MALVERN FEDERAL BANCORP INC
Form 10-K
December 18, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)
x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended: September 30, 2009

or

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

Commission File Number: 001-34051

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

United States	38-3783478
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)
42 E. Lancaster Avenue, Paoli, Pennsylvania	19301
(Address of Principal Executive Offices)	(Zip Code)

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

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

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES o NO x
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES o NO x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. YES x NO o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES o NO o

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

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

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

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

The aggregate market value of the 2,466,047 shares of the Registrant's common stock held by non-affiliates, based upon the closing price of $8.95 for the common stock on March 31, 2009, reported by the NASDAQ Stock Market, was approximately $22.1 million. Shares of common stock held by the registrant's parent, Malvern Federal Mutual Holding Company and its executive officers, directors and certain benefit plans have been excluded since such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares of the Issuer's common stock, par value $0.01 per share, outstanding as of December 17, 2009 was 6,102,500.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2010 Annual Meeting of Stockholders are incorporated by reference into Part III, Items 10-14 of this Form 10-K.

MALVERN FEDERAL BANCORP, INC.
2009 ANNUAL REPORT ON FORM 10-K

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Forward-Looking Statements

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

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

PART I

Item 1. Business.

General

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

The Company is a federally chartered corporation which owns all of the issued and outstanding shares of the Bank’s common stock, the only shares of equity securities which the Bank has issued. While the Company is authorized to pursue all activities permitted by applicable laws and regulations for savings and loan holding companies, the Company's only business activity to date has been holding all of the outstanding common stock of Malvern Federal Savings. Malvern Federal Bancorp 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 may use the Bank's support staff from time to time. These persons are not separately compensated by Malvern Federal Bancorp.

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Malvern Federal Savings is a federally chartered community-oriented savings bank which was originally organized in 1887 and is headquartered in Paoli, Pennsylvania. The Bank currently conducts its business from its headquarters and seven additional financial centers; with an eighth scheduled to open in the summer of 2010.

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

The Bank is an active originator of residential home mortgage loans in our market area. Historically, Malvern Federal Savings was a traditional thrift with an emphasis on originating various residential loan products to hold in its portfolio. Approximately six years ago, we determined to shift the emphasis on the loan products we offer and increased our efforts to originate commercial real estate loans, construction and development loans and consumer loans. We determined to originate greater amounts of commercial real estate loans, construction and development loans and consumer loans because we believed we could compete effectively as a niche lender in our market area for such loans given management's knowledge of, and its extensive network of contacts in, the small to mid-sized businesses community in southeastern Pennsylvania. In addition, commercial real estate loans, construction and development loans and consumer loans are deemed attractive due to their generally higher yields and shorter anticipated lives compared to single-family residential mortgage loans. However, given the continuing recession, in recent periods we have limited our efforts to originate commercial real estate and construction or development loans.

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

Market Area and Competition

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

We face significant competition in originating loans and attracting deposits. This competition stems primarily from commercial banks, other savings banks and savings associations and mortgage-banking companies. Within our market area, we estimate that more than 75 other banks, credit unions and savings institutions are operating. We face additional competition for deposits from short-term money market funds and other corporate and government securities funds, mutual funds and from other non-depository financial institutions such as brokerage firms and insurance companies.

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Lending Activities

General. At September 30, 2009, our net loan portfolio totaled $593.6 million or 85.8% of total assets. Historically, our principal lending activity has been the origination of loans collateralized by one-to four-family, also known as “single-family” residential real estate loans located in our market area. We have increased our emphasis on originating commercial real estate loans, construction and development loans and consumer loans in recent years. Our consumer loans consist primarily of home equity loans, second mortgage loans and lines of credit.

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

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Loan Portfolio Composition. The following table shows the composition of our loan portfolio by type of loan at the dates indicated.

	September 30,									
	2009		2008		2007		2006		2005	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in Thousands)									
Mortgage Loans:										
One-to four-family(1)	$252,308	42.4 %	$248,118	43.3 %	$193,460	40.4 %	$186,760	40.9 %	$202,313	48.6 %
Commercial real estate	142,863	24.0	138,522	24.2	108,500	22.7	94,132	20.6	80,512	19.3
Construction or development	37,508	6.3	45,451	7.9	58,870	12.4	67,833	14.8	48,488	11.6
Multi-family	9,613	1.6	1,906	0.3	2,257	0.5	2,283	0.5	413	0.1
Land loans	3,237	0.6	4,530	0.8	6,665	1.4	7,675	1.6	3,125	0.8
Total mortgage loans	445,529	74.9	438,527	76.5	369,752	77.4	358,683	78.4	334,851	80.4
Commercial	15,647	2.6	17,260	3.0	15,767	3.3	16,504	3.6	16,494	4.0
Consumer:										
Home equity lines of credit	19,149	3.2	12,393	2.2	11,811	2.5	12,702	2.7	14,132	3.4
Second mortgages	113,943	19.1	103,741	18.1	78,733	16.5	67,742	14.9	49,565	11.9
Other	1,143	0.2	1,304	0.2	1,525	0.3	1,621	0.4	1,262	0.3
Total consumer loans	134,235	22.5	117,438	20.5	92,069	19.3	82,065	18.0	64,959	15.6
Total Loans	595,411	100.0%	573,225	100.0%	477,588	100.0%	457,252	100.0%	416,304	100.0%
Deferred loan costs, net	3,872		3,816		2,404		1,954		1,602	
Allowance for loan losses	(5,718)		(5,505)		(4,541)		(3,393)		(3,222)	
Loans receivable, net	$593,565		$571,536		$475,451		$455,813		$414,684	

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

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

	September 30,									
	2009		2008		2007		2006		2005	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in Thousands)									
Fixed-Rate Loans:										
Mortgage Loans:										
One-to four-family(1)	$227,712	38.2 %	$218,214	38.1 %	$163,463	34.2 %	$153,632	33.6 %	$182,210	43.7 %
Multi-family	3,519	0.6	—	—	—	—	—	—	326	0.1
Commercial real estate	56,126	9.4	52,406	9.1	35,053	7.4	40,502	8.9	35,578	8.5
Construction or development	5,382	0.9	4,505	0.8	8,626	1.8	7,435	1.6	7,121	1.7
Land loans	1,558	0.3	1,575	0.2	1,591	0.3	1,606	0.3	44	0.1
Total fixed-rate mortgage loans	294,297	49.4	276,700	48.2	208,733	43.7	203,175	44.4	225,279	54.1
Commercial	3,798	0.6	4,441	0.8	3,847	0.8	4,799	1.1	2,789	0.7
Consumer:										
Home equity lines of credit	—	—	—	—	—	—	—	—	—	—
Second mortgages	113,943	19.1	103,741	18.1	78,706	16.5	67,643	14.8	49,562	11.9
Other	867	0.2	960	0.2	1,097	0.2	1,159	0.3	844	0.2
Total fixed-rate consumer loans	114,810	19.3	104,701	18.3	79,803	16.7	68,802	15.1	50,406	12.1
Total fixed-rate loans	$412,905	69.3	$385,842	67.3	$292,383	61.2	$276,776	60.5	$278,474	66.9
Adjustable-Rate Loans:										
Mortgage Loans:										
One-to four-family	$24,596	4.1 %	$29,904	5.2 %	$29,998	6.3 %	$33,128	7.3 %	$20,103	4.8 %
Multi-family	6,094	1.0	1,906	0.4	2,257	0.5	2,283	0.5	87	0.1
Commercial real estate	86,737	14.6	86,116	15.0	73,448	15.4	53,629	11.7	44,934	10.8
Construction or development	32,126	5.4	40,946	7.1	50,244	10.5	60,398	13.2	41,367	9.9
Land loans	1,679	0.3	2,955	0.5	5,074	1.1	6,069	1.3	3,081	0.7
Total adjustable-rate mortgage loans	151,232	25.4	161,827	28.2	161,021	33.8	155,507	34.0	109,572	26.3
Commercial	11,849	2.0	12,819	2.2	11,920	2.5	11,705	2.5	13,705	3.3

Consumer:										
Home equity lines of credit	19,149	3.2	12,393	2.2	11,811	2.4	12,703	2.7	14,132	3.4
Second mortgages	—	—	—	—	26	—	99	0.1	4	—
Other	276	0.1	344	0.1	427	0.1	462	0.2	417	0.1
Total adjustable-rate consumer loans	19,425	3.3	12,737	2.3	12,264	2.5	13,264	3.0	14,553	3.5
Total adjustable-rate loans	$182,506	30.7 %	$187,383	32.7 %	$185,205	38.8 %	$180,476	39.5 %	$137,830	33.1 %
Total loans(1)	$595,411	100.0%	$573,225	100.0%	$477,588	100.0%	$457,252	100.0%	$416,304	100.0%

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

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Loan Maturity. The following table presents the contractual maturity of our loans at September 30, 2009. The table does not include the effect of prepayments or scheduled principals amortization. Loans having no stated repayment schedule or maturity and overdraft loans are reported as being due in one year or less.

	One-to Four-Family	Multi-family	Commercial Real Estate	Construction or Development	Land Loans	Commercial	Home Equity Lines of Credit	Second Mortgages	Other	Total
	(Dollars in Thousands)									
Amounts due in:										
One year or less	$1,663	$—	$12,261	$20,143	$2,121	$3,504	$300	$166	$26	$40,184
After one year through two years	1,484	—	4,388	11,067	—	2,724	—	456	153	20,272
After two years through three years	926	—	1,716	115	—	226	—	630	164	3,777
After three years through five years	4,554	505	11,656	35	—	1,099	—	3,090	430	21,369
After five years through ten years	28,638	8,117	11,361	6,114	1,116	2,528	27	12,252	95	70,248
After ten years through fifteen years	41,961	463	90,632	—	—	1,599	5,243	47,047	2	186,947
Beyond fifteen years	173,082	528	10,849	34	—	3,967	13,579	50,302	273	252,614
Total	$252,308	$9,613	$142,863	$37,508	$3,237	$15,647	$19,149	$113,943	$1,143	$595,411
Interest rate terms on amounts due after one year:										
Fixed rate	$226,049	$3,519	$48,786	$34	$568	$1,373	$—	$113,777	$841	$394,947
Adjustable rate	24,596	6,094	81,816	17,331	548	10,770	18,849	—	276	160,280
Total	$250,645	$9,613	$130,602	$17,365	$1,116	$12,143	$18,849	$113,777	$1,117	$555,227

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

All of our single-family residential mortgage loans are written on standardized documents used by Freddie Mac and Fannie Mae. We also utilize an automated loan processing and underwriting software system for our new single-family residential mortgage loans. Property valuations of loans secured by real estate are undertaken by an independent third-party appraiser approved by our board of directors. We do not originate, and at September 30, 2009 we had no, sub-prime loans in our portfolio.

In addition to originating loans, we occasionally purchase participation interests in larger balance loans, typically commercial real estate or construction or development loans, from other financial institutions in our market area. Such participations are reviewed for compliance with our underwriting criteria before they are purchased. We actively monitor the performance of such loans through the receipt of regular reports from the lead lender regarding the loan's performance, physically inspecting the loan security property on a periodic basis, discussing the loan with the lead lender on a regular basis and receiving copies of updated financial statements from the borrower. From October 1, 2005 through September 30, 2009, we purchased four loan participation interests from other institutions. At September 30, 2009, the outstanding balance of such participation interests to Malvern Federal Savings was approximately $10.2 million and all were current and performing in accordance with their terms. One such purchased participation interest in a construction and developments loan, which had an outstanding balance on our books of $4.6 million at September 30, 2009, was impaired and on non-accrual status at such date. See "Asset Quality – Non-Performing Loans and Real Estate Owned."

In addition, we also occasionally sell whole loans or participation interests in loans we originate. From October 1, 2005 through September 30, 2009, we sold a participation interest in one construction and development loan in fiscal 2006. We generally have sold participation interests in loans only when a loan would exceed our loans-to-one borrower limits. Our loans-to-one borrower limit, with certain exceptions, generally is 15% of our unimpaired capital and surplus or $10.2 million at September 30, 2009. At September 30, 2009, our five largest outstanding loans to one borrower and related entities amounted to $9.9 million, $8.6 million, $8.0 million, $6.7 million and $6.6 million, respectively, and all of such loans were performing in accordance with their terms. In addition, in an effort to improve our interest rate risk exposure, we sold long-term (20 or 30 year term) fixed-rate single-family residential mortgage loans to Freddie Mac and Fannie Mae while retaining the loan servicing rights for such loans. We receive a fee for continuing to service such loans when they are sold, and such fees are recorded as non-interest income.

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

	Year Ended September 30,		
	2009	2008	2007
	(In Thousands)		
Total gross loans at beginning of period	$573,225	$477,588	$457,252
Originations by type:			
Mortgage:			
One-to four-family	37,842	10,066	24,370
Multi-family	10,431	—	—
Commercial real estate	32,494	35,040	39,561
Construction or development(1)	16,015	26,534	35,802
Land loans	318	257	116
Other:			
Commercial	5,105	10,092	11,751
Home equity lines of credit	19,309	6,940	8,674
Second mortgages	6,103	1,442	10,715
Other	884	878	1,022
Total originations	128,501	91,249	132,011
Principal Repayments:			
Mortgage:			
One-to four-family	59,838	17,508	24,973
Multi-family	2,727	351	26
Commercial real estate	24,167	6,518	25,193
Construction or development	23,763	39,952	44,765
Land loans	1,612	2,392	1,126
Other:			
Commercial	6,696	8,599	12,487
Home equity lines of credit	12,595	6,358	9,565
Second mortgages	27,250	16,194	19,258
Other	1,044	221	780
Total principal repayments	159,692	98,093	138,173
Net loan originations and principal repayments	(31,191)	(6,844)	(6,162)
Purchases:			
One-to four-family mortgage loans(2)	28,293	71,355	7,303
Second mortgage loans	31,964	39,760	19,533
Home equity lines of credit	58	—	—
Commercial real estate loans	—	1,500	—
Total purchased	60,315	112,615	26,836
Sales:			
One-to four-family mortgage loans	—	9,256	—
Construction or development	—	—	—
Other adjustments, net(3)	(6,938)	(878)	(338)
Net increase	22,186	95,637	20,336
Total gross loans at and of period	$595,411	$573,225	$477,588

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

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One-to Four-Family Residential Mortgage Lending. One of our primary lending activities continues to be the origination of loans secured by first mortgages on one-to four-family residences in our market area. At September 30, 2009, $252.3 million, or 42.4%, of our total loans consisted of single-family residential mortgage loans. As a result of our increased emphasis on construction, commercial real estate and consumer loans, our single-family residential real estate loans as a percentage of total loans have decreased from 48.6% at September 30, 2005 to 42.4% at September 30, 2009.

Our single-family residential mortgage loans generally are underwritten on terms and documentation conforming to guidelines issued by Freddie Mac and Fannie Mae. Applications for one-to four-family residential mortgage loans are taken by our Business Development Officer and are accepted at any of our banking offices and are then referred to the lending department at our main office in order to process the loan, which consists primarily of obtaining all documents required by Freddie Mac and Fannie Mae underwriting standards, and completing the underwriting, which includes making a determination whether the loan meets our underwriting standards such that the Bank can extend a loan commitment to the customer. We generally have retained for portfolio a substantial portion of the single-family residential mortgage loans that we originate. We currently originate fixed-rate, fully amortizing mortgage loans with maturities of 15 to 30 years. We also offer adjustable rate mortgage ("ARM") loans where the interest rate either adjusts on an annual basis or is fixed for the initial one, three or five years and then adjusts annually. However, due to local market conditions, we have not originated a significant amount of ARM loans in recent years. At September 30, 2009, $24.6 million, or 4.1%, of our one-to four-family residential loans consisted of ARM loans. We also offer "balloon" loans which are amortized on a 30 year schedule but become due at the fifth or seventh anniversary, bi-weekly mortgage loans and, until August 2008, for borrowers with credit scores exceeding 700, no income/no asset ("NINA") loans. Our NINA loans amounted to $4.3 million in the aggregate at September 30, 2009.

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

Commercial Real Estate, Multi-family Residential Real Estate and Land Loans. At September 30, 2009, our loans secured by commercial real estate amounted to $142.9 million and constituted 24.0% of our total loans at such date. In addition, at such date we had $3.2 million of loans secured by unimproved real estate and lots ("land loans") and $9.6 million of loans secured by multi-family (more than four units) residential real estate, constituting 0.6% and 1.6%, respectively, of total loans at September 30, 2009.

Our commercial real estate loan portfolio consists primarily of loans secured by office buildings, retail and industrial use buildings, strip shopping centers, mixed-use and other properties used for commercial purposes located in its market area. Our commercial real estate loans tend to be originated in an amount less than $3.0 million but will occasionally exceed that amount. At September 30, 2009, the average amount outstanding on our commercial real estate loans was $446,000. The five largest commercial real estate loans outstanding were $7.8 million, $4.8 million, $4.4 million, $3.7 million and $3.7 million at September 30, 2009. During the year ended September 30, 2009, the commercial real estate loan portfolio grew as the result of originations, and the conversion of loans from construction to permanent status, by $4.3 million, or 3.1%. Our commercial real estate loans have grown steadily over each of the past five fiscal years. We have increased our emphasis on originating commercial real estate loans due to the higher average yields they provide compared to single-family residential mortgage loans. During the year ended September 30, 2009, the average yield on our commercial real estate loans was 6.1% compared to 5.8% for our single-family residential mortgage loans. Commercial real estate loans are much more likely to have adjustable interest rates than single-family residential mortgage loans, which adds to the interest rate sensitivity of commercial real estate loans and makes them attractive. At September 30, 2009, approximately 60.7% of our commercial real estate loans had adjustable interest rates compared to 9.8% of our single-family residential mortgage loans with adjustable rates at such date.

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Although terms for commercial real estate and multi-family loans vary, our underwriting standards generally allow for terms up to 10 years with the interest rate being reset in the fifth year and with monthly amortization not greater than 20 years loan and loan-to-value ratios of not more than 75%. Interest rates are either fixed or adjustable, based upon the prime rate plus a margin, and fees ranging from 0.5% to 1.50% are charged to the borrower at the origination of the loan. Prepayment fees are charged on most loans in the event of early repayment. Generally, we obtain personal guarantees of the principals as additional collateral for commercial real estate and multi-family real estate loans.

At September 30, 2009, our loan portfolio included $3.2 million of land loans. Two loans, with outstanding balances of $1.3 million and $763,000, respectively, at September 30, 2009, comprised 62.9% of our land loans at such date. Both of these loans are to local developers for the purpose of acquiring raw land in Chester County, Pennsylvania, subdividing and improving such land and then selling the developed lots to nationally known homebuilders. Both of such loans have performed in accordance with their terms since their originations in 2005 and 2004, respectively. We had no non-performing land loans at September 30, 2009. One land loan in the amount of $763,000 was classified as substandard at September 30, 2009.

Loans secured by commercial real estate, unimproved land and multi-family real estate lending involve different risks than single-family residential lending. These risks include larger loans to individual borrowers and loan payments that are dependent upon the successful operation of the project or the borrower’s business. These risks can be affected by supply and demand conditions in the project’s market area of rental housing units, office and retail space, warehouses, and other commercial space. We attempt to minimize these risks by limiting loans to proven businesses, only considering properties with existing operating performance which can be analyzed, using conservative debt coverage ratios in its underwriting, and periodically monitoring the operation of the business or project and the physical condition of the property. As of September 30, 2009, $785,000 or 0.5% of our commercial real estate mortgage loans were on non-accrual status and an aggregate of $6.6 million of our commercial real estate loans at such date were classified for regulatory reporting purposes (all of which were classified substandard and none of which were classified doubtful or loss). See “Asset Quality – Asset Classification.” As of September 30, 2009, $1.2 million, or 21.8% of our allowance for loan losses was allocated to commercial real estate mortgage loans. In addition, at September 30, 2009 we held $4.0 million of commercial real estate as real estate owned, although subsequent to our 2009 fiscal year end we sold $2.8 million of such commercial real estate at no additional loss. See “Asset Quality – Non-Performing Assets and Real Estate Owned.” During the fiscal year ended September 30, 2009, we charged off an aggregate of $1.8 million in commercial real estate loans.

Various aspects of a commercial and multi-family loan and land loan transactions are evaluated in an effort to mitigate the additional risk in these types of loans. In our underwriting procedures, consideration is given to the stability of the property’s cash flow history, future operating projections, current and projected occupancy levels, location and physical condition. Generally, we impose a debt service ratio (the ratio of net cash flows from operations before the payment of debt service to debt service) of not less than 125%. We also evaluate the credit and financial condition of the borrower, and if applicable, the guarantor. Appraisal reports prepared by independent appraisers are obtained on each loan to substantiate the property’s market value, and are reviewed by us prior to the closing of the loan.

Construction or Development Loans. We originate construction loans for residential and, to a lesser extent, commercial uses within its 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. At September 30, 2009, we had $37.5 million, or 6.3% of total loans, in outstanding construction or development loans. Given the downturn in the economic environment during fiscal year 2008, we decided to reduce our exposure to construction and development lending. As a result, the amount of our outstanding construction or development loans decreased to $37.5 million or 6.3% of total loans at September 30, 2009 from $45.5 million or 7.9% of total loans as of September 30, 2008. As market conditions improve, we will continue to evaluate the origination of construction or development loans as a growth area due to the relatively higher yields and shorter terms to maturity compared to long-term, single-family residential mortgage loans. Our construction or development loans in the portfolio typically have variable rates of interest tied to the prime rate which improves the interest rate sensitivity of our loan portfolio. At September 30, 2009, approximately 85.7% of our construction loans had variable rates of interest and 83.2% of such loans had two years or less in their remaining terms to maturity at such date.

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

Prior to committing to a construction loan, we require that an independent appraiser prepare an appraisal of the property. Each project also is reviewed and inspected at its inception and prior to every disbursement of loan proceeds. Disbursements are made after inspections based upon a percentage of project completion. Monthly payment of interest is required on all construction loans and we often establish interest reserves on construction loans to developers, which helps ensure interest payments are received during the construction period.

We also make construction loans for the acquisition and development of land for sale (i.e. roads, sewer and water lines). We typically make these loans only in conjunction with a commitment for a construction loan for the units to be built on the site. These loans are secured by a lien on the property and are limited to a loan-to-value ratio of 80% of the appraised value. The loans have a variable rate of interest and require monthly payments of interest. The principal of the loan is repaid as units are sold and released. We limit loans of this type to our market area and to developers with whom we have established relationships. In most cases, we also obtain personal guarantees from the borrowers.

Our construction or development loans also include loans made to consumers for the construction of their individual homes underwritten on a construction/permanent basis. During the initial or construction phase, these loans require payment of interest only, which generally is tied to prime rate, as the home is being constructed. Upon the earlier of the completion of construction or one year, these loans automatically convert to long-term (generally 30 years), amortizing, fixed-rate single-family mortgage loans.

Construction and development loans generally are considered to involve a higher level of risk than single-family residential lending, due to the concentration of principal in a limited number of loans and borrowers and the effect of economic conditions on developers, builders and projects. At September 30, 2009, the amounts outstanding on our five largest construction or development loans were $7.0 million, $4.6 million, $3.7 million, $2.6 million and $2.2 million. The average size of our construction or development loans was approximately $375,000 at September 30, 2009. Additional risk is also associated with construction lending because of the inherent difficulty in estimating both a property's value at completion and the estimated cost (including interest) to complete a project. The nature of these loans is such that they are more difficult to evaluate and monitor. In addition, speculative construction loans to a builder are not pre-sold and thus pose a greater potential risk than construction loans to individuals on their personal residences.

In order to mitigate some of the risks inherent to construction lending, we inspect properties under construction, review construction progress prior to advancing funds, work with builders with whom we have established relationships, require annual updating of tax returns and other financial data of developers and obtain personal guarantees from the principals. At September 30, 2009, $1.6 million, or 27.3%, of our allowance for loan losses was attributed to construction or development loans. We have charged off a total of $66,000 in construction or development loans over the past five fiscal years. At September 30, 2009, we had $7.1 million in non-performing construction loans due primarily to a $4.6 million participation interest in a construction and development loan to a single family residential retirement community located in Montgomery County, Pennsylvania and one single family construction loan in the amount of $1.8 million located in Chester County, Pennsylvania. See “Asset Quality – Non-Performing Assets and Real Estate Owned.”

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Commercial Business Loans. At September 30, 2009, we had $15.6 million in commercial business loans (2.6% of gross loans outstanding). Our commercial business loans generally are made to small to mid-sized businesses located in our market area. We originate commercial business loans as these types of loans assist us in our asset/liability management since they generally provide shorter maturities and/or adjustable rates of interest in addition to generally having higher rates of return which are designed to compensate for the additional credit risk associated with these loans. The commercial business loans which we originate may be either a revolving line of credit or for a fixed term of generally 10 years or less. Interest rates are either adjustable, indexed to a published prime rate of interest, or fixed. Generally, equipment, machinery, real property or other corporate assets secure the loans. Personal guarantees from the business principals are generally obtained as additional collateral. At September 30, 2009, the average balance of our commercial business loans was $150,000.

Generally, commercial business loans are characterized as having higher risks associated with them than single-family residential mortgage loans. As of September 30, 2009, we had $35,000 of non-accrual commercial business loans. At such date, $298,000 or 5.2% of the allowance for loan losses was allocated to commercial business loans. During the past five fiscal years, we have charged off an aggregate of $7,000 of commercial business loans.

Consumer Lending Activities. In our efforts to provide a full range of financial services to our customers, we offer various types of consumer loans. Our consumer loans amounted to $134.2 million or 22.5% of our total loan portfolio at September 30, 2009. The largest components of our consumer loans are second mortgages, consisting primarily of home equity loans, which amounted to $113.9 million at September 30, 2009, and home equity lines of credit, which amounted to $19.1 million at such date. Our consumer loans also include automobile loans, unsecured personal loans and loans secured by deposits. Consumer loans are originated primarily through existing and walk-in customers and direct advertising and, with respect to second mortgages and home equity lines of credit, through our broker network.

Our home equity lines of credit are variable rate loans tied to the prime rate. Our second mortgages may have fixed or variable rates, although they generally have had fixed rates in recent periods. Our second mortgages have a maximum term to maturity of 20 years. Both our second mortgages and our home equity lines of credit generally are secured by the borrower's primary residence. However, our security generally consists of a second lien on the property. Our lending policy provides that our home equity loans have loan-to-value ratios, when combined with any first mortgage, of 85% or less. The maximum loan-to-value ratio on our home equity lines of credit is 75%. We offer home equity lines on a revolving line of credit basis, with interest tied to the prime rate. At September 30, 2009, the unused portion of our home equity lines of credit was $24.2 million.

Consumer loans generally have higher interest rates and shorter terms than residential loans; however, they have additional credit risk due to the type of collateral securing the loan or in some cases the absence of collateral. In the year ended September 30, 2009, we charged-off $213,000 of consumer loans. As a result of the recent declines in the market value of real estate and in the overall economy, we have been evaluating 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 efforts to assess the overall credit quality portfolio in connection with our review of the allowance for loan losses. As of September 30, 2009, we had an aggregate of $2.5 million of non-accruing second mortgage loans and home equity lines of credit, representing an increase of $1.6 million over the amount of non-accruing second mortgage loans and home equity lines of credit at September 30, 2008. We attribute the substantial increase in non-performing consumer loans primarily to the current recession and increased unemployment levels. At September 30, 2009, an aggregate of $1.2 million of our allowance for loan losses was allocated to second mortgages and home equity lines of credit.

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

All loans must be approved by at least two bank officers. Loans in amounts exceeding $400,000 must be approved by the Commercial Loan Committee, whose members include the Chief Lending Officer and two directors of Malvern Federal Savings Bank and loans in amounts exceeding $600,000 must be approved by the full board of directors of the Bank.

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Asset Quality

General. One of our key objectives has been, and continues to be, maintaining a high level of asset quality. In addition to maintaining credit standards for new originations which we believe are sound, we are proactive in our loan monitoring, collection and workout processes in dealing with delinquent or problem loans.

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

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

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

We account for our impaired loans under accounting principles generally accepted in the United States of America ("U.S. GAAP"). An impaired loan generally is one for which it is probable, based on current information, that the lender will not collect all the amounts due under the contractual terms of the loan. Large groups of smaller balance, homogeneous loans are collectively evaluated for impairment. Loans collectively evaluated for impairment include smaller balance commercial real estate loans, residential real estate loans and consumer loans. These loans are evaluated as a group because they have similar characteristics and performance experience. Larger commercial and construction loans are individually evaluated for impairment. Our impaired loans amounted to $14.2 million and $6.3 million at September 30, 2009 and 2008, respectively.

Asset Classification. Federal regulations and our policies require that we utilize an internal asset classification system as a means of reporting problem and potential problem assets. We have incorporated an internal asset classification system, substantially consistent with Federal banking regulations, as a part of our credit monitoring system. Federal banking regulations set forth a classification scheme for problem and potential problem assets as "substandard," "doubtful" or "loss" assets. An asset is considered "substandard" if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. "Substandard" assets include those characterized by the distinct possibility" that the insured institution will sustain "some loss" if the deficiencies are not corrected.

Assets classified as "doubtful" have all of the weaknesses inherent in those classified "substandard" with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable." Assets classified as "loss" are those considered "uncollectible" and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets which do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated "special mention."

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

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

We review and classify assets on a monthly basis and the board of directors is provided with monthly reports on our classified assets. We classify assets in accordance with the management guidelines described above. Assets classified as “substandard” were $23.4 million, including $5.9 million of foreclosed other real estate owned, and $8.6 million, at September 30, 2009 and 2008 respectively. We had $3.9 million in assets classified doubtful at September 30, 2009 compared to none at September 30, 2008. Assets designated as “special mention” totaled $13.0 million at September 30, 2009 compared to none at September 30, 2008. We attribute the increases in classified assets and assets designated special mention at September 30, 2009 compared to September 30, 2008 primarily to the effects of the current recession on our borrowers. We have no loans classified as loss at September 30, 2009 or 2008.

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

	At September 30, 2009 Loans Delinquent For:								
	31-89 Days			90 Days and Over			Total Delinquent Loans		
	Number	Amount	Percent of Total Delinquent Loans 31-89 Days	Number	Amount	Percent of Total Delinquent Loans 90 Days and Over	Number	Amount	Percent of Total Delinquent Loans Greater Than 30 Days
	(Dollars in Thousands)								
Mortgage:									
One-to four-family	17	$5,166	60.5 %	12	$3,809	26.8 %	29	$8,975	39.5 %
Multi-family	—	—	—	—	—	—	—	—	—
Commercial real estate	5	1,939	22.7	3	785	5.5	8	2,724	12.0
Construction or development	—	—	—	8	7,086	50.0	8	7,086	31.2
Land loans	—	—	—	—	—	—	—	—	—
Commercial	2	68	0.8	1	35	0.2	3	103	0.4
Home equity	—	—	—	8	407	2.9	8	407	1.8
Second mortgages	20	1,323	15.5	28	2,072	14.6	48	3,395	14.9
Other	7	38	0.5	1	1	—	8	39	0.2
Total	51	$8,534	100.0 %	61	$14,195	100.0 %	112	$22,729	100.0 %

	At September 30, 2008 Loans Delinquent For:								
	31-89 Days			90 Days and Over			Total Delinquent Loans		
	Number	Amount	Percent of Total Delinquent Loans 31-89 Days	Number	Amount	Percent of Total Delinquent Loans 90 Days and Over	Number	Amount	Percent of Total Delinquent Loans Greater Than 30 Days
	(Dollars in Thousands)								
Mortgage:									
One-to four-family	7	$ 2,645	45.6 %	4	$ 1,402	16.3 %	11	$ 4,047	28.0 %
Multi-family	—	—	—	—	—	—	—	—	—
Commercial real estate	4	1,813	31.3	2	4,050	47.2	6	5,863	40.8
Construction or development	1	350	6.0	2	1,695	19.8	3	2,045	14.2
Land loans	—	—	—	—	—	—	—	—	—
Commercial	1	76	1.3	2	561	6.5	3	637	4.4
	—	—	—	4	205	2.4	4	205	1.4

Home equity									
Second mortgages	16	904	15.6	15	672	7.8	31	1,576	11.1
Other	5	12	0.2	—	—	—	5	12	0.1
Total	34	$ 5,800	100.0 %	29	$ 8,585	100.0 %	63	$ 14,385	100.0 %

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Non-Performing Loans and Real Estate Owned. The following table sets forth information regarding our non-performing loans and real estate owned. Our general policy is to cease accruing interest on loans which are 90 days or more past due and to charge-off all accrued interest. The table below sets forth the amounts and categories of non-performing assets in our loan portfolio. Loans are placed on non-accrual status when the collection of principal and/or interest becomes doubtful. Our non-performing assets include troubled debt restructurings (which involve forgiving a portion of interest or principal on any loans or making loans at a rate materially less than that of market rates). Foreclosed assets include real estate owned and other assets acquired in settlement of loans.

	September 30,				
	2009	2008	2007	2006	2005
	(Dollars in thousands)				
Non-accruing loans:					
One-to four-family	$3,809	$1,402	$461	$686	$777
Multi-family	—	—	—	—	—
Commercial real estate	785	4,050	661	1,500	156
Construction or development	7,086	1,695	—	—	—
Land loans	—	—	—	—	—
Commercial	35	561	780	174	559
Home equity lines of credit	407	205	14	—	35
Second mortgages	2,072	672	351	341	270
Other	1	—	—	24	4
Total non-accruing	14,195	8,585	2,267	2,725	