to approximately \$35,000, for the period.

The varying amount of sales from the available-for-sale portfolio over the past few years, and the significant volume of such sales in fiscal 2016, reflect the significant volatility present in the market. Given the historic low interest rates prevalent in the market, it is necessary for the Company to protect itself from interest rate exposure. Securities that once appeared to be sound investments can, after changes in the market, become securities that the Company has the flexibility to sell to avoid losses and mismatches of interest-earning assets and interest-bearing liabilities at a later time.

The table below illustrates the maturity distribution and weighted average yield on a tax-equivalent basis for investment securities at September 30, 2016 on a contractual maturity basis.

	One year or less		More than One Year through Five Years		More than Five Years through Ten Years		More than Ten Years		Total		
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Fair Value	Weighted Average Yield
(Dollars in thousands)											
Available for Sale Securities:											
State and municipal obligations	\$-	- %	\$3,868	2.34 %	\$11,573	2.26 %	\$9,310	2.25 %	\$24,751	\$25,307	2.27 %
Single issuer trust preferred security	-	-	-	-	-	-	1,000	1.38	1,000	878	1.38
Corporate debt securities	-	-	20,596	2.65	19,593	3.33	-	-	40,189	40,202	2.98
Total	\$-	- %	\$24,464	2.60 %	\$31,166	2.93 %	\$10,310	2.17 %	\$65,940	\$66,387	2.69 %
Held to Maturity Securities:											
U.S. government agencies and obligations	\$-	- %	2,999	1.22 %	\$-	- %	\$-	- %	\$2,999	3,015	1.22 %
State and municipal obligations	-	-	-	-	1,212	2.30	8,614	1.54	9,826	9,992	1.64
Corporate debt securities	-	-	-	-	3,916	3.82	-	-	3,916	3,993	3.82
Mortgage-backed securities	-	-	-	-	-	-	23,810	1.78	23,810	23,817	1.78
Total	\$-	- %	\$2,999	1.22 %	\$5,128	3.46 %	\$32,424	1.71 %	40,551	40,817	1.90 %
Total Investment Securities	\$-	- %	\$27,463	2.45 %	\$36,294	3.01 %	\$42,734	1.82 %	\$106,491	\$107,204	2.39 %

For information regarding the carrying value of the investment portfolio, see Note 5 and Note 11 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 three years.

(In thousands)	2016	2015	2014
<b>Investment Securities Available-for-Sale:</b>			
U.S. government agencies	\$—	\$815	\$19,256
State and municipal obligations	25,307	42,083	2,500
Single issuer trust preferred security	878	850	880
Corporate debt securities	40,202	69,982	1,525
<b>Mortgage-backed securities:</b>			
Federal National Mortgage Association	—	8,692	17,226
Federal Home Loan Mortgage Company	—	5,932	15,591
Collateralized mortgage obligations	—	—	43,965
Total available-for-sale	\$66,387	\$128,354	\$100,943
<b>Investment Securities Held-to-Maturity:</b>			
U.S. government agencies	\$2,999	\$14,301	\$—
State and municipal obligations	9,826	10,075	—
Corporate debt securities	3,916	4,011	—
<b>Mortgage-backed securities:</b>			
Collateralized mortgage obligations, fixed-rate	23,810	28,834	—
Total held-to-maturity	\$40,551	\$57,221	\$—
<b>Total investment securities</b>	<b>\$106,938</b>	<b>\$185,575</b>	<b>\$100,943</b>

For information regarding the Company's investment portfolio, see Note 5 and Note 11 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. Growth is generated through business development efforts, repeat customer requests for new financings, penetration into existing markets and entry into new markets.

At September 30, 2016, total gross loans amounted to \$578.4 million, an increase of \$184.2 million or 46.7 percent as compared to September 30, 2015. For the year ended September 30, 2016, growth of \$181.2 million in commercial loans and \$20.8 million in construction and development loans were partially offset by decreases of \$5.8 million in residential mortgage loans and \$12.0 million in total consumer loans. Even though the Company continues to be challenged by the competition for lending relationships that exist within its market, growth in volume has been achieved through successful lending sales efforts to build on continued customer relationships.

Total average loan volume increased \$123.8 million or 32.2 percent in fiscal 2016, while the portfolio yield decreased by 11 basis points compared with fiscal 2015. The increased total average loan volume was due in part to enhanced visibility in the Company's markets coupled with the aggressive business development activities of its sales team and the opening of our location in Villanova, Pennsylvania, and our Private Banking Loan Production headquarters in Morristown, New Jersey. The volume related factors during the period contributed increased revenue of \$5.3 million, while the rate related changes decreased revenue by \$589,000. Total average loan volume increased to \$508.0 million with a net interest yield of 4.18 percent, compared to \$384.1 million with a yield of 4.29 percent for the year ended September 30, 2015. The Company seeks to create growth in commercial lending by offering sound products and competitive pricing and by capitalizing on new and existing relationships in its market area. Products are offered to meet the financial requirements of the Company's clients. It is the objective of the Company's credit policies to diversify the commercial loan portfolio to limit concentrations in any single industry.

The loan 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 home-owner. 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 mortgages include loans secured by first liens on residential real estate, and are generally made to existing customers of the Bank to purchase or refinance primary and secondary residences. Our residential real estate loans totaled \$209.2 million at September 30, 2016, a decrease of \$5.8 million, or 2.7%, compared to \$215.0 million at September 30, 2015.

*Construction and Development Loans.* Construction and development loans are loans to finance the construction of commercial or residential properties secured by first liens on such properties. 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 totaled \$28.6 million at September 30, 2016, an increase of \$20.8 million, or 265.7%, compared to \$7.8 million at September 30, 2015.

At September 30, 2016, our residential and commercial construction loans totaled \$18.6 million, an increase of \$12.9 million, or 227.3 percent, compared to \$5.7 million at September 30, 2015. Our land loans totaled \$10.0 million, an increase of \$7.9 million or 367.5 percent, compared to \$2.1 million at September 30, 2015.

*Commercial Lending.* 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 real estate loans include loans secured by first liens on completed commercial properties, including multi-family properties, to purchase or refinance such properties.

Our commercial real estate totaled \$231.4 million at September 30, 2016, an increase of \$143.8 million, or 163.9 percent, compared to \$87.7 million at September 30, 2015.

Our multi-family loans totaled \$19.5 million at September 30, 2016, an increase of \$12.1 million or 162.2 percent, compared to \$7.4 million at September 30, 2015.

Our commercial business loans totaled \$38.8 million at September 30, 2016, an increase of \$25.4 million or 189.8 percent, compared to \$13.4 million at September 30, 2015.

*Consumer Lending.* In our efforts to provide a full range of financial services to our customers, we offer automobile loans, unsecured personal loans and loans secured by deposits.

Our consumer loans totaled \$50.9 million at September 30, 2016, a decrease of \$12.0 million, or 19.1 percent, compared to \$62.9 million at September 30, 2015. Our home equity loans totaled \$19.8 million at September 30, 2016, a decrease of \$3.2 million, or 13.8 percent, compared to \$22.9 million at September 30, 2015. Second mortgages totaled \$29.2 million at September 30, 2016, a decrease of \$8.4 million or 22.4 percent, compared to \$37.6 million at September 30, 2015.

The following table presents information regarding the components of the Company's loan portfolio on the dates indicated.

	September 30,				
	2016	2015	2014	2013	2012
	(In thousands)				
Residential mortgage	\$209,186	\$214,958	\$231,324	\$239,900	\$231,803
Construction and Development:					
Residential and commercial	18,579	5,677	5,964	6,672	20,500

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Land	10,013	2,142	1,033	2,439	632
Total construction and development	28,592	7,819	6,997	9,111	21,132
Commercial:					
Commercial real estate	231,439	87,686	71,579	70,571	112,199
Multi-family	19,515	7,444	1,032	1,971	2,087
Other	38,779	13,380	5,480	5,573	7,517
Total commercial	289,733	108,510	78,091	78,115	121,803
Consumer:					
Home equity lines of credit	19,757	22,919	22,292	20,431	20,959
Second mortgages	29,204	37,633	47,034	54,532	65,703
Other	1,914	2,359	2,839	2,648	762
Total consumer	50,875	62,911	72,165	77,611	87,424
Total loans	578,386	394,198	388,577	404,737	462,162
Deferred loan fees and costs, net	1,208	1,776	2,086	2,210	2,420
Allowance for loan losses	(5,434 )	(4,667 )	(4,589 )	(5,090 )	(7,581 )
Loans receivable, net	\$574,160	\$391,307	\$386,074	\$401,857	\$457,001



The following table presents the contractual maturity of our loans held in portfolio at September 30, 2016. 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, 2016, Maturing			
	In One Year or Less	After One Years Through Five Years	After Five Years	Total
	(In thousands)			
Residential mortgage	\$ 136	\$ 5,850	\$ 203,200	\$ 209,186
Construction and Development:				
Residential and commercial	8,975	1,975	7,629	18,579
Land	—	10,013	—	10,013
Total construction and development	8,975	11,988	7,629	28,592
Commercial:				
Commercial real estate	10,420	49,647	171,372	231,439
Multi-family	62	7,033	12,420	19,515
Other	1,275	33,281	4,223	38,779
Total commercial	11,757	89,961	188,015	289,733
Consumer:				
Home equity lines of credit	—	—	19,757	19,757
Second mortgages	19	2,912	26,273	29,204
Other	44	1,493	377	1,914
Total consumer	63	4,405	46,407	50,875
Total	\$ 20,931	\$ 112,204	\$ 445,251	\$ 578,386
Loans with:				
Fixed rates	\$ 880	\$ 22,591	\$ 277,571	\$ 301,042
Variable rates	20,051	89,613	167,680	277,344
Total	\$ 20,931	\$ 112,204	\$ 445,251	\$ 578,386

For additional information regarding loans, see Note 6 of the Notes to the Consolidated Financial Statements.

#### Allowance for Loan Losses and Related Provision

The allowance for loan losses is a reserve established through charges to earnings in the form of a provision for loan losses. We maintain an allowance for loan losses at a level considered adequate to provide for all known and probable incurred losses in the portfolio. The level of the allowance is based on management's evaluation of estimated losses in the portfolio, after consideration of risk characteristics of the loans and prevailing and anticipated economic

conditions. Loan charge-offs (i.e., loans judged to be uncollectible) are charged against the reserve and any subsequent recovery is credited. Our officers analyze risks within the loan portfolio on a continuous basis and through an external independent loan review function, and the results of the loan review function are also reviewed by our Audit Committee. A risk system, consisting of multiple grading categories for each portfolio class, is utilized as an analytical tool to assess risk and appropriate reserves. In addition to the risk system, management further evaluates risk characteristics of the loan portfolio under current and anticipated economic conditions and considers such factors as the financial condition of the borrower, past and expected loss experience, and other factors which management feels deserve recognition in establishing an appropriate reserve. These estimates are reviewed at least quarterly and, as adjustments become necessary, they are recognized in the periods in which they become known. Although management strives to maintain an allowance it deems adequate, future economic changes, deterioration of borrowers' creditworthiness, and the impact of examinations by regulatory agencies all could cause changes to our allowance for loan losses.

At September 30, 2016, the allowance for loan losses was \$5.4 million, an increase of \$767,000 or 16.4%, from \$4.7 million for the year ended September 30, 2015. Net charge-offs totaled \$180,000 during fiscal 2016 and \$12,000 for fiscal 2015. The allowance for loan losses as a percentage of loans receivable was 0.94% at September 30, 2016 and 1.18% at September 30, 2015.

## 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,				
	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Average loans outstanding	\$507,973	\$384,125	\$407,169	\$447,196	\$481,424
Total loans at end of period	\$578,386	\$394,198	\$388,577	\$404,737	\$462,162
Analysis of the Allowance of Loan Losses					
Balance at beginning of year	\$4,667	\$4,589	\$5,090	\$7,581	\$10,101
Charge-offs:					
Residential mortgage	9	—	83	994	1,367
Construction and Development:					
Residential and commercial	91	1	37	5,768	826
Land	—	—	—	99	—
Commercial:					
Commercial real estate	99	48	183	6,315	951
Multi-family	—	—	—	—	113
Other	—	—	—	94	88
Consumer:					
Home equity lines of credit	—	—	14	—	72
Second mortgages	291	138	618	1,042	1,184
Other	70	34	6	9	22
Total charge-offs	560	221	941	14,321	4,623
Recoveries:					
Residential mortgage	17	17	23	199	—
Construction and Development:					
Residential and commercial	243	98	1	—	1,139
Commercial:					
Commercial real estate	3	9	9	117	5
Other	3	3	3	23	2
Consumer:					
Home equity lines of credit	1	2	1	17	2
Second mortgages	100	69	136	235	141
Other	13	11	4	4	4
Total recoveries	380	209	177	595	1,293
Net charge-offs	180	12	764	13,726	3,330
Provision for loan losses	947	90	263	11,235	810
Balance at end of year	\$5,434	\$4,667	\$4,589	\$5,090	\$7,581
	0.04	% 0.00	% 0.19	% 3.07	% 0.60
					%

Ratio of net charge-offs during the year to average  
loans outstanding during the year

Allowance for loan losses as a percentage of total loans at end of year	0.94	%	1.18	%	1.18	%	1.26	%	1.64	%
--	------	---	------	---	------	---	------	---	------	---

For additional information regarding loans, see Note 6 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, 2016		2015		2014		2013		2012	
	Loans to Total Amount Loans	%	Loans to Total Amount Loans	%	Loans to Total Amount Loans	%	Loans to Total Amount Loans	%	Loans to Total Amount Loans	%
Residential mortgage	\$1,201	36.2	\$1,486	54.5	\$1,672	59.5	\$1,414	59.3	\$1,487	50.2
Construction and Development:										
Residential and commercial	199	3.2	30	1.5	291	1.5	164	1.6	724	4.4
Land loans	97	1.7	35	0.5	13	0.3	56	0.6	11	0.1
Commercial:										
Commercial real estate	1,874	40.0	1,235	22.2	1,248	18.4	1,726	17.4	3,493	24.3
Multi-family	109	3.4	104	1.9	29	0.3	40	0.5	10	0.5
Other	158	6.7	108	3.4	50	1.4	59	1.4	226	1.6
Consumer:										
Home equity lines of credit	116	3.4	139	5.8	168	5.8	137	5.0	160	4.5
Second mortgages	467	5.0	761	9.6	1,033	12.1	1,393	13.5	1,389	14.2
Other	34	0.4	24	0.6	23	0.7	22	0.7	16	0.2
Total allocated	4,255	100.0	3,922	100.0	4,527	100.0	5,011	100.0	7,516	100.0
Unallocated	1,179	-	745	-	62	-	79	-	65	-
Balance at end of period	\$5,434	100.0	\$4,667	100.0	\$4,589	100.0	\$5,090	100.0	\$7,581	100.0

#### 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, delinquencies, and potential problem loans, 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 cash flows, 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 be restored to an accruing basis when it again becomes well-secured, all past due amounts have been collected and the borrower continues to make payments for the next six months on a timely basis. 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. In general, it is the policy of management 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. Non-performing assets include non-performing loans and other real estate owned. Troubled debt restructured loans represent loans to borrowers experiencing financial difficulties on which a concession was granted, such as a reduction in interest rate which is lower than the current market rate for new debt with similar risks, or modified repayment terms, and are performing under the restructured terms. Such loans, as long as they are performing in accordance with their restructured terms, are not included within the Company's non-performing loans. For additional information regarding loans, see Note 6 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, other real estate owned ("OREO") and troubled debt restructurings.

	At September 30,				
	2016	2015	2014	2013	2012
	(In thousands)				
Non-accrual loans	\$1,617	\$1,399	\$2,391	\$1,901	\$9,749
Accruing loans past due 90 days or more	696	—	—	—	—
Total non-performing loans	2,313	1,399	2,391	1,901	9,749
Other real estate owned	—	1,168	1,964	3,962	4,594
Total non-performing assets	\$2,313	\$2,567	\$4,355	\$5,863	\$14,343
Troubled debt restructured loans — performing	\$2,039	\$1,091	\$1,009	\$1,346	\$8,187

At September 30, 2016, non-performing assets totaled \$2.3 million, or 0.28% of total assets, as compared with \$2.6 million, or 0.39%, at September 30, 2015. The reduction in non-performing assets from September 30, 2015 was attributable to two commercial loans to one borrower with an outstanding balance of approximately \$492,000 at September 30, 2015 which were returned to accruing status during fiscal 2016, as well as, \$117,000 in charge-offs, payments of \$212,000, offset in part by the addition of seven single residential loans (totaling approximately \$658,000), one commercial real estate loan (totaling approximately \$193,000) and six consumer loans (totaling approximately \$186,000) into non-accrual status. In addition, the Company reduced other real estate owned at September 30, 2016 to zero as compared to \$1.2 million at September 30, 2015. The decrease was attributable to three single residential loans and one commercial real estate loan sold during the fiscal 2016. The decrease in REO at September 30, 2016 compared to September 30, 2015, was due to \$1.2 million of sales of REO, at a net gain of \$19,000, as well as \$20,000 in reduction to fair value which are reflected in other REO expense during fiscal 2016.

Troubled debt restructured loans, totaled \$2.2 million and \$1.6 million at September 30, 2016 and at September 30, 2015. A total of \$2.0 and \$1.1 million of troubled debt restructured loans were performing pursuant to the terms of their respective modifications at September 30, 2016 and September 30, 2015, respectively. At September 30, 2016, all except one troubled debt restructured loan with an outstanding balance of approximately \$139,000, were deemed performing, while \$492,000 in troubled debt restructured loans were deemed non-performing at September 30, 2015. The increase in performing troubled debt restructured loans at September 30, 2016 compared to September 30, 2015 was primarily due to the two commercial loans to one borrower, with an outstanding balance of approximately \$492,000 at September 30, 2015, being returned to accruing status, as well as one residential mortgage loan with an outstanding balance of \$85,000 and one commercial loan with an outstanding balance of \$386,000 being classified as a performing TDR fiscal 2016.

Total non-performing assets decreased \$1.8 million from September 30, 2014 to September 30, 2015. The reduction in non-performing assets from September 30, 2014 was achieved notwithstanding the addition of one new residential loan (totaling approximately \$40,000), one construction and development loan (totaling approximately \$12,000), two

commercial loans (totaling approximately \$97,000), and two second mortgage loans (totaling approximately \$41,000) into non-performing status. This was more than offset by decreases from pay-downs and pay offs of \$527,000 of non-performing loans and the return to performing status of \$368,000, while \$288,000 was moved within the non-performing asset category from non-accrual to OREO. We also sold OREO properties with an aggregate carrying value of \$1.1 million with a gain of approximately \$124,000 during fiscal 2015.



## Other Income

The following table presents the principal categories of non-interest income for each of the years in the three-year period ended September 30, 2016.

	Year Ended September 30,							
	2016	2015	Increase (Decrease)	% Change	2015	2014	Increase (Decrease)	% Change
	(Dollars in thousands)							
Service charges and other fees	\$923	\$989	\$ (66 )	(6.67 )%	\$989	\$947	\$ 42	4.44 %
Rental income-other	211	249	(38 )	(15.26 )	249	255	(6 )	(2.35 )
Gain on sale of investments, net	565	515	50	9.71	515	83	432	520.48
Gain (loss) on disposal of fixed assets	1	—	1	100.00	—	(41 )	41	100.00
Gain on sale of loans, net	116	102	14	13.73	102	352	(250 )	(71.02 )
Earnings on bank-owned life insurance	517	680	(163 )	(23.97 )	680	559	121	21.65
Total other income	\$2,333	\$2,535	\$ (202 )	(7.97 )%	\$2,535	\$2,155	\$ 380	17.64 %

For the year ended September 30, 2016, total other income decreased \$202,000 compared to fiscal 2015. This was primarily as a result of a \$66,000 decrease in service charges, a \$38,000 decrease in rental income, and a \$163,000 decrease in earnings on bank-owned insurance, partially offset by an increase of \$50,000 in net gains on sales of investment securities, an increase of \$14,000 in net gain on sale of loans and an increase in gain on disposal of fixed assets of \$1,000. Excluding net securities gains and losses, a non-GAAP measure, the Company recorded other income of \$1.8 million for the twelve months ended September 30, 2016 compared to \$2.0 million for the comparable period in fiscal 2015, a decrease of \$252,000, or 12.5 percent.

For fiscal 2015, other income increased by \$380,000 compared to fiscal 2014, primarily as a result of \$432,000 increase in net securities gains, an increase of \$42,000 in service charges on deposit accounts, an increase in bank owned life insurance income of \$121,000 and a decrease of \$41,000 in loss of disposal of fixed assets, offset in part by decreased income on rental income, and net gain on sale of loans. Excluding net securities gains and losses, a non-GAAP measure, the Company had recorded other income of \$2.0 million for the year ended September 30, 2015 compared to other income, excluding net securities gains and losses, of \$2.1 million for fiscal 2014, representing an increase of \$52,000 or 2.5 percent.

The Company's other income is presented in the table below excluding net investment security gains.

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

	For the Year Ended September 30,		
	2016	2015	2014
	(In thousands)		
Other income (GAAP basis)	\$ 2,333	\$ 2,535	\$ 2,155
Less: Net investment securities gains	565	515	83
Other income, excluding net investment securities gain (Non-GAAP)	\$ 1,768	\$ 2,020	\$ 2,072

-40-

## Other Expense

The following table presents the principal categories of other expense for each of the years in the three-year period ended September 30, 2016.

	Year Ended September 30,							
	2016	2015	Increase (Decrease)	% Change	2015	2014	Increase (Decrease)	% Change
	( Dollars in thousands)							
Salaries and employee benefits	\$6,290	\$5,998	\$ 292	4.87 %	\$5,998	\$7,770	\$ (1,772 )	(22.81 )%
Occupancy expense	1,820	1,715	105	6.12	1,715	2,091	(376 )	(17.98 )
Federal deposit insurance premium	579	784	(205 )	(26.15 )	784	735	49	6.67
Advertising	131	239	(108 )	(45.19 )	239	561	(322 )	(57.40 )
Data processing	1,128	1,236	(108 )	(8.74 )	1,236	1,245	(9 )	(0.70 )
Professional fees	1,683	1,571	112	7.13	1,571	2,205	(634 )	(28.75 )
Other real estate owned expense, net	27	(46 )	73	(158.70)	(46 )	(299 )	253	(84.62 )
Other operating expense	2,264	2,464	(200 )	(8.12 )	2,464	2,336	128	5.48
Total other expense	\$13,922	\$13,961	\$ (39 )	(0.28 )%	\$13,961	\$16,644	\$ (2,683 )	(16.12 )%

Total other expense decreased \$39,000, or 0.3 percent, in fiscal 2016 from fiscal 2015 as compared with a decrease of \$2.7 million, or 16.1 percent, from fiscal 2014 to fiscal 2015. Decreases in fiscal 2016 compared to fiscal 2015, primarily included a \$205,000 decrease in federal deposit insurance, a \$108,000 decrease in advertising, a \$108,000 decrease in data processing expense and a \$200,000 decrease in other operating expenses. These decreases were partially offset by an increase in salaries and employee benefits of \$292,000, a \$105,000 increase in occupancy expense, an \$112,000 increase in professional fees and a \$73,000 change in other real estate owned (income) expense, net.

Prudent management of operating expenses has been and will continue to be a key objective of management in an effort to improve earnings performance. The Company's ratio of other expenses to average assets decreased to 1.85 percent in fiscal 2016 compared to 2.25 percent in fiscal 2015 and 2.84 percent in fiscal 2014.

Salaries and employee benefits increased \$292,000 or 4.9 percent in fiscal 2016 compared to fiscal 2015 and decreased \$1.8 million or 22.8 percent from fiscal 2014 to fiscal 2015. The increase in fiscal 2016 was primarily attributable to workforce increases. The decrease in fiscal 2015 was primarily attributable to workforce reductions. Salaries and employee benefits accounted for 45.2 percent of total non-interest expense in fiscal 2016, as compared to

43.0 percent and 46.7 percent in fiscal 2015 and fiscal 2014, respectively.

Occupancy expense for fiscal 2016 increased by \$105,000 or 6.1 percent, over fiscal 2015. Occupancy expense for fiscal 2015 decreased by \$376,000 or 18.0 percent, compared to fiscal 2014. The increase during fiscal 2016 primarily reflected the cost associated with our two new private banking / loan production offices in Villanova, Pennsylvania and Morristown, New Jersey. The increase in fiscal 2016 compared to fiscal 2015 was primarily due to an increase in rent expense of \$75,000, an \$11,000 increase in real estate taxes and a \$15,000 increase in depreciation expense. For the year ended September 30, 2015, the Company recorded decreases of \$21,000 in utility expense, \$153,000 in insurance, \$68,000 in building and equipment maintenance expense, \$109,000 in rent expense and \$37,000 in real estate taxes compared to fiscal 2014. These decreases were off by an increase of \$12,000 in depreciation expense.

Federal deposit insurance premium for fiscal 2016 decreased \$205,000, or 26.2 percent, compared to fiscal 2015. The decrease in the federal deposit insurance premium for fiscal 2016 is due to the termination on January 21, 2016 of the Formal Agreement with the Office of the Comptroller of the Currency (“OCC”). For the year ended September 30, 2015, FDIC insurance expense increased \$49,000 compared to fiscal 2014.

Advertising expense for fiscal 2016 decreased \$108,000, or 44.8 percent, compared to fiscal 2015. The decrease for fiscal 2016 is due to reductions in advertising retainers. For fiscal 2015, these expenses decreased \$322,000 or 57.4 percent compared to fiscal 2014.

Data processing expense for fiscal 2016 decreased \$108,000, or 8.7 percent, compared to the fiscal 2015. For fiscal 2015, data processing expense decreased \$9,000, or 0.7 percent, over fiscal 2014.

Professional fees for fiscal 2016 increased \$112,000, or 7.1 percent, compared to fiscal 2015. The increase is due primarily to an \$185,000 increase in legal fees and a \$129,000 increase in fees associated with audit and accounting services. The increase was offset by \$205,000 reduction in professional services. Professional fees decreased \$634,000 in fiscal 2015 from fiscal 2014 primarily due to reduced compliance and legal loan workout issues due to improvements in our level of non-performing assets.

OREO expense (income), net for fiscal 2016 changed by \$73,000 or 158.7 percent, compared to fiscal 2015. The change was due to the sale of three single residential loans and one commercial real estate loan sold during fiscal 2016. Due to the sale of such properties, there was a net gain of \$19,000, offset by a \$20,000 write-down on the commercial property. OREO expense for fiscal 2015 decreased by \$253,000 from fiscal 2014 due primarily to a decreased level of OREO properties. The change in other real estate owned expense was primarily due to a \$500,000 insurance reimbursement of a fire claim for a property located in Melrose Park, Pennsylvania received during the fourth quarter of fiscal 2014.

Other operating expense decreased in fiscal 2016 by approximately \$200,000, or 8.1 percent, compared to fiscal 2015. The decrease during the year ended September 30, 2016 was primarily due to a \$373,000 decrease in other operating expense related to \$105,000 in reimbursement for an insurance claim paid in fiscal 2015, a \$27,000 decrease in OCC assessment fees, a \$19,000 decrease in expenses related to director compensation and a reduction of \$14,000 in expenses related to education, subscriptions and dues. These expenses were offset by an increase of \$135,000 in business expenses related to entertainment and meals and auto expense, a \$65,000 increase in telephone expense, a \$17,000 increase in contribution expense and an \$11,000 increase in expenses associated with annual credit review such as appraisals. Other operating expense increased in fiscal 2015 by approximately \$128,000, or 5.5 percent, compared to fiscal 2014. The increase in other operating expense during fiscal 2015 was primarily due to an increase of \$121,000 in insurance and bond expense, a \$274,000 increase in other operating expense and a \$104,000 increase in amortization of mortgage servicing rights, offset by decreases in various expenses. The decreases in other operating expense were due to a \$139,000 decrease associated with annual credit review such as appraisals and searches, a \$61,000 decrease due to expenses related to education, subscriptions and dues, and a \$127,000 decrease for third party fees associated with the dissolution of two former Delaware subsidiaries of the Company during the fourth quarter of fiscal 2014.

#### Provision for Income Taxes

The Company recorded \$6.0 million in income tax benefit in fiscal 2016, compared to no income tax expense in fiscal 2015 and a \$21,000 expense in fiscal 2014, respectively. The change in fiscal 2016 resulted from the reversal of

approximately \$7.8 million representing the valuation allowance related to net deferred tax assets. The effective tax rates for the Company for the years ended September 30, 2016, 2015 and 2014 were 99.8 percent, zero percent and 3.3 percent, respectively. For a more detailed description of income taxes see Note 12 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, 2016, the Company reflected a negative interest sensitivity gap with an interest sensitivity ratio of 0.26:1.00 at the cumulative one-year position. Based on management's perception of interest rates remaining low through 2016, 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, 2016, 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, 2016, 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.

	6 Months or Less	More than 6 Months to 1 Year	More than 1 Year to 3 Years	More than 3 Year to 5 Years	More than 5 Years	Total Amount
(Dollars in thousands)						
Interest-earning assets <sup>(1)</sup> :						
Loans receivable <sup>(2)</sup>	\$ 135,248	\$ 43,968	\$ 109,614	\$ 119,185	\$ 168,750	\$ 576,765
Investment securities and restricted securities	11,614	3,234	28,590	40,355	28,122	111,915
Other interest-earning assets	95,465	-	-	-	-	95,465
Total interest-earning assets	242,327	47,202	138,204	159,540	196,872	784,145
Interest-bearing liabilities:						
Demand and NOW accounts	95,041	-	-	-	-	95,041
Money market accounts	177,486	-	-	-	-	177,486
Savings accounts	44,714	-	-	-	-	44,714
Certificate accounts	89,944	60,670	65,887	24,769	8,988	250,258
FHLB advances	35,000	-	55,000	28,000	-	118,000
Total interest-bearing liabilities	442,185	60,670	120,887	52,769	8,988	685,499
Interest-earning assets less interest-bearing liabilities	\$(199,858)	\$(13,468 )	\$ 17,317	\$ 106,771	\$ 187,884	\$ 98,646
Cumulative interest-rate sensitivity gap <sup>(3)</sup>	\$(199,858)	\$(213,326)	\$(196,009 )	\$( 89,238 )	\$ 98,646	
Cumulative interest-rate gap as a percentage of total assets at September 30, 2016	(24.34 )%	(25.98 )%	(23.87 )%	(10.87 )%	12.01 %	
Cumulative interest-earning assets as a percentage of cumulative interest-bearing liabilities at September 30, 2016	54.80 %	57.58 %	68.58 %	86.81 %	114.39 %	

(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, 2016 and 2015, 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) <sup>(1)</sup>	As of September 30, 2016			As of September 30, 2015		
	Amount	Dollar Change from Base	Percentage Change from Base	Amount	Dollar Change from Base	Percentage Change from Base
	(Dollars in thousands)					
+300	\$82,438	\$ (22,296 )	(21 )%	\$62,346	\$ (31,016 )	(33 )%
+200	91,344	(13,390 )	(13 )	73,513	(19,849 )	(21 )
+100	99,266	(5,468 )	(5 )	84,140	(9,222 )	(10 )
0	104,734	-	-	93,362	-	-
-100	106,608	1,874	2	94,944	1,582	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, 2016.

Changes in Interest Rates in Basis Points (Rate Shock)	Net Interest Income (Dollars in thousands)		
	\$ Change	% Change	
200	\$23,100	\$ 1,380	6.35 %
100	22,440	720	3.31
Static	21,720	-	-
(100)	21,191	(529 )	(2.44 )

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, 2016, the Company had \$96.8 million in cash and cash equivalents compared to \$40.3 million at September 30, 2015. In addition, our investment securities available-for-sale amounted to \$66.4 million at September 30, 2016 and \$128.4 million at September 30, 2015.

## **Deposits**

Total deposits increased to \$602.0 million at September 30, 2016 from \$465.5 million at September 30, 2015. Total interest-bearing deposits increased from \$438.5 million at September 30, 2015 to \$567.5 million at September 30, 2016, an increase of \$129.0 million or 29.4 percent. Interest-bearing demand, savings, money market and time deposits under \$100,000 increased \$75.7 million to a total of \$400.4 million at September 30, 2016 as compared to \$324.7 million at September 30, 2015. Time deposits \$100,000 and over increased \$53.3 million at September 30, 2016 as compared to September 30, 2015. Time deposits \$100,000 and over represented 27.8 percent of total deposits at September 30, 2016 compared to 24.5 percent at September 30, 2015. We had brokered deposits totaling \$58.8 million at September 30, 2016. We had no brokered deposits at September 30, 2015.

The Company derives a significant proportion of its liquidity from its core deposit base. Total demand deposits, savings and money market accounts of \$351.8 million at September 30, 2016 increased by \$88.0 million, or 33.4 percent, from September 30, 2015. Total demand deposits, savings and money market accounts were 58.4 percent of total deposits at September 30, 2016 and 56.7 percent at September 30, 2015. Alternatively, the Company uses a more stringent calculation for the management of its liquidity positions internally, which calculation consists of total demand, savings accounts and money market accounts (excluding money market accounts and certificates of deposit greater than \$100,000) as a percentage of total deposits. This number increased by \$13.8 million, or 5.4 percent, from \$258.1 million at September 30, 2015 to \$272.0 million at September 30, 2016 and represented 45.2 percent of total deposits at September 30, 2016 as compared with 55.5 percent at September 30, 2015.

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 demand, savings and money market balances during fiscal 2016.

The following table depicts the Company's core deposit mix at September 30, 2016 and 2015 based on the Company's alternative calculation:

	September 30, 2016		2015		Net Change
	Amount	Percentage	Amount	Percentage	2016 vs. 2015
	(Dollars in thousands)				
Non interest-bearing demand	\$34,547	12.7	% \$27,010	10.5	% \$ 7,537
Interest-bearing demand	95,041	35.0	82,897	32.1	12,144
Savings	44,714	16.4	45,189	17.5	(475 )
Money market deposits under \$100,000	14,543	5.3	15,154	5.9	(611 )
Certificates of deposit under \$100,000	83,110	30.6	87,880	34.0	(4,770 )
Total core deposits	\$271,955	100.0	% \$258,130	100.0	% \$ 13,825
Total deposits	\$602,046		\$465,522		\$ 136,524
Core deposits to total deposits		45.2	%	55.5	%

At September 30, 2016, our certificates of deposit and other time deposits with a balance of \$100,000 or more amounted to \$167.1 million, of which \$110.1 million are scheduled to mature within twelve months. At September 30, 2016, the weighted average remaining maturity of our certificate of deposit accounts was 16.4 months. The following table presents the maturity of our certificates of deposit and other time deposits with balances of \$100,000 or more.

	Amount
	(In thousands)
Maturity Period:	
Three months or less	\$ 48,256
Over three months through six months	20,229
Over six months through twelve months	41,635
Over twelve months	57,028
Total	\$ 167,148

## Borrowings

Borrowings from the Federal Home Loan Bank ("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, 2016 and 2015, the Company's outstanding balance of FHLB advance, totaled \$118.0 million and \$103.0 million, respectively. Of the \$118.0 million in advances, \$28.0 million represent long-term, fixed-rate advances maturing in 2020 that have terms enabling the FHLB to call the borrowing at their option prior to maturity. The remaining balance of long-term, fixed rate advances totaled \$55.0 million, representing five separate advances maturing during fiscal year 2019. At September 30, 2016, there were two short-term FHLB

advances totaling \$35.0 million of fixed-rate borrowing with rollover of 90 days.

## **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, 2016, cash and cash equivalents increased by \$56.5 million over the balance at September 30, 2015. Net cash of \$9.3 million was provided by operating activities in fiscal 2016, primarily, net income as adjusted to net cash. Net income of \$11.9 million in fiscal 2016 was adjusted principally by net gains on sales of investment securities of \$565,000, amortization of premiums and accretion of discounts on investment securities net of \$1.2 million, an increase in other assets of \$44,000 and an increase in other liabilities of \$974,000. Net cash used by investing activities amounted to approximately \$104.2 million in fiscal 2016, primarily reflecting a net decrease in investment securities of \$78.6 million. Net cash of \$151.4 million was provided by financing activities in fiscal 2016, primarily from the increase in deposits of \$136.5 million and an increase of \$15.0 million in FHLB advances.

### Payments Due Under Contractual Obligations

The following table presents information relating to the Company's payments due under contractual obligations as of September 30, 2016.

	Payments Due by Period				Total
	Less than One Year	One to Three Years	Three to Five Years	More than Five Years	
	(In thousands)				
Long-term debt obligations <sup>(1)</sup>	\$ 35,057	\$ 30,995	\$ 56,776	\$ —	\$ 122,828
Certificates of deposit <sup>(1)</sup>	152,538	67,012	25,225	9,159	253,934
Operating lease obligations	385	860	900	2,225	4,370
Total contractual obligations	\$ 187,980	\$ 98,867	\$ 82,901	\$ 11,384	\$ 381,132

<sup>(1)</sup> Includes interest payments.

### 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, 2016 and 2015 were as follows:

September 30,  
2016      2015  
(In thousands)

Commitments to extend credit:<sup>(1)</sup>



Future loan commitments	\$97,566	\$26,849
Undisbursed construction loans	33,135	14,187
Undisbursed home equity lines of credit	25,270	27,074
Undisbursed Commercial lines of credit	48,667	25,600
Overdraft protection lines	850	840
Standby letters of credit	1,927	566
Total commitments	\$207,415	\$95,116

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition (1) 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 \$94.6 million, or 11.5 percent of total assets, at September 30, 2016, compared to \$81.4 million or 12.4 percent of total assets at September 30, 2015. Book value per common share was \$14.42 at September 30, 2016, compared to \$12.41 at September 30, 2015.

#### Capital

At September 30, 2016, the Bank's common equity tier 1 ratio was 14.24 percent, tier 1 leverage ratio was 10.79 percent, tier 1 risk-based capital ratio was 14.24 percent and the total risk-based capital ratio was 15.16 percent. At September 30, 2015, the Bank's common equity tier 1 ratio was 15.90 percent, tier 1 leverage ratio was 10.80 percent, tier 1 risk-based capital ratio was 15.90 percent and the total risk-based capital ratio was 16.99 percent. At September 30, 2016, the Bank was in compliance with all applicable regulatory capital requirements.

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

The information contained in the section captioned “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Asset and Liability Management” in Item 7 hereof is incorporated herein by reference.

-49-

**Item 8. Financial Statements and Supplementary Data.**

**Report of Independent Registered Public Accounting Firm**

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

Paoli, Pennsylvania

We have audited the accompanying consolidated statement of financial condition of Malvern Bancorp, Inc. and its subsidiaries (collectively the “Company”) as of September 30, 2016 and 2015, and the related consolidated statements of operations, comprehensive income (loss), changes in shareholders’ equity, and cash flows for each of the three years in the period ended September 30, 2016. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Malvern Bancorp, Inc. and its subsidiaries at September 30, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2016, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Malvern Bancorp, Inc.’s internal control over financial reporting as of September 30, 2016, based on the criteria established in *Internal Control-Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria) and our report dated December 13, 2016 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Philadelphia, Pennsylvania  
December 13, 2016

-50-

***Malvern Bancorp, Inc. and Subsidiaries***  
**Consolidated Statements of Financial Condition**

	September 30,	
	2016	2015
	(Dollars in thousands, except per share data)	
<b>Assets</b>		
Cash and due from depository institutions	\$ 1,297	\$ 16,026
Interest bearing deposits in depository institutions	95,465	24,237
Cash and Cash Equivalents	96,762	40,263
Investment securities available for sale, at fair value	66,387	128,354
Investment securities held to maturity, at cost (fair value of \$40,817 and \$56,825, respectively)	40,551	57,221
Restricted stock, at cost	5,424	4,765
Loans receivable, net of allowance for loan losses of \$5,434 and \$4,667, respectively	574,160	391,307
Other real estate owned	-	1,168
Accrued interest receivable	2,558	2,484
Property and equipment, net	6,637	6,535
Deferred income taxes, net	8,827	2,874
Bank-owned life insurance	18,418	17,905
Other assets	1,548	2,814
<b>Total Assets</b>	<b>\$ 821,272</b>	<b>\$ 655,690</b>
<b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities</b>		
<b>Deposits:</b>		
Deposits-noninterest-bearing	\$ 34,547	\$ 27,010
Deposits-interest-bearing	567,499	438,512
<b>Total Deposits</b>	<b>602,046</b>	<b>465,522</b>
FHLB advances	118,000	103,000
Advances from borrowers for taxes and insurance	1,659	1,806
Accrued interest payable	427	396
Other liabilities	4,549	3,575
<b>Total Liabilities</b>	<b>726,681</b>	<b>574,299</b>
<b>Commitments and Contingencies</b>	<b>-</b>	<b>-</b>
<b>Shareholders' Equity</b>		
Preferred stock, \$0.01 par value, 10,000,000 shares authorized, none issued	-	-
Common stock, \$0.01 par value, 40,000,000 shares authorized, issued and outstanding: 6,560,403 shares at September 30, 2016 and 6,558,473 shares at September 30, 2015	66	66

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Additional paid-in-capital	60,461		60,365	
Retained earnings	35,756		23,814	
Unearned Employee Stock Ownership Plan (ESOP) shares	(1,629	)	(1,775	)
Accumulated other comprehensive loss	(63	)	(1,079	)
Total Shareholders' Equity	94,591		81,391	
Total Liabilities and Shareholders' Equity	\$ 821,272		\$ 655,690	

See notes to consolidated financial statements.

-51-

***Malvern Bancorp, Inc. and Subsidiaries***  
**Consolidated Statements of Operations**

	Year Ended September 30,		
	2016	2015	2014
	(Dollars in thousands, except per share data)		
<b>Interest and Dividend Income</b>			
Loans, including fees	\$ 21,206	\$ 16,484	\$ 17,736
Investment securities, taxable	2,824	3,073	2,109
Investment securities, tax-exempt	751	522	145
Dividends, restricted stock	250	311	123
Interest-bearing cash accounts	213	72	54
Total Interest and Dividend Income	25,244	20,462	20,167
<b>Interest Expense</b>			
Deposits	4,537	3,431	3,969
Long-term borrowings	2,195	1,817	1,102
Total Interest Expense	6,732	5,248	5,071
Net Interest Income	18,512	15,214	15,096
Provision for Loan Losses	947	90	263
Net Interest Income after Provision for Loan Losses	17,565	15,124	14,833
<b>Other Income</b>			
Service charges and other fees	923	989	947
Rental income-other	211	249	255
Gain on sale of investments, net	565	515	83
Loss on disposal of fixed assets	1	-	(41)
Gain on sale of loans, net	116	102	352
Earnings on bank-owned life insurance	517	680	559
Total Other Income	2,333	2,535	2,155
<b>Other Expense</b>			
Salaries and employee benefits	6,290	5,998	7,770
Occupancy expense	1,820	1,715	2,091
Federal deposit insurance premium	579	784	735
Advertising	131	239	561
Data processing	1,128	1,236	1,245
Professional fees	1,683	1,571	2,205
Other real estate owned expense (income), net	27	(46)	(299)
Other operating expenses	2,264	2,464	2,336
Total Other Expenses	13,922	13,961	16,644
Income before income tax (benefit) expense	5,976	3,698	344
Income tax (benefit) expense	(5,966)	-	21
Net Income	\$ 11,942	\$ 3,698	\$ 323
<b>Earnings Per Common Share:</b>			
Basic	\$ 1.86	\$ 0.58	\$ 0.05

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Diluted	\$ 1.86	n/a	n/a
Weighted Average Common Shares Outstanding			
Basic	6,409,265	6,393,330	6,378,930
Diluted	6,409,325	n/a	n/a
Dividends Declared Per Share	\$ 0.00	\$ 0.00	\$ 0.00

See notes to consolidated financial statements.

-52-



***Malvern Bancorp, Inc. and Subsidiaries***  
**Consolidated Statements of Comprehensive Income (Loss)**

(In thousands)	Year Ended September 30,		
	2016	2015	2014
Net Income	\$ 11,942	\$ 3,698	\$ 323
Other Comprehensive Income (Loss), Net of Tax:			
Unrealized holding gains (losses) on available-for-sale securities	2,128	2,120	1,419
Tax effect	(723 )	(721 )	(482 )
Net of tax amount	1,405	1,399	937
Reclassification adjustment for net gains arising during the period <sup>(1)</sup>	(565 )	(515 )	(83 )
Tax effect	192	175	29
Net of tax amount	(373 )	(340 )	(54 )
Accretion of unrealized holding losses on securities transferred from available-for-sale to held-to-maturity <sup>(2)</sup>	9	5	—
Tax effect	(3 )	(2 )	—
Net of tax amount	6	3	—
Fair value adjustment on derivatives	(194 )	(348 )	—
Tax effect	172	12	—
Net of tax amount	(22 )	(336 )	—
Total other comprehensive income	1,016	726	883
Total comprehensive income	\$ 12,958	\$ 4,424	\$ 1,206

<sup>(1)</sup> Amounts are included in net gain on sales of securities on the Consolidated Statements of Operations in total other income.

<sup>(2)</sup> 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, 2016, 2015, and 2014**

	Common Stock	Additional Paid-In Capital	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
(in thousands, except share data)						
Balance, October 1, 2013	\$66	\$ 60,302	\$ 19,793	\$ (2,067)	) \$ (2,688)	) \$ 75,406
Net Income	—	—	323	—	—	323
Other comprehensive income	—	—	—	—	883	883
Committed to be released ESOP shares (14,400 shares)	—	15	—	145	—	160
Balance, September 30, 2014	\$66	\$ 60,317	\$ 20,116	\$ (1,922)	) \$ (1,805)	) \$ 76,772
Net Income	—	—	3,698	—	—	3,698
Other comprehensive income	—	—	—	—	726	726
Committed to be released ESOP shares (14,400 shares)	—	48	—	147	—	195
Balance, September 30, 2015	\$66	\$ 60,365	\$ 23,814	\$ (1,775)	) \$ (1,079)	) \$ 81,391
Net Income	—	—	11,942	—	—	11,942
Other comprehensive income	—	—	—	—	1,016	1,016
Committed to be released ESOP shares (14,400 shares)	—	96	—	146	—	242
Balance, September 30, 2016	\$66	\$ 60,461	\$ 35,756	\$ (1,629)	) \$ (63)	) \$ 94,591

See notes to consolidated financial statements.

**Malvern Bancorp, Inc. and Subsidiaries**  
**Consolidated Statements of Cash Flows**

	Year Ended September 30,		
	2016	2015	2014
	(In thousands)		
<b>Cash Flows from Operating Activities</b>			
Net income	\$ 11,942	\$ 3,698	\$ 323
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation expense	650	646	638
Provision for loan losses	947	90	263
Deferred income taxes (benefit) expense	(6,316 )	(1,035 )	(367 )
ESOP expense	242	195	160
Amortization (accretion) of premiums and discounts on investment securities, net	1,243	849	(488 )
Amortization (accretion) of loan origination fees and costs	748	296	(193 )
Amortization (accretion) of mortgage service rights	73	82	(22 )
Net gain on sale of investment securities available for sale	(565 )	(515 )	(83 )
Net (gain) loss on disposal of fixed assets	(1 )	—	41
Net (gain) loss on sale of loans	—	—	(281 )
Net gain on sale of secondary market loans	(116 )	(102 )	(71 )
Proceeds on sale of secondary market loans	6,390	4,090	7,738
Originations of secondary market loans	(6,274 )	(3,988 )	(7,667 )
Gain on sale of other real estate owned	(19 )	(124 )	(93 )
Write down of other real estate owned	20	54	341
Earnings on bank-owned life insurance	(517 )	(680 )	(559 )
(Increase) decrease in accrued interest receivable	(74 )	(1,162 )	82
Increase (decrease) in accrued interest payable	31	247	10
Increase in other liabilities	974	1,319	309
Increase in other assets	(44 )	(714 )	(114 )
<b>Net Cash Provided by (Used in) by Operating Activities</b>	<b>9,334</b>	<b>3,246</b>	<b>(33 )</b>
<b>Cash Flows from Investing Activities</b>			
<b>Investment securities available-for-sale:</b>			
Purchases	(2,116 )	(160,103)	(5,258 )
Sales	62,818	70,413	16,751
Maturities, calls and principal repayments	2,437	6,032	14,138
<b>Investment securities held-to-maturity:</b>			
Purchases	—	(4,152 )	—
Maturities, calls and principal repayments	16,391	4,454	—
Proceeds from sale of loans	—	—	25,836
Loan buyback for sale of loans	—	—	(1,117 )
Loan purchases	—	—	(18,952)
(Loan originations) and principal collections, net	(184,548)	(5,927 )	19,649
Proceeds from sale of other real estate owned	1,167	1,174	2,694
Additions to mortgage servicing rights	—	(30 )	(160 )

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Proceeds from cash surrender on bank-owned life insurance	—	—	3,636
Proceeds from death benefit of bank-owned life insurance	1,049	—	—
Net (increase) decrease in restricted stock	(659 )	(1,262 )	(465 )
Proceeds from sale of property and equipment	1	—	—
Purchases of property and equipment	(752 )	(358 )	(244 )
Net Cash (Used in) Provided by Investing Activities	(104,212)	(89,759 )	56,508
Cash Flows from Financing Activities			
Net increase (decrease) in deposits	136,524	52,569	(71,643)
Proceeds for long-term borrowings	121,000	93,000	14,500
Repayment of long-term borrowings	(106,000)	(38,000 )	(4,500 )
Increase in advances from borrowers for taxes and insurance	(147 )	20	668
Net Cash Provided by (Used in) Financing Activities	151,377	107,589	(60,975)
Net Increase (Decrease) in Cash and Cash Equivalents	56,499	21,076	(4,500 )
Cash and Cash Equivalent - Beginning	40,263	19,187	23,687
Cash and Cash Equivalent - Ending	\$96,762	\$40,263	\$19,187
Supplementary Cash Flows Information			
Interest paid	\$6,701	\$5,001	\$5,061
Income taxes paid	\$—	\$—	\$17
Non-cash transfer of loans to other real estate owned	\$—	\$308	\$944
Transfer from investment securities available-for-sale to investment securities held-to-maturity	\$—	\$57,523	\$—
Non-cash proceeds from death benefit on BOLI	\$—	\$1,039	\$—

See notes to consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 1 – Organizational Structure and Nature of Operations

On May 19, 2008, Malvern Federal Savings Bank ("Malvern Federal Savings" or the "Bank") completed its reorganization to the mutual holding company form of organization and formed Malvern Federal Bancorp, Inc. (the "Mid-Tier Holding Company") to serve as the "mid-tier" stock holding company for the Bank. An Employee Stock Ownership Plan ("ESOP") was established which borrowed approximately \$2.6 million from Malvern Federal Bancorp, Inc. to purchase 241,178 shares of common stock. Principal and interest payments of the loan are being made quarterly over a term of 18 years at a fixed interest rate of 5.0%.

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

The Company is a Pennsylvania chartered corporation which, since October 11, 2012, has owned all of the issued and outstanding shares of the Bank's common stock, the only shares of equity securities which the Bank has issued. The Company does not own or lease any property, but instead uses the premises, equipment and furniture of the Bank. At the present time, the Company employs only persons who are officers of Malvern Federal Savings to serve as officers of the Company. The Company also uses the Bank's support staff from time to time. These persons are not separately compensated by Company.

Malvern Federal Savings Bank is a federally chartered, FDIC-insured savings bank that was originally organized in 1887. The Bank conducts business from its headquarters in Paoli, Pennsylvania, a suburb of Philadelphia, as well as eight full service financial center offices in Chester and Delaware Counties, Pennsylvania and a Private Banking Loan Production headquarters office in Morristown, New Jersey. The Bank is primarily engaged in attracting deposits from

the general public and using those funds to invest in loans and investment securities. The Bank's principal sources of funds are deposits, repayments of loans and investment securities, maturities of investments and interest-bearing deposits, other funds provided from operations and wholesale funds borrowed from outside sources such as the Federal Home Loan Bank of Pittsburgh (the "FHLB"). These funds are primarily used for the origination of various loan types including single-family residential mortgage loans, commercial real estate mortgage loans, construction and development loans, home equity loans and lines of credit and other consumer loans. The Bank derives its income principally from interest earned on loans, investment securities and, to a lesser extent, from fees received in connection with the origination of loans and for other services. Malvern Federal Savings' primary expenses are interest expense on deposits and borrowings and general operating expenses. Funds for activities are provided primarily by deposits, amortization of loans, loan prepayments and the maturity of loans, securities and other investments and other funds from operations.

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 System (the "Federal Reserve Board" or the "FRB").

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 1 – Organizational Structure and Nature of Operations (Continued)

The Company and the Bank and the Bank's subsidiary, Strategic Asset Management Group, Inc. ("SAMG"), provide various banking services, primarily accepting deposits and originating residential and commercial mortgage loans, consumer loans and other loans through the Bank's headquarters and eight full-service branches in Chester and Delaware Counties, Pennsylvania. SAMG owns 50% of Malvern Insurance Associates, LLC. Malvern Insurance Associates, LLC offers a full line of business and personal lines of insurance products. As of September 30, 2016 and 2015, SAMG's total assets were approximately \$62,000 and \$68,000, respectively. The net loss of SAMG for the year ended September 30, 2016, was approximately \$6,000 and for the years ended September 30, 2015 and 2014, the net income was approximately \$2,000 and \$5,000, respectively. The Company is subject to competition from various other financial institutions and financial services companies. The Company is also subject to the regulations of certain federal agencies and, therefore, undergoes periodic examinations by those regulatory agencies.

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 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, 2016.

### Note 2 – Summary of Significant Accounting Policies

#### *Basis of Presentation and Consolidation*

The consolidated financial statements at and for the years ended September 30, 2016, 2015 and 2014 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 5 discusses the types of investment securities that the Company invests in. Note 6 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 debtors 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.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 2 - Summary of Significant Accounting Policies (Continued)

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 \$4.8 million and \$3.7 million at September 30, 2016 and 2015, respectively.

#### *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, 2016 and 2015, 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.

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. 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 2 - Summary of Significant Accounting Policies (Continued)

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.

#### *Allowance for Loan Losses*

The allowance for credit losses consists of the allowance for loan losses and the reserve for unfunded lending commitments. 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. 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 statement of financial condition. The allowance for loan losses ("ALLL") 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 immediately 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 charge-off 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 2 - Summary of Significant Accounting Policies (Continued)

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.

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 2 - Summary of Significant Accounting Policies (Continued)

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 approved by the Board of Directors. 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.

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. As a result of the declines in the market value of real estate and the deterioration in the overall economy, we are continuing to evaluate and monitor the credit conditions of our consumer loan borrowers and the real estate values of the properties securing our second mortgage loans as part of our on-going efforts to assess the overall credit quality of the portfolio in connection with our review of the allowance for loan losses.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 2 - Summary of Significant Accounting Policies (Continued)

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.

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 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.

An allowance for loan losses 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 2 - Summary of Significant Accounting Policies (Continued)

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 serving released.

#### *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, 2016, restricted stock consists of the common stock of the Federal Home Loan Bank of Pittsburgh (“FHLB”) and Atlantic Community Bankers Bank (“ACBB”). As of September 30, 2015, restricted stock consists solely of the common stock of the Federal Home Loan Bank of Pittsburgh (“FHLB”).

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 FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB.

During the years ended September 30, 2016 and 2015, there were net repurchases of restricted stock of \$659,000 and \$1.3 million, respectively. Also as of September 30, 2016 and 2015 the number of FHLB shares was 53,441 and 47,651, respectively. There were approximately \$250,000, \$311,000 and \$123,000 of dividends on FHLB stock received or recognized in income for fiscal years 2016, 2015 and 2014, respectively.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 2 - Summary of Significant Accounting Policies (Continued)

#### *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 statement 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 \$90,000, \$64,000, and \$118,000, for fiscal 2016, 2015, and 2014, respectively. There were no bonus matching contributions for fiscal years 2016, 2015 or 2014.

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 \$1.1 million and \$1.2 million at September 30, 2016 and 2015, respectively. Distributions made to directors for the fiscal year 2016 and 2015 were approximately \$4,000 and \$13,000, respectively. The (benefit)/expense associated with the Plans for the years ended September 30, 2016, 2015, and 2014 was \$11,000, (\$24,000), and \$78,000, respectively. At fiscal 2015, the benefit associated with the Plans was due to the Plan being frozen at September 30, 2014 and the Company had to credit fiscal 2015 accruals for the first quarter of fiscal 2015.

### *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, 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 2 - Summary of Significant Accounting Policies (Continued)

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.

#### *Advertising Costs*

The Company follows the policy of charging the costs of advertising to expense as incurred.

#### *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 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.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 2 - Summary of Significant Accounting Policies (Continued)

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 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 income.

#### *Reclassifications*

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

#### *Recent Accounting Pronouncements*

In October 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory". The ASU requires an entity to recognize the income tax consequences of intra-entity transfers of assets other than inventory at the time that the transfer occurs. Current guidance does not require recognition of tax consequences until the asset is eventually sold to a third party. ASU 2016-16 is effective for fiscal years, and interim periods within, beginning after December 15, 2017, with early adoption permitted as of the first interim period presented in a year. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230)". The ASU is intended to reduce the diversity in practice around how certain transactions are classified within the statement of cash flows. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2017. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments–Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” The 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 today 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, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2019. The Company has not yet determined the impact the adoption of ASU 2016-13 will have on the consolidated financial statements and related disclosures.

In May 2016, the FASB issued ASU No. 2016-12 “Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients.” The guidance is intended to clarify the guidance previously issued in May 2014 related to the recognition of revenue from contracts with customers. The updated guidance includes narrow-scope improvements intended to address implementation issues and to provide additional practical expedients in the guidance. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted for interim and annual reporting periods beginning after December 15, 2016. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 2 - Summary of Significant Accounting Policies (Continued)

In April 2016, the FASB issued ASU No. 2016-10 “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing.” The guidance is intended to clarify the guidance previously issued in May 2014 related to the recognition of revenue from contracts with customers. The updated guidance is intended to reduce the cost and complexity of applying the guidance on identifying promised goods or services in a contract and to improve the operability and understandability of the implementation guidance regarding the licensing of intellectual property. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted for interim and annual reporting periods beginning after December 15, 2016. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee share-Based Payment Accounting.” The new guidance simplifies certain aspects related to income taxes, statement of cash flows, and forfeitures when accounting for share-based payment transactions. This new guidance will be effective for the Company for the first reporting period beginning after December 15, 2016, with earlier adoption permitted. Certain of the amendments related to timing of the recognition of tax benefits and tax withholding requirements should be applied using a modified retrospective transition method. Amendments related to the presentation of the statement of cash flows should be applied retrospectively. All other provisions may be applied on a prospective or modified retrospective basis. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842).” The guidance in this update supersedes the current lease accounting guidance for both the lessees and lessors under ASC 840, Leases. The new guidance requires lessees to evaluate whether a lease is a finance lease using criteria that are similar to what lessees use today to determine whether they have a capital lease. Leases not classified as finance leases are classified as operating leases. This classification will determine whether the lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. The lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to today’s guidance for operating leases. The new guidance will require lessors to account for leases using an approach that is substantially similar to the existing guidance for sales-type, direct financing leases and operating leases. This new guidance will be effective for the Company for the first reporting period beginning after December 15, 2018, with earlier adoption permitted. Adoption of the amendment must be applied on a modified retrospective approach. The Company is currently evaluating the effect that the standard will have on its consolidated financial statements and related disclosures.

In January 2016, the FASB issued ASU No. 2016-01, “Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.” The new guidance is intended to improve the recognition and measurement of financial instruments. The ASU affects public and private companies, not-for-profit organizations, and employee benefit plans that hold financial assets or owe financial liabilities. ASU No. 2016-01 is effective for interim and annual reporting periods beginning after December 15, 2017. The Company is currently evaluating the effect that the standard will have on its consolidated financial statements and related disclosures.

In November 2015, the FASB issued ASU No. 2015-17, “Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes.” The FASB is issuing the amendments in this Update as part of its initiative to reduce complexity in accounting standards (the Simplification Initiative). The objective of the Simplification Initiative is to identify, evaluate, and improve areas of generally accepted accounting principles (“GAAP”) for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements. To simplify the presentation of deferred income taxes, the amendments in this Update require that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The amendments in this Update apply to all entities that present a classified statement of financial position. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected by the amendments in this Update. ASU No. 2015-17 is effective for interim and annual reporting periods beginning after December 15, 2016. Early adoption is permitted, including adoption in an interim period. All other amendments will be effective upon the issuance of this Update. The Company has evaluated the standard and determined that it has no effect on the Company’s consolidated financial statements and related disclosures.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Note 3 – Earnings (Loss) Per Share**

Basic earnings per common share is computed based on the weighted average number of shares outstanding reduced by unearned 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, 2016, the Company issued stock options to purchase 5,000 shares of common stock, as well as 1,930 restricted shares, which are considered CSEs. At September 30, 2016, all restricted stocks were anti-dilutive. For the fiscal years ended September 30, 2015 and 2014, the Company did not issue and did not have any outstanding CSEs.

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

(In thousands, except for share data)	Year Ended September 30,		
	2016	2015	2014
Net Income	\$ 11,942	\$ 3,698	\$ 323
Weighted average shares outstanding	6,560,012	6,558,473	6,558,473
Average unearned ESOP shares	(150,747 )	(165,143 )	(179,543 )
Basic weighted average shares outstanding	6,409,265	6,393,330	6,378,930
Plus: effect of dilutive options	60	-	-
Diluted weighted average common shares outstanding	6,409,325	6,393,330	6,378,930
Earnings per share:			
Basic	\$ 1.86	\$ 0.58	\$ 0.05
Diluted	\$ 1.86	n/a	n/a

**Note 4 – Employee Stock Ownership Plan**

The Company established an employee stock ownership plan (“ESOP”) for substantially all of its full-time employees. As of September 30, 2016, 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 the common stock for approximately \$2.6 million, 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%, is being repaid in quarterly installments through 2026. Shares are released to participants proportionately as the loan is repaid. During years ended September 30, 2016, 2015 and 2014, there were 14,400, 14,400 and 14,400 shares, respectively, committed to be released. At September 30, 2016, there were 143,565 unallocated shares and 115,653 allocated shares held by the ESOP. The unallocated shares had an aggregate fair value of approximately \$2.4 million at September 30, 2016.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 5 - Investment Securities

The Company's investment securities are classified as available-for-sale or held-to-maturity at September 30, 2016 and 2015. 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, 2016 and 2015.

	September 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
Investment Securities Available-for-Sale:				
State and municipal obligations	\$24,751	\$ 557	\$ (1 )	\$ 25,307
Single issuer trust preferred security	1,000	—	(122)	878
Corporate debt securities	40,189	347	(334)	40,202
Total	65,940	904	(457)	66,387
Investment Securities Held-to-Maturity:				
U.S. government agencies	\$2,999	\$ 16	\$ —	\$,015
State and municipal obligations	9,826	167	(1 )	9,992
Corporate debt securities	3,916	77	—	3,993
Mortgage-backed securities:				

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Collateralized mortgage obligations, fixed-rate	23,810	102	(95	)	23,817
Total	\$40,551	\$ 362	\$ (96	) \$	40,817
Total investment securities	\$106,491	\$ 1,266	\$ (553	)	\$07,204

-69-



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 5 - Investment Securities (Continued)

	September 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Investment Securities Available-for-Sale:				
U.S. government agencies	\$816	\$ —	\$ (1	) \$815
State and municipal obligations	42,007	192	(116	) 42,083
Single issuer trust preferred security	1,000	—	(150	) 850
Corporate debt securities	70,874	34	(926	) 69,982
	114,697	226	(1,193	) 113,730
Mortgage-backed securities:				
Federal National Mortgage Association (FNMA), fixed-rate	8,797	—	(105	) 8,692
Federal Home Loan Mortgage Company (FHLMC), fixed-rate	5,986	—	(54	) 5,932
	14,783	—	(159	) 14,624
Total	\$129,480	\$ 226	\$ (1,352	) \$128,354
Investment Securities Held-to-Maturity:				
U.S. government agencies	\$14,301	\$ 8	\$ (13	) \$14,296
State and municipal obligations	10,075	23	(75	) 10,023
Corporate debt securities	4,011	—	(55	) 3,956
Mortgage-backed securities:				
Collateralized mortgage obligations, fixed-rate	28,834	55	(339	) 28,550
Total	\$57,221	\$ 86	\$ (482	) \$56,825
Total investment securities	\$186,701	\$ 312	\$ (1,834	) \$185,179

During the year ended September 30, 2015, the Company transferred at fair value approximately \$57.5 million in available-for-sale investment securities to the held-to-maturity category. The net unrealized loss at date of transfer amounted to \$115,000. This will be amortized over the remaining life of the securities as an adjustment of yield, offsetting the related amortization of the premium or accretion of the discount on the transferred securities. No gains or losses were recognized at the time of transfer. Management considers the held-to-maturity classification of these investment securities to be appropriate as the Company has the positive intent and ability to hold these securities to maturity.

For fiscal 2016, proceeds of available-for-sale investment securities sold amounted to approximately \$62.8 million. Gross realized gains on investment securities sold amounted to approximately \$595,000, while gross realized

losses amounted to approximately \$30,000 for the period. For fiscal 2015, proceeds of available-for-sale investment securities sold amounted to approximately \$70.4 million. Gross realized gains on investment securities sold amounted to approximately \$610,000, while gross realized losses amounted to approximately \$95,000 for the period. For fiscal 2014, proceeds of investment securities sold amounted to approximately \$16.8 million. Gross realized gains on investment securities sold amounted to approximately \$118,000, while gross realized losses amounted to approximately \$35,000 for the period.

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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 5 - Investment Securities (Continued)

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, 2016 and 2015.

	September 30, 2016					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair value	Unrealized Losses
	(In thousands)					
Investment Securities Available-for-Sale:						
State and municipal obligations	\$501	\$ (1 )	\$ —	\$ —	\$501	\$ (1 )
Single issuer trust preferred security	—	—	878	(122 )	878	(122 )
Corporate debt securities	984	(9 )	10,614	(325 )	11,598	(334 )
Total	\$1,485	\$ (10 )	\$ 11,492	\$ (447 )	\$ 12,977	\$ (457 )
Investment Securities Held-to-Maturity:						
State and municipal obligations	1,193	(1 )	—	—	1,193	(1 )
Mortgage-backed securities:						
CMO, fixed-rate	4,342	(17 )	6,283	(78 )	10,625	(95 )
Total	5,535	(18 )	6,283	(78 )	11,818	(96 )
Total investment securities	\$7,020	\$ (28 )	\$ 17,775	\$ (525 )	\$ 24,795	\$ (553 )
	September 30, 2015					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair value	Unrealized Losses
	(In thousands)					
Investment Securities Available-for-Sale:						
U.S. government agencies	\$—	\$ —	\$ 815	\$ (1 )	\$ 815	\$ (1 )
State and municipal obligations	18,223	(116 )	—	—	18,223	(116 )
Single issuer trust preferred security	—	—	850	(150 )	850	(150 )
Corporate debt securities	58,064	(926 )	—	—	58,064	(926 )
Mortgage-backed securities:						
FNMA, fixed-rate	5,459	(53 )	3,233	(52 )	8,692	(105 )
FHLMC, fixed-rate	3,280	(25 )	2,652	(29 )	5,932	(54 )
Total	\$85,026	\$ (1,120 )	\$ 7,550	\$ (232 )	\$ 92,576	\$ (1,352 )

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Investment Securities Held-to-Maturity:

U.S. government agencies	4,792	(13	)	—	—	4,792	(13	)	
State and municipal obligations	6,917	(75	)	—	—	6,917	(75	)	
Corporate debt securities	3,957	(55	)	—	—	3,957	(55	)	
Mortgage-backed securities:									
CMO, fixed-rate	22,734	(339	)	—	—	22,734	(339	)	
Total	38,400	(482	)	—	—	38,400	(482	)	
Total investment securities	\$123,426	\$ (1,602	)	\$ 7,550	\$ (232	)	\$130,976	\$ (1,834	)

-71-

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 5 - Investment Securities (Continued)

As of September 30, 2016, the estimated fair value of the securities disclosed above was primarily dependent upon the movement in market interest rates, particularly given the negligible inherent credit risk associated with these securities. These investment securities are comprised of securities that are rated investment grade by at least one bond credit rating service. Although the fair value will fluctuate as the market interest rates move, management believes that these fair values will recover as the underlying portfolios mature and are reinvested in market rate yielding investments. As of September 30, 2016, the Company held two municipal bonds, nine corporate securities, 15 mortgage-backed securities and one single issuer trust preferred security which were in an unrealized loss position. As of September 30, 2015, the Company held six U.S. government agency securities, 20 municipal bonds, 29 corporate securities, 37 mortgage-backed securities and one single issuer trust preferred security which were in an unrealized loss position. The Company does not intend to sell and expects that it is not more likely than not that it will be required to sell these securities until such time as the value recovers or the securities mature. Management does not believe any individual unrealized loss as of September 30, 2016 represents other-than-temporary impairment.

Investment securities having a carrying value of approximately \$552,000 at September 30, 2016 were pledged to secure public deposits. At September 30, 2015 the Company had no securities pledged to secure public deposits.

The following table presents information for investment securities at September 30, 2016, 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, 2016	
	Amortized Cost	Fair Value
	(In thousands)	
Investment Securities Available-for-Sale:		
Due in one year or less	\$—	\$—
Due after one year through five years	24,464	24,718
Due after five years through ten years	31,166	31,277
Due after ten years	10,310	10,392
Total	\$65,940	\$66,387
Investment Securities Held-to-Maturity:		
Due after one year through five years	\$2,999	\$3,015
Due after five years through ten years	5,128	5,291
Due after ten years	32,424	32,511

Total	\$40,551	\$40,817
Total investment securities	\$106,491	\$107,204

-72-

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 6 - 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,	
	2016	2015
	(In thousands)	
Residential mortgage	\$209,186	\$214,958
Construction and Development:		
Residential and commercial	18,579	5,677
Land	10,013	2,142
Total Construction and Development	28,592	7,819
Commercial:		
Commercial real estate	231,439	87,686
Multi-family	19,515	7,444
Other	38,779	13,380
Total Commercial	289,733	108,510
Consumer:		
Home equity lines of credit	19,757	22,919
Second mortgages	29,204	37,633
Other	1,914	2,359
Total Consumer	50,875	62,911
Total loans	578,386	394,198
Deferred loan fees and cost, net	1,208	1,776
Allowance for loan losses	(5,434 )	(4,667 )
Total loans receivable, net	\$574,160	\$391,307

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 6 - 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, 2016, 2015 and 2014.

	Year Ended September 30, 2016										Total
	Residential Mortgage	Residential and Commercial	Land	Commercial Real Estate	Multi- family	Other	Consumer Home Equity Lines of Credit	Second Mortgages	Other	Unallocated	
	(In thousands)										
Allowance for loan losses:											
Beginning balance	\$1,486	\$30	\$35	\$1,235	\$104	\$108	\$139	\$761	\$24	\$745	\$4,667
Charge-offs	(9 )	(91 )	-	(99 )	-	-	-	(291 )	(70 )	-	(560)
Recoveries	17	243	-	3	-	3	1	100	13	-	380
Provision	(293 )	17	62	735	5	47	(24 )	(103 )	67	434	947
Ending Balance	\$1,201	\$199	\$97	\$1,874	\$109	\$158	\$116	\$467	\$34	\$1,179	\$5,434
Ending balance: individually evaluated for impairment	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$23	\$-	\$-	\$23
Ending balance: collectively evaluated for impairment	\$1,201	\$199	\$97	\$1,874	\$109	\$158	\$116	\$444	\$34	\$1,179	\$5,411



Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Loans receivable: Ending balance	\$209,186	\$18,579	\$10,013	\$231,439	\$19,515	\$38,779	\$19,757	\$29,204	\$1,914		\$578,386
Ending balance: individually evaluated for impairment	\$1,159	\$109	\$-	\$2,039	\$-	\$-	\$74	\$277	\$-		\$3,658
Ending balance: collectively evaluated for impairment	\$208,027	\$18,470	\$10,013	\$229,400	\$19,515	\$38,779	\$19,683	\$28,927	\$1,914		\$574,728

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 6 - Loans Receivable and Related Allowance for Loan Losses (Continued)

	Year Ended September 30, 2015										Total
	Residential Mortgage	Residential and Commercial	Construction and Development Land	Commercial Real Estate	Multi- family	Other	Consumer Home Equity Lines of Credit	Second Mortgages	Other	Unallo-	
	(In thousands)										
Allowance for loan losses:											
Beginning balance	\$1,672	\$291	\$13	\$1,248	\$29	\$50	\$168	\$1,033	\$23	\$62	\$4,589
Charge-offs	-	(1 )	-	(48 )	-	-	-	(138 )	(34 )	-	(221 )
Recoveries	17	98	-	9	-	3	2	69	11	-	209
Provision	(203 )	(358 )	22	26	75	55	(31 )	(203 )	24	683	90
Ending Balance	\$1,486	\$30	\$35	\$1,235	\$104	\$108	\$139	\$761	\$24	\$745	\$4,667
Ending balance: individually evaluated for impairment	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-
Ending balance: collectively evaluated for impairment	\$1,486	\$30	\$35	\$1,235	\$104	\$108	\$139	\$761	\$24	\$745	\$4,667
Loans receivable:											
Ending balance	\$214,958	\$5,677	\$2,142	\$87,686	\$7,444	\$13,380	\$22,919	\$37,633	\$2,359		\$394,198
Ending balance: individually evaluated	\$599	\$121	\$-	\$1,571	\$-	\$-	\$20	\$179	\$-		\$2,490

for  
impairment  
Ending  
balance:  
collectively  
evaluated  
for  
impairment

\$214,359	\$5,556	\$2,142	\$86,115	\$7,444	\$13,380	\$22,899	\$37,454	\$2,359	\$391,708
-----------	---------	---------	----------	---------	----------	----------	----------	---------	-----------

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 6 - Loans Receivable and Related Allowance for Loan Losses (Continued)

	Year Ended September 30, 2014										Total
	Residential Mortgage	Residential and Commercial	Construction and Development Land	Commercial Real Estate	Multi- family	Other	Consumer Home Equity Lines of Credit	Second Mortgages	Other	Unallo-	
	(In thousands)										
Allowance for loan losses:											
Beginning balance	\$1,414	\$164	\$56	\$1,726	\$40	\$59	\$137	\$1,393	\$22	\$79	\$5,090
Charge-offs	(83 )	(37 )	-	(183 )	-	-	(14 )	(618 )	(6 )	-	(941 )
Recoveries	23	1	-	9	-	3	1	136	4	-	177
Provision	318	163	(43 )	(304 )	(11 )	(12 )	44	122	3	(17)	263
Ending Balance	\$1,672	\$291	\$13	\$1,248	\$29	\$50	\$168	\$1,033	\$23	\$62	\$4,589
Ending balance: individually evaluated for impairment	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-	\$-
Ending balance: collectively evaluated for impairment	\$1,672	\$291	\$13	\$1,248	\$29	\$50	\$168	\$1,033	\$23	\$62	\$4,589
Loans receivable:											
Ending balance	\$231,324	\$5,964	\$1,033	\$71,579	\$1,032	\$5,480	\$22,292	\$47,034	\$2,839		\$388,577
Ending balance: individually evaluated	\$999	\$187	\$-	\$504	\$-	\$900	\$115	\$695	\$-		\$3,400

for  
impairment  
Ending  
balance:  
collectively  
evaluated  
for  
impairment

\$230,325	\$5,777	\$1,033	\$71,075	\$1,032	\$4,580	\$22,177	\$46,339	\$2,839	\$385,177
-----------	---------	---------	----------	---------	---------	----------	----------	---------	-----------

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 6 - Loans Receivable and Related Allowance for Loan Losses (Continued)

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, 2016 and 2015.

	Impaired Loans With Specific Allowance		Impaired Loans With No Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
(In thousands)					
September 30, 2016:					
Residential mortgage	\$—	\$ —	\$ 1,159	\$ 1,159	\$ 1,225
Construction and Development:					
Residential and commercial	—	—	109	109	109
Commercial:					
Commercial real estate	—	—	2,039	2,039	2,039
Consumer:					
Home equity lines of credit	—	—	74	74	90
Second mortgages	31	23	246	277	451
Total impaired loans	\$31	\$ 23	\$ 3,627	\$ 3,658	\$ 3,914
September 30, 2015:					
Residential mortgage	\$—	\$ —	\$ 599	\$ 599	\$ 696
Construction and Development:					
Residential and commercial	—	—	121	121	253
Commercial:					
Commercial real estate	—	—	1,571	1,571	1,807
Consumer:					
Home equity lines of credit	—	—	20	20	36
Second mortgages	—	—	179	179	342
Total impaired loans	\$—	\$ —	\$ 2,490	\$ 2,490	\$ 3,134

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 6 - 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, 2016, 2015 and 2014.

	Average Interest Income Impaired/Recognized on Loans Impaired Loans (In thousands)	
Year Ended September 30, 2016:		
Residential mortgages	\$707	\$ —
Construction and Development:		
Residential and commercial	150	4
Commercial:		
Commercial real estate	1,646	69
Consumer:		
Home equity lines of credit	24	—
Second mortgages	214	—
Total	\$2,741	\$ 73
Year Ended September 30, 2015:		
Residential mortgages	\$729	\$ —
Construction and Development:		
Residential and commercial	144	5
Commercial:		
Commercial real estate	690	4
Other	340	12
Consumer:		
Home equity lines of credit	23	—
Second mortgages	537	—
Total	\$2,463	\$ 21
Year Ended September 30, 2014:		
Residential mortgages	\$1,731	\$ —
Construction and Development:		
Residential and commercial	609	17
Land	240	14
Commercial:		
Commercial real estate	21	—

Other	900	32
Consumer:		
Home equity lines of credit	104	—
Second mortgages	622	—
Total	\$4,227	\$ 63

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

-78-



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 6 - 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, 2016 and 2015.

	September 30, 2016				
	Pass	Special Mention	Substandard	Doubtful	Total
	(In thousands)				
Residential mortgage	\$207,880	\$ 122	\$ 1,184	\$ —	\$209,186
Construction and Development:					
Residential and commercial	18,470	—	109	—	18,579
Land	10,013	—	—	—	10,013
Commercial:					
Commercial real estate	221,742	4,990	4,707	—	231,439
Multi-family	19,303	212	—	—	19,515
Other	37,848	259	672	—	38,779
Consumer:					
Home equity lines of credit	19,584	—	173	—	19,757
Second mortgages	27,843	119	1,242	—	29,204
Other	1,903	11	—	—	1,914
Total	\$564,586	\$ 5,713	\$ 8,087	\$ —	\$578,386

	September 30, 2015				
	Pass	Special Mention	Substandard	Doubtful	Total
	(In thousands)				
Residential mortgage	\$214,146	\$ 130	\$ 682	\$ —	\$214,958
Construction and Development:					
Residential and commercial	5,450	106	121	—	5,677
Land	2,142	—	—	—	2,142
Commercial:					
Commercial real estate	78,207	4,791	4,688	—	87,686
Multi-family	7,166	278	—	—	7,444
Other	12,387	272	721	—	13,380
Consumer:					
Home equity lines of credit	22,801	—	118	—	22,919

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Second mortgages	36,834	133	666	—	37,633
Other	2,345	14	—	—	2,359
Total	\$381,478	\$ 5,724	\$ 6,996	\$ —	\$394,198

-79-

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 6 - 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,	
	2016	2015
	(In thousands)	
Residential mortgage	\$1,072	\$599
Construction and Development:		
Residential and commercial	—	12
Commercial:		
Commercial real estate	193	589
Consumer:		
Home equity lines of credit	74	20
Second mortgages	278	179
Total non-accrual loans	\$1,617	\$1,399

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. Interest income that would have been recognized on nonaccrual loans had they been current in accordance with their original terms was \$48,000, \$84,000 and \$121,000 for fiscal 2016, 2015 and 2014, respectively. At September 30, 2016 there were approximately \$696,000 loans past due 90 days or more and still accruing interest. There were no loans past due 90 days or more and still accruing interest at September 30, 2015.

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, 2016 and 2015.

Current	30-59 Days Past Due	60-89 Days Past Due	90 Days or More	Total Past Due	Total Loans Receivable	Accruing 90 Days or More
---------	------------------------------	------------------------------	--------------------------	----------------------	---------------------------	-----------------------------------

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

						Past Due	Past Due
	(in thousands)						
September 30, 2016:							
Residential mortgage	\$204,816	\$1,750	\$1,345	\$1,275	\$4,370	\$209,186	\$509
Construction and Development:							
Residential and commercial	18,579	—	—	—	—	18,579	—
Land	10,013	—	—	—	—	10,013	—
Commercial:							
Commercial real estate	231,059	—	—	380	380	231,439	187
Multi-family	19,515	—	—	—	—	19,515	—
Other	38,433	346	—	—	346	38,779	—
Consumer:							
Home equity lines of credit	19,513	170	43	31	244	19,757	—
Second mortgages	27,933	473	566	232	1,271	29,204	—
Other	1,913	1	—	—	1	1,914	—
Total	\$571,774	\$2,740	\$1,954	\$1,918	\$6,612	\$578,386	\$696

-80-

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 6 - Loans Receivable and Related Allowance for Loan Losses (Continued)

	Current	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Total Loans Receivable
(in thousands)						
September 30, 2015:						
Residential mortgage	\$ 213,253	\$ 913	\$ 193	\$ 599	\$ 1,705	\$ 214,958
Construction and Development:						
Residential and commercial	5,665	—	—	12	12	5,677
Land	2,142	—	—	—	—	2,142
Commercial:						
Commercial real estate	86,119	485	493	589	1,567	87,686
Multi-family	7,444	—	—	—	—	7,444
Other	13,380	—	—	—	—	13,380
Consumer:						
Home equity lines of credit	22,899	—	—	20	20	22,919
Second mortgages	37,010	345	99	179	623	37,633
Other	2,329	30	—	—	30	2,359
Total	\$ 390,241	\$ 1,773	\$ 785	\$ 1,399	\$ 3,957	\$ 394,198

Restructured loans deemed to be 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 seven and five loans classified as TDRs with an aggregate outstanding balance of \$2.2 million and \$1.6 million at September 30, 2016 and 2015, respectively. At September 30, 2016, these loans were also classified as impaired. All of the TDR loans continue to perform under the restructured terms through September 30, 2016 and we continued to accrue interest on such loan through such date. Two commercial loans to one borrower, with an aggregate balance of \$477,000 at September 30, 2016, were returned to accruing status and consolidated into one loan during fiscal 2016. The increase in TDRs of approximately \$600,000 during fiscal 2016 was due to the addition of one residential mortgage loan with an outstanding balance of \$85,000 and a commercial loan with an outstanding balance of \$386,000 were classified as a performing TDR and impaired loan. As well as, one residential mortgage loan with a

balance of \$139,000 was classified as a non-performing TDR and impaired loan at September 30, 2016. At September 30, 2015, the two commercial loans to one borrower with a balance of \$492,000 were non-accruing. All of such loans have been classified as TDRs since we modified the payment terms and in some cases interest rate from the original agreements and allowed the borrowers, who were experiencing financial difficulty, to make 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 6 - 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 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 \$141,000 and \$1.2 million of residential real estate properties in the process of foreclosure at September 30, 2016 and 2015, 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 (Dollars in thousands)	Number of Loans	Recorded Investment
At September 30, 2016:				
Residential mortgage	2	\$ 224	1	\$ 139
Construction and Development:				
Residential and commercial	1	109	—	—
Commercial:				
Commercial real estate	4	1,845	—	—
Total	7	\$ 2,178	1	\$ 139
At September 30, 2015:				
Construction and Development:				
Residential and commercial	1	\$ 109	—	\$ —
Commercial:				
Commercial real estate	4	1,474	2	492
Total	5	\$ 1,583	2	\$ 492

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.

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

	September 30, 2016		2015	
	Performing	Non-Performing	Performing	Non-Performing
	(In thousands)			
Residential mortgage	\$85	\$ 139	\$—	\$ —
Construction and Development:				
Residential and commercial	109	—	109	—
Commercial:				
Commercial real estate	1,845	—	982	492
Total	\$2,039	\$ 139	\$1,091	\$ 492

-82-



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 6 - Loans Receivable and Related Allowance for Loan Losses (Continued)

The following table shows the new TDR's for the twelve months ended September 30, 2016 and 2015.

	September 30, 2016		2015	
	Pre- Recorded Investments	Post- Recorded Investments	Pre- Recorded Investments	Post- Recorded Investments
Restructured During Period				
Number of Loans	Number of Loans	Number of Loans	Number of Loans	Number of Loans
Modifications of Outstanding Loans	Modifications of Outstanding Loans	Modifications of Outstanding Loans	Modifications of Outstanding Loans	Modifications of Outstanding Loans
(In thousands)				
Troubled Debt Restructurings:				
Residential mortgage	2 \$ 245	\$ 245	- \$ -	\$ -
Commercial:				
Commercial real estate	1 386	386	4 1,485	1,485
Total	3 \$ 631	\$ 631	4 \$ 1,485	\$ 1,485

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.

(In thousands)	Year Ended September 30,	
	2016	2015
Balance at beginning of year	\$ 5,635	\$ 252
New loans	12,249	8,474
Repayments	(9,892 )	(3,091 )
Balance at end of year	\$ 7,992	\$ 5,635

At September 30, 2016, 2015 and 2014, the Company was servicing loans for the benefit of others in the amounts of \$45.4 million, \$54.1 million and \$59.9 million, respectively. A summary of mortgage servicing rights included in other assets and the activity therein follows for the periods indicated:

	September 30,		
	2016	2015	2014
	(In thousands)		
Balance at beginning of year	\$401	\$453	\$271
Amortization	(73 )	(82 )	22
Addition	—	30	160
Balance at end of year	\$328	\$401	\$453

For the fiscal year ended September 30, 2016, 2015 and 2014, the fair value of servicing rights was determined using a base discount rate between 11% and 12%. 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, 2016, we sold \$6.4 million of long-term, fixed-rate residential mortgage loans with servicing released. This transaction resulted in a gain of \$116,000. For the year ended September 30, 2016, the Company only sold loans with servicing released. For the fiscal year ended September 30, 2015, we sold \$4.1 million of long-term, fixed-rate residential mortgage loans with the servicing retained. This transaction resulted in a gain of \$102,000. For the fiscal year ended September 30, 2014, we sold \$7.7 million of long-term, fixed-rate residential mortgage loans with the servicing retained. This transaction resulted in a gain of \$71,000.

No valuation allowance on servicing rights has been recorded at September 30, 2016, 2015, or 2014.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Note 7 - Property and Equipment**

Property and equipment, net consisted of the following at September 30, 2016 and 2015:

	Estimated Useful Life (years)	September 30,	
		2016	2015
		(In thousands)	
Land	-	\$711	\$711
Building and improvements	10-39	11,400	11,124
Construction in process	-	222	154
Furniture, fixtures and equipment	3-7	4,722	4,317
		17,055	16,306
Accumulated depreciation		(10,418)	(9,771)
		\$6,637	\$6,535

Depreciation expense was approximately \$650,000, \$646,000 and \$638,000 for the years ended September 30, 2016, 2015 and 2014, respectively. We also had a \$41,000 loss on disposal of fixed assets related to the closure of our Westtown branch in June 2014.

**Note 8 - Deposits**

Deposits classified by interest rates with percentages to total deposits at September 30, 2016 and 2015 consisted of the following:

	September 30,			
	2016	2015	2016	2015
	Amount	Amount	Percent of Total Deposits	Percent of Total Deposits
	(Dollars in thousands)			
Balances by types of deposit:				
Savings	\$44,714	\$45,189	7.43 %	9.71 %

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Money market accounts	177,486	29.48	108,706	23.35
Interest bearing demand	95,041	15.78	82,897	17.81
Non-interest bearing demand	34,547	5.74	27,010	5.80
	351,788	58.43	263,802	56.67
Certificates of deposit	250,258	41.57	201,720	43.33
Total	\$602,046	100.00	% \$465,522	100.00 %

The total amount of certificates of deposit of \$250,000 and greater at September 30, 2016 and 2015 was \$13.7 million and \$12.2 million, respectively. We had brokered deposits totaling \$58.8 million at September 30, 2016. We had no brokered deposits at September 30, 2015.

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

	September 30,		
	2016	2015	2014
	(In thousands)		
Savings accounts	\$33	\$29	\$27
Money market accounts	874	271	164
Interest bearing demand	139	83	85
Certificates of deposit	3,491	3,048	3,693
Total deposits	\$4,537	\$3,431	\$3,969

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 8 - Deposits (Continued)**

The following is a schedule of certificates of deposit maturities.

	September 30, 2016 (In thousands)
Maturing in the Fiscal Year Ending September 30,	
2017	\$ 150,614
2018	48,906
2019	16,981
2020	8,218
2021	16,551
Thereafter	8,988
	\$ 250,258

Deposits from related parties held by the Company at September 30, 2016 and 2015 amounted to \$6.4 million and \$5.5 million, respectively.

**Note 9 - Borrowings**

Under terms of its collateral agreement with the Federal Home Loan Bank of Pittsburgh (“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 \$127.8 million and \$108.5 million, respectively, of which none was outstanding at September 30, 2016 or 2015. The interest rate on the line of credit at September 30, 2016 and 2015 was 0.46% and 0.34%, respectively.

The summary of long-term borrowings as of September 30, 2016 and 2015 are as follows:

	September 30, 2016		2015		
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	
	(Dollars in thousands)				
Due by September 30:					
2016	\$-	-	% \$20,000	0.61	%
2017	35,000	0.22	-	-	
2018	-	-	30,000	3.38	
2019	55,000	1.62	25,000	2.12	
2020	28,000	2.83	28,000	2.51	
Total FHLB Advances	\$118,000	1.65	% \$103,000	2.48	%

At September 30, 2016, the Company had \$118.0 million in outstanding long-term fixed rate FHLB advances and \$223.0 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.

#### Note 10 - 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 10 - Derivatives (Continued)

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 and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. At September 30, 2016, such derivatives were used to hedge the variable cash flows associated with FHLB advances. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. The Company's derivatives did not have any hedge ineffectiveness recognized in earnings during fiscal 2016 and 2015.

Amounts reported in accumulated other comprehensive 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 \$203,000 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 table below presents the fair value of the Company's derivative financial instruments as well as their classification on the Balance Sheet as of September 30, 2016 and 2015:

	September 30, 2016			Expiration Date
	Notional Amount	Fair Value	Balance Sheet Location	
Derivatives designated as hedging instruments				
Interest rate swaps by effective date:				
August 3, 2015	\$ 15,000	\$ 394	Other liabilities	August 3, 2020
February 5, 2016	20,000	148	Other liabilities	February 1, 2021

	September 30, 2015			
	Notional Amount	Fair Value	Balance Sheet Location	Expiration Date
	(Dollars in thousand)			
Derivatives designated as hedging instruments				
Interest rate swaps by effective date:				
August 3, 2015	\$15,000	\$ 348	Other liabilities	August 3, 2020

Interest expense recorded on these swaps transactions totaled approximately \$272,000 and \$36,000 for the years ended September 30, 2016 and 2015, respectively, and is reported as a component of interest expense on FHLB Advances. There are no related expenses for the year ended September 30, 2014.





At September 30, 2016 and 2015, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was \$586,000 and \$195,000, respectively. As of September 30, 2016 and 2015, the Company has minimum collateral posting thresholds with certain of its derivative counterparties and has posted collateral of \$800,000 and \$600,000, respectively, against its obligations under these agreements. If the Company had breached any of these provisions at September 30, 2016, 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 11 - 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 11 - Fair Value Measurements (Continued)

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.

FASB ASC Topic 825 "Financial Instruments" provides an option to elect fair value as an alternative measurement for selected financial assets and financial liabilities not previously recorded at fair value. The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation.

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, 2016 and 2015.

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

The tables below present the balances of assets measured at fair value on a recurring basis at September 30, 2016 and 2015:

	September 30, 2016			
	Total	Level 1	Level 2	Level 3
	(in thousands)			
Assets:				
Investment securities available-for-sale:				
Debt securities:				
State and municipal obligations	\$25,307	\$ —	\$25,307	\$ —
Single issuer trust preferred security	878	—	878	—
Corporate debt securities	40,202	—	40,202	—
Total investment securities available-for-sale	66,387	—	66,387	—
Liabilities:				
Derivative instruments	\$542	\$ —	\$542	\$ —

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 11 - Fair Value Measurements (Continued)

	September 30, 2015			
	Total	Level 1	Level 2	Level 3
	(in thousands)			
Assets:				
Investment securities available-for-sale:				
Debt securities:				
U.S. government agencies	\$815	\$ —	\$815	\$ —
State and municipal obligations	42,083	—	42,083	—
Single issuer trust preferred security	850	—	850	—
Corporate debt securities	69,982	—	69,982	—
Total investment securities available-for-sale	113,730	—	113,730	—
Mortgage-backed securities available-for-sale:				
FNMA, fixed-rate	8,692	—	8,692	—
FHLMC, fixed-rate	5,932	—	5,932	—
Total mortgage-backed securities available-for-sale	14,624	—	14,624	—
Total investments securities available for sale	\$128,354	\$ —	\$128,354	\$ —
Liabilities:				
Derivative instruments	\$348	\$ —	\$348	\$ —

For assets measured at fair value on a nonrecurring basis in fiscal 2016 and fiscal 2015 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, 2016 and 2015:

	September 30, 2016			
	Total	Level 1	Level 2	Level 3
	(in thousands)			
Impaired loans <sup>(1)</sup>	\$ 8	\$ —	\$ —	\$ 8
Total	\$ 8	\$ —	\$ —	\$ 8

	September 30, 2016		
	Fair Valuation Technique Value	Unobservable Input	Range/(Weighted Average)
at September 30,			

	2016			
	(dollars in thousands)			
Impaired loans <sup>(1)</sup>	\$8	Appraisal of collateral <sup>(2)</sup>	Collateral discounts <sup>(3)</sup>	0%/(0%)
Total	\$8			

(1) At September 30, 2016, consisted of one loan with an aggregate balance of \$31,000 and with \$23,000 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 11 - Fair Value Measurements (Continued)

	September 30, 2015			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Impaired loans <sup>(1) (2)</sup>	\$48	\$ —	\$ —	\$ 48
Mortgage servicing rights	30	—	30	—
Total	\$78	\$ —	\$ 30	\$ 48

	September 30, 2015			
	Fair Value	at	Unobservable Input	Range/(Weighted Average)
		September 30, 2015		
	(Dollars in thousands)			
Impaired loans <sup>(1) (2)</sup>	\$48	Valuation Technique	Collateral discounts <sup>(4)</sup>	65 – 80%/(74 )%
Total	\$48			

(1) At September 30, 2015, consisted of two loans with an aggregate balance of \$48,000 and there were no specific loan loss allowance.

(2) Includes assets directly charged-down to fair value during the year-to-date period.

(3) Fair value is generally determined through independent appraisals of the underlying collateral primarily using comparable sales.

(4) Appraisals may be adjusted by management for qualitative factors such as time, changes in economic conditions and estimated liquidation expense.

For the year ended September 30, 2016, the Company did not have any additions to our mortgage servicing assets. For the fiscal year end 2016, the Company only sold loans with servicing released. The following table shows active information regarding significant techniques and inputs used at September 30, 2015 for measures in a non-recurring basis using unobservable inputs (Level 2):

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

	Fair Value at September 30, 2015 (In thousands)	Valuation Technique	Unobservable Input	Method or Value as of September 30, 2015
Mortgage servicing rights	\$ 30	Discounted rate	Discount rate	11.00 – 12.00 % Rate used through modeling period
			Loan prepayment speeds	14.73 % Weighted-average conditional prepayment rate
			Servicing fees	0.25 % Of loan balance
			Servicing costs	\$6.25 Monthly servicing cost per account
				\$300 – 500 Additional monthly servicing cost per loan on loans more than 30 days delinquent



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 11 - Fair Value Measurements (Continued)

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, 2016 and 2015. 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, 2016 and 2015 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) and held to maturity (carried at amortized cost) 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 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. The Company had no Level 1 or Level 3 securities as of September 30, 2016 or 2015.

**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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 11 - Fair Value Measurements (Continued)

**Restricted Stock**—Although restricted stock is an equity interest in the FHLB, 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 borrowings of similar maturities. A decay rate is estimated for non-time deposits. The discount rate for non-time deposits is adjusted for servicing costs based on industry estimates.

**Long-Term 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.

**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. 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 11 - Fair Value Measurements (Continued)

The carrying amount and estimated fair value of the Company's financial instruments as of September 30, 2016 and 2015 were as follows:

	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
	(in thousands)				
September 30, 2016:					
Financial assets:					
Cash and cash equivalents	\$96,762	\$96,762	\$96,762	\$—	\$—
Investment securities available-for-sale	66,387	66,387	—	66,387	—
Investment securities held-to-maturity	40,551	40,817	—	40,817	—
Loans receivable, net (including impaired loans)	574,160	589,844	—	—	589,844
Accrued interest receivable	2,558	2,558	—	2,558	—
Restricted stock	5,424	5,424	—	5,424	—
Mortgage servicing rights (included in Other Assets)	328	308	—	308	—
Financial liabilities:					
Savings accounts	44,714	44,714	—	44,714	—
Checking and NOW accounts	129,588	129,588	—	129,588	—
Money market accounts	177,486	177,486	—	177,486	—
Certificates of deposit	250,258	252,232	—	252,232	—
FHLB advances	118,000	119,946	—	119,946	—
Derivatives (included in Other Liabilities)	542	542	—	542	—
Accrued interest payable	427	427	—	427	—
September 30, 2015:					
Financial assets:					
Cash and cash equivalents	\$40,263	\$40,263	\$40,263	\$—	\$—
Investment securities available-for-sale	128,354	128,354	—	128,354	—
Investment securities held-to-maturity	57,221	56,825	—	56,825	—
Loans receivable, net	391,307	400,305	—	—	400,305
Accrued interest receivable	2,484	2,484	—	2,484	—
Restricted stock	4,765	4,765	—	4,765	—
Mortgage servicing rights	401	416	—	416	—
Financial liabilities:					
Savings accounts	45,189	45,189	—	45,189	—
Checking and NOW accounts	109,907	109,907	—	109,907	—
Money market accounts	108,706	108,706	—	108,706	—

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Certificates of deposit	201,720	203,257	—	203,257	—
FHLB advances	103,000	104,889	—	104,889	—
Derivatives	348	348	—	348	—
Accrued interest payable	396	396	—	396	—

-93-

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 12 - 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.

In accordance with ASC Topic 740, the Company considered prudent and feasible tax-planning strategies available at September 30, 2016 that, if implemented, could prevent an operating loss or tax credit carry-forward from expiring unused and could result in realization of the existing DTA. The Company has no present intention to implement such strategies; however, in the event that the Company determined future earnings would not be sufficient to realize the deferred tax asset, the Company has the ability to realize a portion of DTA through tax strategies such as: selling available-for-sale securities in a gain position from the investment portfolio, surrendering BOLI policies, and selling loans in a gain position from the loan portfolio, as well as sales or sale/leaseback of branch offices/office buildings to recognize built-in gains.

Deferred income taxes at September 30, 2016 and 2015 were as follows:

	September 30,	
	2016	2015
	(In thousands)	
Deferred Tax Assets:		
Unrealized loss on investments available for sale	\$—	\$383
Allowance for loan losses	3,299	2,985
Non-accrual interest	56	98
Write-down of real estate owned	—	106
Alternative minimum tax (AMT) credit carryover	287	128
Low-income housing tax credit carryover	217	337
Supplement Employer Retirement Plan	412	455
Charitable contributions	61	36
Depreciation	60	205

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Federal net operating loss	4,344	6,375
Other	651	338
Total Deferred Tax Assets	9,387	11,446
Valuation allowance for DTA	(61 )	(8,043 )
Total Deferred Tax Assets, Net of Valuation Allowance	\$9,326	\$3,403
Deferred Tax Liabilities:		
State net operating income	—	(187 )
Unrealized gain on investments available-for-sale	(152 )	—
Mortgage servicing rights	(112 )	(136 )
Other	(235 )	(206 )
Total Deferred Tax Liabilities	(499 )	(529 )
Deferred Tax Assets, Net	\$8,827	\$2,874

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

Gross federal net operating loss carryforwards of \$12.7 million (net DTA of \$4.3 million) to expire in the fiscal year ending September 30, 2031;

Low income housing credit carryforwards of \$217,000 to expire in the fiscal years ending September 30, 2030 and 2031;



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 12 – Income Taxes (Continued)

AMT credit carryforward has no expiration date; and

Gross charitable contributions carryforwards of \$180,000 (net DTA of \$61,000) to expire in the fiscal year ending September 30, 2018.

Income tax expense for the years ended September 30, 2016, 2015 and 2014 was comprised of the following:

	September 30,		
	2016	2015	2014
	(In thousands)		
Federal:			
Current	\$350	\$1,035	\$388
Deferred	(6,316)	(1,035)	(367)
	(5,966)	-	21
State, current	-	-	-
	\$(5,966)	\$-	\$21

The following reconciliation between federal income tax at the statutory rate of 34% and the actual income tax expense (benefit) recorded on income (loss) before income taxes for the years ended September 30, 2016, 2015 and 2014:

	September 30,		
	2016	2015	2014
	(Dollars in thousands)		
At federal statutory rate at 34%	\$2,032	\$1,257	\$-
Adjustments resulting from:			
Tax-exempt interest	(265 )	(186 )	-
Earnings on bank-owned life insurance	(176 )	(231 )	-
Federal tax on cash surrender of BOLI	-	-	21
DTA valuation allowance	(7,775)	(873 )	-
Other	218	33	-
	\$(5,966)	\$-	\$21

Effective tax rate (99.8 )% 0.0 % 3.3 %

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 like than not to be sustained upon examination by tax authorities. As of September 30, 2016 and 2015, 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, 2013 to September 30, 2016.

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.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 13 - Leases**

Pursuant to the terms of non-cancelable operating lease agreements expiring in September 2030, pertaining to Company property, future minimum rent commitments are (In thousands):

Years ending September 30:	
2017	\$385
2018	429
2019	431
2020	434
2021	466
Thereafter	2,225
	\$4,370

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

Years ending September 30:	
2017	\$133
2018	22
2019	-
2020	-
2021	-
	\$155

**Note 14 - 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, 2016 and 2015, the uncollateralized portion of the letters of credit extended by the Company was approximately \$1.9 million and \$566,000, respectively. The current amount of the liability for guarantees under letters of credit was not material as of September 30, 2016 or 2015.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Note 14 – Commitments and Contingencies (Continued)**

At September 30, 2016 and 2015, the following financial instruments were outstanding whose contract amounts represent credit risk:

	September 30,	
	2016	2015
	(In thousands)	
Commitments to extend credit:		
Future loan commitments	\$97,566	\$26,849
Undisbursed construction loans	33,135	14,187
Undisbursed home equity lines of credit	25,270	27,074
Undisbursed commercial lines of credit	22,272	20,325
Undisbursed commercial unsecured lines of credit	26,395	5,275
Overdraft protection lines	850	840
Standby letters of credit	1,927	566
Total Commitments	\$207,415	\$95,116

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 15 - Regulatory Matters**

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 new regulations establish a new tangible common equity capital requirement, increase the minimum requirement for the current Tier 1 risk-weighted asset ("RWA") ratio, phase out certain kinds of intangibles treated as capital and certain types of instruments and change the risk weightings of certain assets used to determine required capital ratios. The new common equity Tier 1 capital component requires capital of the highest quality – predominantly composed of retained earnings and common stock instruments. For community banks such as Malvern Federal Savings Bank, a common equity Tier 1 capital ratio of 4.5% became effective on January 1, 2015. The new capital rules also increased the minimum Tier 1 capital ratio from 4.0% to 6.0% beginning on January 1, 2015. The rules also establish a capital conservation buffer of 2.5% 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%, (2) a Tier 1 capital ratio of 8.5%, and (3) a total capital ratio of 10.5%. The new capital conservation buffer requirement was phased in beginning in January 2016 at 0.625% 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.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## Note 15 - Regulatory Matters – (continued)

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, 2016, 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, 2016:

(Dollars in thousands)	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, 2016:						
Tier 1 Leverage (Core) Capital (to average assets)	\$90,310	11.45%	\$ 31,561	4.00 %	\$39,452	5.00 %
Common Equity Tier 1 Capital (to risk weighted assets)	90,310	15.11%	26,894	4.50 %	38,847	6.50 %
Tier 1 Capital (to risk weighted assets)	90,310	15.11%	35,859	6.00 %	47,812	8.00 %
Total Risk Based Capital (to risk weighted assets)	95,806	16.03%	47,812	8.00 %	59,765	10.00 %

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## Note 15 - Regulatory Matters – (continued)

The following table summarizes the Bank's compliance with applicable regulatory capital requirements as of September 30, 2016 and 2015:

(Dollars in thousands)	Actual		For Capital		To Be Well	
	Capital Amount	Ratio	Adequacy Capital Amount	Purposes Ratio	Capitalized Under Prompt Corrective Action Provisions Capital Amount	Ratio
As of September 30, 2016:						
Tier 1 Leverage (to average assets)	\$85,030	10.79%	\$ 31,533	4.00 %	\$39,417	5.00 %
Common Equity Tier 1 Capital (to risk weighted assets)	85,030	14.24%	26,875	4.50 %	38,820	6.50 %
Tier 1 Capital (to risk weighted assets)	85,030	14.24%	35,834	6.00 %	47,779	8.00 %
Total Capital (to risk weighted assets)	90,526	15.16%	47,779	8.00 %	59,723	10.00 %
As of September 30, 2015:						
Tier 1 Leverage (to average assets)	\$69,030	10.80%	\$ 25,573	4.00 %	\$31,966	5.00 %
Common Equity Tier 1 Capital (to risk weighted assets)	69,030	15.90%	19,538	4.50 %	28,222	6.50 %
Tier 1 Capital (to risk weighted assets)	69,030	15.90%	26,051	6.00 %	34,734	8.00 %
Total Capital (to risk weighted assets)	73,759	16.99%	34,734	8.00 %	43,418	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, 2016 and 2015:

September 30, 2016	2015
(In thousands)	



Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Bank GAAP equity	\$ 89,311	\$ 67,951
Disallowed portion of deferred tax asset	(4,344 )	-
Net unrealized gain on securities available for sale, net of income taxes	(294 )	743
Net unrealized gain on derivatives, net of income taxes	357	336
Tangible Capital , Core Capital and Tier 1 Capital	85,030	69,030
Allowance for loan losses	5,496	4,729
Total Risk-Based Capital	\$ 90,526	\$ 73,759

-99-

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## Note 16 – Comprehensive Income (Loss)

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

	September 30,		
	2016	2015	2014
	(In thousands)		
Net unrealized holding gains (losses) on available-for- sale securities	\$447	\$(1,011)	\$(2,736)
Tax effect	(152)	344	931
Net of tax amount	295	(667 )	(1,805)
Net unrealized holding losses on securities available-for- sale transferred to held-to-maturity	—	(115 )	—
Tax effect	—	39	—
Net of tax amount	—	(76 )	—
Fair value adjustment on derivatives	(542)	(348 )	—
Tax effect	184	12	—
Net of tax amount	(358)	(336 )	—
Total accumulated other comprehensive loss	\$(63 )	\$(1,079)	\$(1,805)

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

	Year Ended September 30,		
	2016	2015	2014
	(In thousands)		
Net unrealized holding gains (losses) on available-for-sale securities	\$2,128	\$2,120	\$1,419
Net realized gain on securities available-for-sale	(565 )	(515 )	(83 )
Amortization of unrealized holding losses on securities available- for-sale transferred to held-to-maturity	9	5	—
Fair value adjustment on derivatives	(194 )	(348 )	—

Other comprehensive income (loss) before taxes	1,378	1,262	1,336
Tax effect	(362 )	(536 )	(453 )
Total comprehensive income (loss)	\$ 1,016	\$ 726	\$ 883

**Note 17 – 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, 2016, there were 393,070 remaining shares available for future grants.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

### Note 17 - Equity Based Incentive Compensation Plan – (continued)

Restricted stock and option awards granted during fiscal 2016 vest in 20% 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.

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.

No options were granted in fiscal 2015 or 2014. In fiscal 2016, stock options covering 5,000 shares of common stock were granted. Total compensation expense related to options granted under the 2014 Plan was \$3,000 for fiscal 2016 and zero for fiscal 2015 and 2014, respectively.

During fiscal 2016, 2,240 shares of restricted stock were awarded and 310 of those shares were forfeited. During fiscal 2015 and 2014 no shares of restricted stock were awarded. The compensation expense related to restricted stock awards was approximately \$5,000 for fiscal 2016 and zero in fiscal 2015 and 2014, respectively.

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.

The assumptions used in determining the fair value of stock option grants for the year ended September 30, 2016 are as follows:

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Weighted average fair value of awards	\$5.15	
Risk-free rate	1.45	%
Dividend yield	-	%
Volatility	28.88	%
Expected life	6.5	years

The following is a summary of currently outstanding options at September 30, 2016:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In Years)	Aggregate Intrinsic Value
Outstanding, beginning of year	—			
Granted	5,000	\$ 16.02		
Exercised	—	—		
Forfeited/cancelled/expired	—	—		
Outstanding, end of year	5,000	\$ 16.02	9.498	\$ 1,900
Vested and expected to vest, end of year	5,000	\$ 16.02	9.498	\$ 1,900

-101-

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****Note 17 - Equity Based Incentive Compensation Plan – (continued)**

The table below summarizes the activity for the Company's restricted stock outstanding at September 30, 2016:

	Shares	Weighted Average Fair Value
Outstanding, beginning of year	—	
Granted	2,240	\$ 17.40
Vested	—	—
Forfeited/cancelled/expired	(310 )	17.40
Outstanding, end of year	1,930	\$ 17.40

As of September 30, 2016, there was \$29,000 of total unrecognized compensation cost related to nonvested shares of restricted stock granted under the Plan. The cost is expected to be recognized over a weighted average period of 9.25 years.

**Note 18 – Condensed Financial Information - Parent Company Only****Condensed Statements of Financial Condition**

	September 30,	
	2016	2015
	(In thousands)	
Assets		
Cash and Cash Equivalents	\$3,192	\$5,325
Investment in subsidiaries	89,311	67,951
Investment securities held to maturity, (fair value at \$5,666)	—	5,762
Loans receivable, net	1,709	1,842
Other assets	418	532
Total Assets	\$94,630	\$81,412

Liabilities

Accounts payable	\$39	\$21
Shareholders' Equity	94,591	81,391
Total Liabilities and Shareholders' Equity	\$94,630	\$81,412

-102-

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Note 18 – Condensed Financial Information - Parent Company Only (Continued)****Condensed Statements of Operations**

	Year Ended September 30,		
	2016	2015	2014
	(In thousands)		
Income			
Interest income	\$ 116	\$ 196	\$ 254
Total Interest Income	116	196	254
Expense			
Other operating expenses	189	251	331
Total Other Expenses	189	251	331
Loss before Equity in Undistributed Net Income of Subsidiaries and Income Tax Expense	(73 )	(55 )	(77 )
Equity in Undistributed Net Income of Subsidiaries	12,126	3,753	400
Income tax expense	111	-	-
Net Income	\$ 11,942	\$ 3,698	\$ 323

**Condensed Statements of Comprehensive Income**

(In thousands)	Year Ended September 30,		
	2016	2015	2014
Net Income	\$ 11,942	\$ 3,698	\$ 323
Other Comprehensive Income (Loss), Net of Tax:			
Unrealized holding gains (losses) on available-for- sale securities	2,128	2,120	1,419
Tax effect	(723 )	(721 )	(482 )
Net of tax amount	1,405	1,399	937
Reclassification adjustment for net gains arising during the period <sup>(1)</sup>	(565 )	(515 )	(83 )
Tax effect	192	175	29
Net of tax amount	(373 )	(340 )	(54 )



Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Accretion of unrealized holding losses on securities transferred from available-for-sale to held- to-maturity <sup>(2)</sup>	9	5	—
Tax effect	(3 )	(2 )	—
Net of tax amount	6	3	—
Fair value adjustment on derivatives	(194 )	(348 )	—
Tax effect	172	12	—
Net of tax amount	(22 )	(336 )	—
Total other comprehensive income	1,016	726	883
Total comprehensive income	\$ 12,958	\$ 4,424	\$ 1,206

(1) Amounts are included in net gain on sales of securities 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 18 – Condensed Financial Information - Parent Company Only (Continued)

## Condensed Statements of Cash Flows

	Year Ended September 30,		
	2016	2015	2014
	(In thousands)		
Cash Flows from Operating Activities			
Net income	\$11,942	\$3,698	\$323
Undistributed net income of subsidiaries	(12,126)	(3,752)	(400 )
Deferred income taxes, net	-	84	197
ESOP shares committed to be released	242	195	160
Increase (decrease) in accounts payable	18	(27 )	(14 )
(Increase) decrease in other assets	(2,629 )	239	227
Net Cash (Used in) Provided by Operating Activities	(2,553 )	437	493
Cash Flows from Investing Activities			
Proceeds from maturities and principal collection on investments available for sale, net	-	-	422
Proceeds from maturities and principal collection on investments held to maturity	287	511	-
Purchases of investment securities	-	-	(992 )
Calls, sales of investment securities	-	1,812	-
Loan originations and principal collections, net	133	127	121
Net Cash Provided by (Used in) Investing Activities	420	2,450	(449 )
Net (Decrease) Increase in Cash and Cash Equivalents	(2,133 )	2,887	44
Cash and Cash Equivalents - Beginning	5,325	2,438	2,394
Cash and Cash Equivalents - Ending	\$3,192	\$5,325	\$2,438
Supplementary Cash Flows Information			
Non-cash transfer of investment securities from Parent Company to Bank	\$5,475	\$-	\$-

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 19 – 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, 2016 and 2015.

	2016 4 <sup>th</sup> Quarter	3 <sup>rd</sup> Quarter	2 <sup>nd</sup> Quarter	1 <sup>st</sup> Quarter
	(Dollars in thousands, except per share data)			
Total Interest and Dividend Income	6,817	\$6,530	\$6,210	\$5,687
Total Interest Expense	1,796	1,750	1,710	1,476
Net Interest Income	5,021	4,780	4,500	4,211
Provision for Loan Losses	100	472	375	—
Total Other Income	615	659	501	558
Total Other Expenses	3,759	3,378	3,360	3,425
Income before income tax benefit	1,777	1,589	1,266	1,344
Income tax benefit	(5,966)	—	—	—
Net Income	\$7,743	\$1,589	\$1,266	\$1,344
Earnings Per Common Share:				
Basic	\$1.21	\$0.25	\$0.20	\$0.05
Diluted	\$1.21	\$0.25	\$0.20	n/a
Weighted Average Common Shares Outstanding				
Basic	6,415,049	6,411,766	6,408,167	6,402,332
Diluted	6,415,207	6,411,804	6,408,167	n/a
	2015 4 <sup>th</sup> Quarter	3 <sup>rd</sup> Quarter	2 <sup>nd</sup> Quarter	1 <sup>st</sup> Quarter
	(Dollars in thousands, except per share data)			
Total Interest and Dividend Income	5,344	\$5,139	\$5,166	\$4,813
Total Interest Expense	1,365	1,301	1,330	1,252
Net Interest Income	3,979	3,838	3,836	3,561
Provision for Loan Losses	—	—	—	90
Total Other Income	639	640	745	511
Total Other Expenses	3,454	3,273	3,573	3,661

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

Income before income tax benefit	1,164	1,205	1,008	321
Income tax benefit	—	—	—	—
Net Income	\$1,164	\$1,205	\$1,008	\$321
Earnings Per Common Share:				
Basic	\$0.18	\$0.19	\$0.16	\$0.05
Diluted	n/a	n/a	n/a	n/a
Weighted Average Common Shares				
Outstanding				
Basic	6,398,720	6,395,126	6,391,521	6,387,932
Diluted	n/a	n/a	n/a	n/a

-105-

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

Not Applicable.

**Item 9A. Controls and Procedures.**

**Evaluation of Disclosure 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, 2016. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective.

**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;

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.

Management including the Chief Executive Officer and Chief Financial Officer, conducted a review, evaluation and testing of the effectiveness of the Company's controls over financial reporting based on the 2013 framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Management concluded that the Company's internal control over financial reporting was effective as of September 30, 2016.

### **Remediation of Material Weakness**

Item 9A of the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2015, indicated that management's review of the Company's internal control over financial reporting identified certain deficiencies which, in the aggregate, constituted a material weakness at September 30, 2015, and described the Company's remediation plan to address such deficiencies. An internal control material weakness is a significant deficiency, or combination of significant deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. The Company's remediation efforts included: enhancement of the Company's procedures with respect to documentation and identification of troubled debt restructurings; enhancement of the Company's analysis and review process with respect to impaired loans; and re-evaluation of its policies and procedures regarding use of real estate appraisers who are not on the Company's list of approved appraisers. During the quarter ended December 31, 2015, the Company commenced the remediation efforts described in Item 9A of the fiscal 2015 Annual Report on Form 10-K and such efforts continued through the quarter ended September 30, 2016. As indicated above, after completing its assessment of the Company's internal control over financial reporting as of September 30, 2016, management concluded that the Company had remediated the previously identified weaknesses.

### **Changes in Internal Control over Financial Reporting**

Other than the changes described above, no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15(d)-15(f) under the Securities Exchange Act of 1934) occurred during the fourth quarter of fiscal 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders

Malvern Bancorp, Inc. and Subsidiaries

Paoli, Pennsylvania

We have audited Malvern Bancorp Inc. and subsidiaries (the “Company”) internal control over financial reporting as of September 30, 2016, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Malvern Bancorp Inc.’s management is responsible 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 Item 9A, “Management’s Annual Report on Internal Control over Financial Reporting.” Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit 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 audit 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.

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.



In our opinion, Malvern Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of September 30, 2016, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statement of financial condition of Malvern Bancorp, Inc. as of September 30, 2016 and 2015, and the related consolidated statements of operations, comprehensive income (loss), changes in shareholders' equity, and cash flows for each of the three years in the period ended September 30, 2016 and our report dated December 13, 2016 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Philadelphia, Pennsylvania  
December 13, 2016

-108-

**Item 9B. Other Information.**

Not applicable.

**PART III.**

**Item 10. Directors, Executive Officers and Corporate Governance.**

The information required herein is incorporated by reference from the information contained in the sections captioned “Information with Respect to Nominees for Director, Continuing Directors and Executive Officers” and “Beneficial Ownership of Common Stock by Certain Beneficial Owners and Management – Section 16(a) Beneficial Ownership Reporting Compliance” in the Company’s definitive proxy statement for the Annual Meeting of Shareholders to be held in February 2017 (the “Proxy Statement”).

The Company has adopted a Code of Conduct and Ethics that applies to its principal executive officer and principal financial officer, as well as other officers and employees of the Company and the Bank. A copy of the Code of Ethics is available on the Company's website at [www.malvernfederal.com](http://www.malvernfederal.com).

**Item 11. Executive Compensation.**

The information required herein is incorporated by reference from the information contained in the sections captioned “Management Compensation” in the Proxy Statement.

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

*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”). 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 Shareholders	5,000	\$ 16.02	393,070
Equity Compensation Plans Not Approved by Shareholders	-	-	-
Total	5,000	\$ 16.02	393,070

The remaining information required herein is incorporated by reference from the information contained in the section captioned “Beneficial Ownership of Common Stock by Certain Beneficial Owners and Management” in the Proxy Statement.

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

The information required herein is incorporated by reference from the information contained in the sections captioned “Management Compensation – Related Party Transactions” and “Information with Respect to Nominees for Director, Continuing Directors and Executive Officers” in the Proxy Statement.

**Item 14. Principal Accounting Fees and Services.**

The information required herein is incorporated by reference from the information contained in the section captioned “Ratification of Appointment of Independent Registered Public Accounting Firm (Proposal Six) – Audit Fees” in the Proxy Statement.

**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

Edgar Filing: MALVERN BANCORP, INC. - Form 10-K

All schedules are omitted because they are not required or applicable, or the required information  
(2)  
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.

No.	Description	Location
3.1	Articles of Incorporation of Malvern Bancorp, Inc.	(1)
3.2	Amended and Restated Bylaws of Malvern Bancorp, Inc.	(2)
4.0	Form of Stock Certificate of Malvern Bancorp, Inc.	(1)
10.1	Malvern Bancorp 2014 Long Term Incentive Plan*	(3)
10.2	Employment Agreement with Anthony C. Weagley*	(4)
10.3	Change of Control Agreement with Joseph D. Gangemi*	(5)
10.4	Change of Control Agreement with William Woolworth*	(6)
10.5	Change of Control Agreement with William Boylan	Filed herewith
23.0	Consent of BDO USA, LLP	Filed herewith
31.1	Rule 13(a)-14(a) Certification of the Chief Executive Officer	Filed herewith
31.2	Rule 13(a)-14(a) Certification of the Chief Financial Officer	Filed herewith
32.0	Section 1350 Certification	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

No.	Description	Location
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, 2016 and 2015, (ii) the Consolidated Statement of Operations for the years ended September 30, 2016, 2015 and 2014, (iii) the Consolidated Statement of Comprehensive Income (Loss) for the years ended September 30, 2016, 2015 and 2014, (iv) the Consolidated Statement of Changes in Shareholders' Equity for the years ended September 30, 2016, 2015 and 2014, (v) the Consolidated Statement of Cash Flows for the years ended September 30, 2016, 2015 and 2014 and (vi) the Notes to Condensed Consolidated Financial Statements, tagged as detailed footnote tagging.

(1) Incorporated by reference from the like-numbered exhibit included in Malvern Bancorp's registration statement on Form S-1, filed May 31, 2012 (SEC File No. 333-181798).

(2) Incorporated by reference from Exhibit 3.2 included in the Current Report on Form 8-K of Malvern Bancorp, Inc. dated as of February 17, 2016 and filed February 19, 2016 (SEC File No. 000-54835).

(3) Incorporated by reference to Appendix A of the definitive proxy statement filed by Malvern Bancorp, Inc. with the SEC on January 2, 2015 (SEC File No. 000-54835).

(4) Incorporated by reference to Exhibit 10.1 included in the Current Report on Form 8-K of Malvern Bancorp, Inc., dated as of June 23, 2016, and filed on June 24, 2016 (SEC File No. 000-54835).

(5) Incorporated by reference to Exhibit 10.1 included in the Current Report on Form 8-K of Malvern Bancorp, Inc., dated as of May 23, 2016, and filed on May 27, 2016 (SEC File No. 000-54835).

(6) Incorporated by reference to Exhibit 10.2 included in the Current Report on Form 8-K of Malvern Bancorp, Inc., dated as of May 23, 2016, and filed on May 27, 2016 (SEC File No. 000-54835).

(b) Exhibits

The exhibits listed under (a)(3) of this Item 15 are filed herewith.

(c) Reference is made to (a)(2) of this Item 15.

**Item 16. Form 10-K Summary.**

Not Applicable

-111-

## 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 13, 2016 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 13, 2016, have signed this report below.

/s/ Anthony C. Weagley      Director, President and Chief Executive Officer (principal executive officer)  
Anthony C. Weagley

/s/ Howard Kent              Chairman of the Board  
Howard Kent

/s/ Therese Woodman        Vice Chairman of the Board  
Therese Woodman

/s/ Cynthia Felzer            Director  
Leitzell  
Cynthia Felzer Leitzell

John P. O'Grady              Director

/s/ Norman Feinstein        Director  
Norman Feinstein

/s/ Stephen P. Scartozzi     Director  
Stephen P. Scartozzi

/s/ George E. Steinmetz      Director  
George E. Steinmetz



/s/ Andrew Fish  
Andrew Fish

Director

/s/ Joseph D. Gangemi  
Joseph D. Gangemi

Senior Vice President and Chief Financial Officer (principal financial and accounting officer)

-112-