

Magyar Bancorp, Inc.  
Form 10-K  
December 20, 2018

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-K**

o ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

**For the Fiscal Year Ended September 30, 2018**

OR

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-51726

Magyar Bancorp, Inc.

(Exact Name of Registrant as Specified in its Charter)

**Delaware**

(State or Other Jurisdiction of Incorporation or Organization)

**20-4154978**

(I.R.S. Employer Identification Number)

**400 Somerset Street, New Brunswick, New Jersey**

(Address of Principal Executive Office)

**08901**

(Zip Code)

**(732) 342-7600**

(Issuer's Telephone Number including area code)

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Securities Registered Pursuant to Section 12(b) of the Act:

| <u>Title of Class</u>                    | <u>Name of Each Exchange On Which Registered</u> |
|--|--|
| Common Stock, par value \$0.01 per share | The NASDAQ Stock Market, LLC                     |

Securities Registered Pursuant to Section 12(g) of the Act:

None

(Title of Class)

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 15(d) of the Exchange 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 Exchange Act during the preceding twelve months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The aggregate value of the voting stock held by non-affiliates of the registrant, computed by reference to the closing price of the Common Stock as of March 31, 2018 was \$33.4 million. As of December 15, 2018, there were 5,820,746 outstanding shares of the registrant’s Common Stock, including 3,200,450 shares owned by Magyar Bancorp, MHC, the registrant’s mutual holding company.

**DOCUMENTS INCORPORATED BY REFERENCE**

1. Proxy Statement for the Annual Meeting of Stockholders to be held in February, 2019 (Part III)

**Magyar Bancorp, Inc.**

**Annual Report On Form 10-K**

For The Fiscal Year Ended

September 30, 2018

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PART I

ITEM 1.

Business

Forward Looking Statements

We have included or incorporated by reference in this Annual Report on Form 10-K, and from time to time our management may make, statements that may constitute “forward-looking statements” within the meaning of the safe harbour provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements are not historical facts but instead represent only our beliefs regarding future events, many of which, by their nature, are inherently uncertain and outside our control. These statements include statements other than historical information or statements of current condition and may relate to our future plans and objectives and results, as well as statements about the objective and effectiveness of our risk management and liquidity policies, statements about trends in or growth opportunities for our business, statements about our future status, and activities or reporting under U.S. banking and financial regulation. Forward-looking statements generally are identified by the words “believe,” “project,” “expect,” “anticipate,” “estimate,” “intend,” “strategy,” “future,” “opportunity,” “plan,” “may,” “should,” “will,” “would,” “will likely result,” and similar expressions. By identifying these statements for you in this manner, we are alerting you to the possibility that our actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these forward-looking statements. Important factors that could cause our actual results and financial condition to differ from those indicated in the forward-looking statements include, among others, those discussed below and under “Risk Factors” in Part 1, Item 1A of this Annual Report on Form 10-K.

Magyar Bancorp, MHC

Magyar Bancorp, MHC is the New Jersey-chartered mutual holding company of Magyar Bancorp, Inc. Magyar Bancorp, MHC’s only business is the ownership of 54.0% of the issued shares of common stock of Magyar Bancorp, Inc. So long as Magyar Bancorp, MHC exists, it will be required to own a majority of the voting stock of Magyar Bancorp, Inc. The executive office of Magyar Bancorp, MHC is located at 400 Somerset Street, New Brunswick, New Jersey 08901, and its telephone number is (732) 342-7600. Magyar Bancorp, MHC is subject to regulation and examination by the Board of Governors of the Federal Reserve System (“FRB”) and the New Jersey Department of Banking and Insurance (“NJDBI”).

Magyar Bancorp, Inc.

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Magyar Bancorp, Inc. is the mid-tier stock holding company of Magyar Bank. Magyar Bancorp, Inc. is a Delaware-chartered corporation and owns 100% of the outstanding shares of common stock of Magyar Bank. Magyar Bancorp, Inc. has not engaged in any significant business activity other than owning all of the shares of common stock of Magyar Bank. At September 30, 2018, Magyar Bancorp, Inc. had consolidated assets of \$624.0 million, total deposits of \$530.1 million and stockholders' equity of \$51.4 million. The executive offices of Magyar Bancorp, Inc. are located at 400 Somerset Street, New Brunswick, New Jersey 08901, and its telephone number is (732) 342-7600. Magyar Bancorp, Inc. is subject to comprehensive regulation and examination by the FRB and the NJDBI.

### Magyar Bank

Magyar Bank is a New Jersey-chartered savings bank headquartered in New Brunswick, New Jersey that was originally founded in 1922 as a New Jersey building and loan association. In 1954, Magyar Bank converted to a New Jersey savings and loan association, before converting to a New Jersey savings bank charter in 1993. We conduct business from our main office located at 400 Somerset Street, New Brunswick, New Jersey, and our seven branch offices located in New Brunswick, North Brunswick, South Brunswick, Branchburg, Bridgewater, and Edison, New Jersey. The telephone number at our main office is (732) 342-7600.

### General

Our principal business consists of attracting retail deposits from the general public in the areas surrounding our main office in New Brunswick, New Jersey and our branch offices located in Middlesex and Somerset Counties, New Jersey, and investing those deposits, together with funds generated from operations and wholesale funding, in residential mortgage loans, home equity loans, home equity lines of credit, commercial real estate loans, commercial business loans, Small Business Administration ("SBA") loans, construction loans and investment securities. We also originate consumer loans, which consist primarily of secured demand loans. We originate loans primarily for our loan portfolio. However, from time to time we have sold some of our long-term fixed-rate residential mortgage loans into the secondary market, while retaining the servicing rights for such loans. In addition we sell the SBA guaranteed portion of SBA loans while retaining the servicing rights for such loans. Our revenues are derived principally from interest on loans and securities, our investment securities consist primarily of mortgage-backed securities and U.S. Government and government-sponsored enterprise obligations. We also generate revenues from fees and service charges. Our primary sources of funds are deposits, borrowings and principal and interest payments on loans and securities. We are subject to comprehensive regulation and examination by the NJDBI and the Federal Deposit Insurance Corporation ("FDIC").

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### Market Area

We are headquartered in New Brunswick, New Jersey, and our primary deposit market area is concentrated in the communities surrounding our headquarters branch and our branch offices located in Middlesex and Somerset Counties, New Jersey. Our primary lending market area is broader than our deposit market area and includes all of New Jersey.

The economy of our primary market area is largely urban and suburban with a broad economic base that is typical for counties surrounding the New York metropolitan area. The median household income in Middlesex and Somerset county ranks among the highest in the nation.

### Competition

We face intense competition within our market area both in making loans and attracting deposits. Our market area has a high concentration of financial institutions including large money center and regional banks, community banks and credit unions. Some of our competitors offer products and services that we currently do not offer, such as trust services and private banking. According to the Federal Deposit Insurance Corporation's annual *Summary of Deposit* report, at June 30, 2018 our market share of deposits was 1.25% and 0.58% in Middlesex and Somerset Counties, respectively. Our market share of deposits was 1.18% and 0.62%, respectively, at June 30, 2017.

Our competition for loans and deposits comes principally from commercial banks, savings institutions, mortgage banking firms and credit unions. We face additional competition for deposits from short-term money market funds, brokerage firms, mutual funds and insurance companies. Our primary focus is to build and develop profitable customer relationships across all lines of business while maintaining our role as a community bank.

### Lending Activities

We originate residential mortgage loans to purchase or refinance residential real property. Residential mortgage loans represented \$185.3 million, or 36.2% of our total loans at September 30, 2018. Historically, we have not originated a significant number of loans for the purpose of reselling them in the secondary market. In the future, however, to help manage interest rate risk and to increase fee income, we may increase our origination and sale of residential mortgage loans. No loans were held for sale at September 30, 2018. We also originate commercial real estate, commercial business and construction loans. At September 30, 2018, these loans totaled \$219.3 million, \$53.3 million and \$30.4 million, respectively. We also offer consumer loans, which consist primarily of home equity lines of credit and stock-secured demand loans. At September 30, 2018, home equity lines of credit and stock-secured demand loans



totaled \$18.0 million and \$6.2 million, respectively.

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**Loan Portfolio Composition.** The following table sets forth the composition of our loan portfolio by type of loan, at the dates indicated.

|                                | September 30,<br>2018 |         | 2017      |         | 2016      |         | 2015      |         | 2014      |         |
|--------------------------------|-----------------------|---------|-----------|---------|-----------|---------|-----------|---------|-----------|---------|
|                                | Amount                | Percent | Amount    | Percent | Amount    | Percent | Amount    | Percent | Amount    | Percent |
| (Dollars in thousands)         |                       |         |           |         |           |         |           |         |           |         |
| One-to four-family residential | \$185,287             | 36.2%   | \$178,336 | 37.6%   | \$173,235 | 37.8%   | \$169,781 | 40.1%   | \$160,335 | 39.4%   |
| Commercial real estate         | 219,347               | 42.8%   | 207,118   | 43.7%   | 199,510   | 43.6%   | 173,864   | 41.0%   | 169,449   | 41.6%   |
| Construction                   | 30,412                | 5.9%    | 22,622    | 4.8%    | 14,939    | 3.3%    | 6,679     | 1.6%    | 12,232    | 3.0%    |
| Home equity lines of credit    | 17,982                | 3.5%    | 18,536    | 3.9%    | 21,967    | 4.8%    | 21,176    | 5.0%    | 19,366    | 4.8%    |
| Commercial business            | 53,320                | 10.4%   | 41,113    | 8.7%    | 38,865    | 8.5%    | 41,485    | 9.8%    | 35,035    | 8.6%    |
| Other                          | 6,150                 | 1.2%    | 6,266     | 1.3%    | 9,355     | 2.0%    | 10,305    | 2.5%    | 10,396    | 2.6%    |
| Total loans receivable         | \$512,498             | 100.0%  | \$473,991 | 100.0%  | \$457,871 | 100.0%  | \$423,290 | 100.0%  | \$406,813 | 100.0%  |
| Net deferred loan costs        | 132                   |         | 177       |         | 216       |         | 192       |         | 217       |         |
| Allowance for loan losses      | (4,200 )              |         | (3,475 )  |         | (3,056 )  |         | (2,886 )  |         | (2,835 )  |         |
| Total loans receivable, net    | \$508,430             |         | \$470,693 |         | \$455,031 |         | \$420,596 |         | \$404,195 |         |

**Loan Portfolio Maturities and Yields.** The following table summarizes the scheduled repayments of our loan portfolio at September 30, 2018. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in one year or less.

| Due During the Fiscal Years Ending September 30, | One-to Four-Family Residential |                       | Commercial Real Estate |                       | Construction |                       | Home Equity Lines of Credit |                       |
|--|--------------------------------|-----------------------|------------------------|-----------------------|--------------|-----------------------|-----------------------------|-----------------------|
|  | Amount                         | Weighted Average Rate | Amount                 | Weighted Average Rate | Amount       | Weighted Average Rate | Amount                      | Weighted Average Rate |
| (Dollars in thousands)                           |                                |                       |                        |                       |              |                       |                             |                       |
| 2019   | \$7,084                        | 5.16%                 | \$17,226               | 5.35%                 | \$29,016     | 6.07%                 | \$6,373                     | 5.52%                 |

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|                 |           |       |           |       |          |       |          |       |
|-----------------|-----------|-------|-----------|-------|----------|-------|----------|-------|
| 2020            | 778       | 3.21% | 3,834     | 4.16% | 843      | 6.00% | 167      | 5.75% |
| 2021            | 151       | 4.85% | 2,819     | 4.43% | 459      | 5.68% | 7        | 5.00% |
| 2022 to 2023    | 2,938     | 3.91% | 5,046     | 4.92% | —        | —     | 267      | 4.00% |
| 2024 to 2028    | 10,908    | 3.84% | 18,708    | 4.60% | —        | —     | 204      | 4.64% |
| 2029 to 2033    | 16,122    | 3.98% | 28,725    | 4.54% | —        | —     | 1,959    | 4.52% |
| 2034 and beyond | 147,306   | 4.28% | 142,989   | 4.76% | 94       | 4.50% | 9,005    | 5.43% |
| Total           | \$185,287 | 4.25% | \$219,347 | 4.75% | \$30,412 | 6.06% | \$17,982 | 5.34% |

| Due During the<br>Fiscal Years Ending<br>September 30, | Commercial<br>Business |                             | Other   |                             | Total     |                             |
|--|------------------------|-----------------------------|---------|-----------------------------|-----------|-----------------------------|
|  | Amount                 | Weighted<br>Average<br>Rate | Amount  | Weighted<br>Average<br>Rate | Amount    | Weighted<br>Average<br>Rate |
|  | (Dollars in thousands) |                             |         |                             |           |                             |
| 2019   | \$37,119               | 5.21%                       | \$575   | 6.43%                       | \$97,393  | 5.52%                       |
| 2020   | 2,797                  | 5.39%                       | 4       | 8.68%                       | 8,423     | 4.70%                       |
| 2021   | 555                    | 5.55%                       | 7       | 13.00%                      | 3,998     | 4.76%                       |
| 2022 to 2023   | 2,168                  | 4.86%                       | 26      | 13.06%                      | 10,445    | 4.62%                       |
| 2024 to 2028   | 6,802                  | 5.44%                       | 26      | 4.99%                       | 36,648    | 4.53%                       |
| 2029 to 2033   | 1,134                  | 5.62%                       | 2       | 13.00%                      | 47,942    | 4.38%                       |
| 2034 and beyond  | 2,745                  | 5.30%                       | 5,510   | 4.34%                       | 307,649   | 4.55%                       |
| Total  | \$53,320               | 5.25%                       | \$6,150 | 4.59%                       | \$512,498 | 4.72%                       |

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The following table sets forth the scheduled repayments of fixed- and adjustable-rate loans at September 30, 2018 that are contractually due after September 30, 2019.

|                                | Due After September 30, 2019 |                   |                   |
|--------------------------------|------------------------------|-------------------|-------------------|
|                                | Fixed                        | Adjustable        | Total             |
|                                | (In thousands)               |                   |                   |
| One-to four-family residential | \$ 109,168                   | \$ 69,035         | \$ 178,203        |
| Commercial real estate         | 12,345                       | 189,776           | 202,121           |
| Construction                   | 346                          | 1,050             | 1,396             |
| Home equity lines of credit    | 453                          | 11,156            | 11,609            |
| Commercial business            | 5,527                        | 10,674            | 16,201            |
| Other                          | 79                           | 5,496             | 5,575             |
| <b>Total</b>                   | <b>\$ 127,918</b>            | <b>\$ 287,187</b> | <b>\$ 415,105</b> |

**Residential Mortgage Loans.** We originate residential mortgage loans, most of which are secured by properties located in our primary market area and most of which we hold in portfolio. At September 30, 2018, \$185.3 million, or 36.2% of our total loan portfolio, consisted of residential mortgage loans (including home equity loans). Residential mortgage loan originations are generally obtained from our in-house loan representatives, from existing or past customers, through advertising, and through referrals from local builders, real estate brokers and attorneys, and are underwritten pursuant to Magyar Bank's policies and standards. Generally, residential mortgage loans are originated in amounts up to 80% of the lesser of the appraised value or purchase price of the property, with private mortgage insurance required on loans with a loan-to-value ratio in excess of 80%. We generally will not make residential mortgage loans with a loan-to-value ratio in excess of 95%, which is the upper limit that has been established by the Board of Directors. Mortgage loans have been primarily originated for terms of up to 30 years. Magyar Bank has not participated in "sub-prime" (mortgages granted to borrowers whose credit history is not sufficient to get a conventional mortgage) or option ARM mortgage lending. At September 30, 2018, non-performing residential mortgage loans totaled \$138,000, or 0.1% of the total residential loan portfolio. Interest income of \$6,000 would have been recorded on non-performing residential mortgage loans for the year ended September 30, 2018, if they had been current in accordance with their original terms. During the year ended September 30, 2018, \$213,000 was charged-off against the allowance for loan loss for three impaired residential real estate loans while \$87,000 was recovered from a prior year charge off.

We also originate home equity loans secured by residences located in our market area. The underwriting standards we use for home equity loans include a determination of the applicant's credit history, an assessment of the applicant's ability to meet existing obligations, the ongoing payments on the proposed loan and the value of the collateral securing the loan. The maximum combined (first and second mortgage liens) loan-to-value ratio for home equity loans and home equity lines of credit is 80%. Home equity loans are generally offered with fixed rates of interest with the loan amount not to exceed \$500,000 and with terms of up to 30 years.

Generally, all fixed-rate residential mortgage loans are underwritten according to Federal Home Loan Mortgage Corporation ("Freddie Mac") guidelines, policies and procedures. Historically, we have not originated a significant number of loans for the purpose of reselling them in the secondary market. In the future we may increase our origination and sale of fixed-rate residential mortgage loans to help manage interest rate risk and to increase fee income. There were no fixed-rate mortgage loans sold to Freddie Mac during the year ended September 30, 2018 and there were no loans were held for sale at September 30, 2018.

We generally do not purchase residential mortgage loans, except for loans to low-income borrowers to enhance our Community Reinvestment Act performance. However we did purchase participations in \$1.2 million of residential mortgage loans during the year ended September 30, 2018. We underwrite residential mortgage loans participations using the same criteria as if we were originating the loans.

At September 30, 2018, we had \$114.9 million of fixed-rate residential mortgage loans, which represented 62.0% of our total residential mortgage loan portfolio. At September 30, 2018, our largest fixed-rate residential mortgage loan was \$2.4 million. The loan was performing in accordance with its terms at September 30, 2018.

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We also offer adjustable-rate residential mortgage loans with interest rates based on the weekly average yield on U.S. Treasuries or the London Interbank Offering Rate (“LIBOR”) adjusted to a constant maturity of one year, which adjusts either annually from the outset of the loan or which adjusts annually after a one-, three-, five-, seven-, and ten-year initial fixed-rate period. Our adjustable-rate mortgage loans generally provide for maximum rate adjustments of 2% per adjustment, with a lifetime maximum adjustment up to 5%, regardless of the initial rate. We also offer adjustable-rate mortgage loans with an interest rate based on the prime rate as published in *The Wall Street Journal* or the Federal Home Loan Bank of New York advance rates.

Adjustable-rate mortgage loans decrease the risk associated with changes in market interest rates by periodically repricing. However, these loans have other risks because, as interest rates increase, the underlying payments by the borrower increase, which increases the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. The maximum periodic and lifetime interest rate adjustments also may limit the effectiveness of adjustable-rate mortgage loans during periods of rapidly rising interest rates.

At September 30, 2018, adjustable-rate residential mortgage loans totaled \$70.4 million, or 38.0% of our total residential mortgage loan portfolio. The largest adjustable-rate residential mortgage loan was for \$2.6 million. The loan was performing in accordance with its terms at September 30, 2018.

In an effort to provide financing for low-and moderate-income home buyers, we offer low-to-moderate income residential mortgage loans. These loans are offered with fixed rates of interest and terms of up to 40 years, and are secured by one-to four-family residential properties. All of these loans are originated using underwriting guidelines of U.S. government-sponsored enterprises such as Federal Home Loan Mortgage Corporation (“Freddie Mac”). These loans are originated with maximum loan-to-value ratios of 95%.

All residential mortgage loans we originate include “due-on-sale” clauses, which give us the right to declare a loan immediately due and payable if the borrower sells or otherwise disposes of the real property securing the mortgage loan. All borrowers are required to obtain title insurance, fire and casualty insurance and, if warranted, flood insurance on properties securing real estate loans.

**Commercial Real Estate Loans.** We have continued our focus on increasing our originations of commercial real estate loans. At September 30, 2018, \$219.3 million, or 42.8%, of our total loan portfolio consisted of these types of loans. Commercial real estate loans are generally secured by five-or-more-unit apartment buildings, industrial properties and properties used for business purposes such as small office buildings and retail facilities primarily located in our market area. We generally originate adjustable-rate commercial real estate loans with a maximum term of 25 years with adjustable rate periods every five years. The maximum loan-to-value ratio for our commercial real estate loans is 75%, based on the appraised value of the property.

We consider a number of factors when we originate commercial real estate loans. During the underwriting process we evaluate the business qualifications and financial condition of the borrower, including credit history, profitability of the property being financed, as well as the value and condition of the mortgaged property securing the loan. When evaluating the business qualifications of the borrower, we consider the financial resources of the borrower, the borrower’s experience in owning or managing similar property and the borrower’s payment history with us and other financial institutions. In evaluating the property securing the loan, we consider the net operating income of the mortgaged property before debt service and depreciation, the ratio of the loan amount to the appraised value of the mortgaged property and the debt service coverage ratio (the ratio of net operating income to debt service) to ensure it is at least 120% of the monthly debt service. We require personal guarantees on all commercial real estate loans made to individuals. Generally, commercial real estate loans made to corporations, partnerships and other business entities require personal guarantees by the principals. All borrowers are required to obtain title, fire and casualty insurance

and, if warranted, flood insurance.

Loans secured by commercial real estate generally are larger than residential mortgage loans and involve greater credit risk. Commercial real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general. Accordingly, the nature of these loans makes them more difficult for management to monitor and evaluate.

The maximum amount of a commercial real estate loan is limited by our Board-established loans-to-one-borrower limit, which is currently 15% of Magyar Bank's capital, or \$8.6 million. At September 30, 2018, our largest commercial real estate loan was \$6.0 million to finance the purchase of a manufacturing business in New Jersey. The loan was performing in accordance with its terms at September 30, 2018.

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At September 30, 2018, three commercial real estate loans totaling \$455,000 were non-performing. During the year ended September 30, 2018, no commercial real estate loans were charged-off against the allowance for loan loss, while \$23,000 was recovered from a prior year charge off. Interest income of \$17,000 would have been recorded on non-performing commercial real estate loans for the year ended September 30, 2018, if they had been current in accordance with their original terms. All other loans secured by commercial real estate were performing in accordance with their terms.

**Construction Loans.** We also originate construction loans for the development of one-to four-family homes, apartment buildings and commercial properties. Construction loans are generally offered to experienced local developers operating in our primary market area and to individuals for the construction of their personal residences. At September 30, 2018, our construction loans totaled \$30.4 million, or 5.9% of total loans.

At September 30, 2018, construction loans for the development of one-to four-family residential properties totaled \$13.9 million. These construction loans generally have a maximum term of 24 months. We provide financing for land acquisition, site improvement and construction of individual homes. Land acquisition loans are limited to 50% to 75% of the sale price of the land. Site improvement loans are limited to 100% of the bonded site improvement costs. Construction loans are limited to 75% of the lesser of the contract sale price or appraised value of the property (less funds already advanced for land acquisition and site improvement).

At September 30, 2018, construction loans for the development of commercial properties totaled \$10.1 million. These construction loans have a maximum term of 24 months. The maximum loan-to-value ratio limit applicable to these loans is 75% of the appraised value of the property.

At September 30, 2018, construction loans for the development of town homes, condominiums and apartment buildings totaled \$6.5 million. The maximum loan-to-value ratio limit applicable to these loans is 70% of the appraised value of the property. Finally, we may retain up to 10% of each loan advance until the property attains a 90% occupancy level.

The maximum amount of a construction loan is limited by our loans-to-one-borrower limit, which is currently 15% of Magyar Bank's capital, or \$8.6 million. At September 30, 2018, our largest outstanding construction loan was a \$3.9 million loan to finance the construction of a commercial office building located in New Jersey. The loan was performing in accordance with its terms at September 30, 2018. At September 30, 2018, there were no non-performing construction loans. During the year ended September 30, 2018, there were no loans charged-off against the allowance for loan loss while \$3,000 was recovered from a prior year charge-off.

Before making a commitment to fund a construction loan, we require an appraisal of the property by an independent licensed appraiser. We generally also engage an outside engineering firm to review and inspect each property before disbursement of funds during the term of a construction loan. Loan proceeds are disbursed after inspection based on the percentage of completion method. We require a personal guarantee from each principal of all of our construction loan borrowers.

Construction lending is generally considered to involve a higher degree of credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost (including interest) of construction and other assumptions. If the estimate of construction cost is inaccurate, we may be required to advance funds beyond the amount originally committed in order to protect the value of the property. Additionally, if our estimate of the value of the completed property is inaccurate, our construction loan may exceed the value of the



collateral.

**Commercial Business Loans.** At September 30, 2018, our commercial business loans totaled \$53.3 million, or 10.4% of total loans. We make commercial business loans primarily in our market area to a variety of professionals, sole proprietorships and small and mid-sized businesses. Our commercial business loans include term loans and revolving lines of credit. The maximum term of a commercial business loan is 25 years. Such loans are generally used for longer-term working capital purposes such as purchasing equipment or furniture. Commercial business loans are made with either adjustable or fixed rates of interest. The interest rates for adjustable commercial business loans are typically based on the prime rate as published in *The Wall Street Journal*.

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Included in commercial business loans are SBA 7(a) loans, on which the SBA provides guarantees of up to 75% of the principal balance (85% for loans under \$150,000). These loans are made for the purposes of providing working capital and financing the purchase of equipment, inventory or commercial real estate, and may be made inside or outside the Company's market place. Generally, an SBA 7(a) loan has a deficiency in its credit profile that would not allow the borrower to qualify for a traditional commercial loan, which is why the government provides the guarantee. The deficiency may be a higher loan to value ratio, lower debt service coverage ratio or weak personal financial guarantees. In addition, many SBA 7(a) loans are for start-up businesses where there is no history of financial information. Finally, many SBA borrowers do not have an ongoing and continuous banking relationship with the Bank, but merely work with the Bank on a single transaction. The guaranteed portions of the Company's SBA loans are generally sold in the secondary market.

When making commercial business loans, we consider the financial strength of the borrower, our lending history with the borrower, the debt service capabilities of the borrower, the projected cash flows of the business and the value and type of the collateral. Commercial business loans generally are secured by a variety of collateral, primarily accounts receivable, inventory, equipment, savings instruments and readily marketable securities. In addition, we generally require the business principals to execute personal guarantees.

Commercial business loans generally have greater credit risk than residential mortgage loans. Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to repay the loan from his or her employment income, and which are secured by real property with ascertainable value, commercial business loans generally are made on the basis of the borrower's ability to repay the loan from the cash flow of the borrower's business. As a result, the repayment of commercial business loans may depend substantially on the success of the borrower's business. Further, any collateral securing commercial business loans may depreciate over time, may be difficult to appraise and may fluctuate in value. We try to minimize these risks through our underwriting standards.

The maximum amount of a commercial business loan is limited by our loans-to-one-borrower limit, which is 15% of Magyar Bank's capital, or \$8.6 million. At September 30, 2018, our largest commercial business loan was a \$5.9 million loan to a company that provides janitorial services and was secured by the accounts receivable of the company. This loan was performing according to its terms at September 30, 2018. At September 30, 2018, two commercial business loan totaling \$223,000 were non-performing. Interest income of \$14,000 would have been recorded on non-performing commercial business loans for the year ended September 30, 2018, if they had been current in accordance with their original terms. During the year ended September 30, 2018, \$170,000 was charged-off against the allowance for loan loss for two impaired commercial business loans and \$1,000 was recovered from a prior year charge-off.

***Home Equity Lines of Credit and Other Loans.*** We originate home equity lines of credit secured by residences located in our market area. At September 30, 2018, these loans totaled \$18.0 million, or 3.5% of our total loan portfolio. The underwriting standards we use for home equity lines of credit include a determination of the applicant's credit history, an assessment of the applicant's ability to meet existing obligations, the ongoing payments on the proposed loan and the value of the collateral securing the loan. The maximum combined (first and second mortgage liens) loan-to-value ratio for home equity lines of credit is 80%. Home equity lines of credit have adjustable rates of interest, indexed to the prime rate, as reported in *The Wall Street Journal*, with terms of up to 25 years.

The maximum amount of a home equity line of credit loan is limited by our loans-to-one-borrower limit, which is 15% of Magyar Bank's capital, or \$8.6 million currently. At September 30, 2018, our largest home equity line of credit loan was \$1.4 million. The loan was performing according to its terms at September 30, 2018. At September 30, 2018, there were no non-performing home equity line of credit loans. There were no charge-offs for home equity lines of

credit during the year ended September 30, 2018, while \$1,000 was recovered from a prior year charge-off.

We also originate loans secured by the common stock of publicly traded companies, provided their shares are listed on the New York Stock Exchange or the NASDAQ Stock Market, and provided the company is not a banking company. Stock-secured loans are interest-only and are offered for terms up to twelve months and for adjustable rates of interest indexed to the prime rate, as reported in *The Wall Street Journal*. The loan amount is not to exceed 70% of the value of the stock securing the loan at any time.

At September 30, 2018, stock-secured loans totaled \$5.4 million, or 1.06% of our total net loan portfolio. Generally, we limit the aggregate amount of loans secured by the common stock of any one corporation to 15% of Magyar Bank's capital, with the exception of Johnson & Johnson, for which the collateral concentration limit is 150% of Magyar Bank's capital. At September 30, 2018, loans totaling \$5.3 million, or 1.05% of our loan portfolio, were secured by the common stock of Johnson & Johnson, a New York Stock Exchange company that operates a number of facilities in our market area and employs a substantial number of residents. Although these loans are underwritten based on the ability of the individual borrower to repay the loan, the concentration of our portfolio secured by this stock subjects us to the risk of a decline in the market price of the stock and, therefore, a reduction in the value of the collateral securing these loans. As of September 30, 2018, the aggregate loan-to-value ratio of the stock-secured portfolio was 30.5%.

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***Loan Originations, Purchases, Participations and Servicing of Loans.*** Lending activities are conducted primarily by our loan personnel operating at our main and branch office locations. All loans originated by us are underwritten pursuant to our policies and procedures. We originate both adjustable rate and fixed rate loans. Our ability to originate fixed or adjustable rate loans is dependent upon the relative customer demand for such loans, which is affected by the current and expected future levels of market interest rates.

Generally, we retain in our portfolio substantially all loans that we originate. Historically, we have not originated a significant number of loans for the purpose of selling them in the secondary market. In the future, however, to help manage our interest rate risk and to increase fee income, we may increase our origination and sale of fixed-rate residential loans and commercial business loans guaranteed by the SBA. All one-to four-family residential mortgage loans that we sell in the secondary market are sold with servicing rights retained pursuant to master commitments negotiated with Freddie Mac. We sell our loans to Freddie Mac without recourse. No loans were held for sale at September 30, 2018.

At September 30, 2018, we were servicing SBA guaranteed and commercial participation loans sold in the amount of \$26.5 million and \$6.4 million, respectively. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent mortgagors, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans.

From time-to-time, we will also participate in loans, sometimes as the “lead lender.” Whether we are the lead lender or not, we underwrite our participation portion of the loan according to our own underwriting criteria and procedures. At September 30, 2018, we had \$9.5 million of loan participation interests in which we were the lead lender, and \$21.7 million in loan participations in which we were not the lead lender. There were \$4.4 million of commercial real estate loan participations during the year ended September 30, 2018 in which we were not the lead lender. We have entered into certain loan participations when the aggregate outstanding balance of a particular customer relationship exceeds our loan-to-one-borrower limit. All loan participations are loans secured by real estate that adhere to our loan policies. At September 30, 2018, all participation loans were performing in accordance with their terms.

During the fiscal year ended September 30, 2018, we originated \$32.1 million of fixed-rate and adjustable-rate one-to four-family residential mortgage loans and \$27.3 million of fixed-rate and adjustable-rate commercial real estate loans. The fixed-rate loans are primarily loans with terms of 30 years or less. We also originated \$8.6 million of construction loans, \$8.1 million of commercial business loans, and \$3.1 million of home equity lines of credit and other loans.

We generally do not purchase residential mortgage loans, except for loans to low-income borrowers as part of our Community Reinvestment Act lenders program. At September 30, 2018, we had \$10.0 million of one-to four-family residential mortgage loans that were serviced by other lenders, of which \$1.2 million were participations during the year ended September 30, 2018.

## **Asset Quality**

We commence collection efforts when a loan becomes 15 days past due with system-generated reminder notices. Subsequent late charge and delinquent notices are issued and the account is monitored on a regular basis thereafter. Personal, direct contact with the borrower is attempted early in the collection process as a courtesy reminder and later to determine the reason for the delinquency and to safeguard our collateral. When a loan is more than 60 days past due, the credit file is reviewed and, if deemed necessary, information is updated or confirmed and collateral

re-evaluated. We make every effort to contact the borrower and develop a plan of repayment to cure the delinquency. Loans are placed on non-accrual status when they are delinquent for more than three months. When loans are placed on non-accrual status, unpaid accrued interest is fully reversed, and further income is recognized only to the extent received.

A summary report of all loans 30 days or more past due is provided to the Board of Directors on a monthly basis. If no repayment plan is in process, the file is referred to counsel for the commencement of foreclosure or other collection efforts.

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**Non-Performing Assets.** The table on the following page sets forth the amounts and categories of our non-performing assets at the dates indicated. The table includes troubled debt restructurings (loans for which a portion of interest or principal has been forgiven and loans modified at interest rates materially less than current market rates) for each date presented.

|   | September 30,          |                  |                  |                  |                  |
|---|------------------------|------------------|------------------|------------------|------------------|
|   | 2018                   | 2017             | 2016             | 2015             | 2014             |
|   | (Dollars in thousands) |                  |                  |                  |                  |
| Non-accrual loans:  |                        |                  |                  |                  |                  |
| One-to four-family residential  | \$ 138                 | \$ 1,663         | \$ 2,486         | \$ 2,057         | \$ 4,179         |
| Commercial real estate  | 455                    | 482              | 443              | 1,895            | 2,171            |
| Construction  | —                      | —                | —                | —                | 2,278            |
| Home equity lines of credit   | 90                     | —                | 281              | 255              | 883              |
| Commercial business   | 223                    | 213              | 997              | 1,690            | 274              |
| <b>Total non-accrual loans</b>  | <b>906</b>             | <b>2,358</b>     | <b>4,207</b>     | <b>5,897</b>     | <b>9,785</b>     |
| Accruing loans three months or more past due:   |                        |                  |                  |                  |                  |
| One-to four-family residential  | —                      | —                | —                | —                | —                |
| Commercial real estate  | —                      | —                | —                | —                | —                |
| Construction  | —                      | —                | —                | —                | —                |
| Home equity lines of credit   | —                      | —                | —                | —                | —                |
| Commercial business   | —                      | —                | —                | —                | —                |
| Other   | —                      | —                | —                | —                | —                |
| <b>Total loans three months or more past due</b>  | <b>—</b>               | <b>—</b>         | <b>—</b>         | <b>—</b>         | <b>—</b>         |
| <b>Total non-performing loans</b>   | <b>906</b>             | <b>2,358</b>     | <b>4,207</b>     | <b>5,897</b>     | <b>9,785</b>     |
| <b>Other real estate owned</b>  | <b>8,586</b>           | <b>11,056</b>    | <b>12,082</b>    | <b>16,192</b>    | <b>17,342</b>    |
| <b>Total non-performing assets</b>  | <b>9,492</b>           | <b>13,414</b>    | <b>16,289</b>    | <b>22,089</b>    | <b>27,127</b>    |
| Performing troubled debt restructurings   | —                      | 182              | —                | 713              | 193              |
| <b>Performing troubled debt restructurings and total non-performing assets</b>          | <b>\$ 9,492</b>        | <b>\$ 13,596</b> | <b>\$ 16,289</b> | <b>\$ 22,803</b> | <b>\$ 27,320</b> |
| Ratios:   |                        |                  |                  |                  |                  |
| Total non-performing loans to total loans   | 0.18%                  | 0.50%            | 0.92%            | 1.39%            | 2.41%            |
| Total non-performing loans and performing troubled debt restructurings to total loans   | 0.18%                  | 0.54%            | 0.92%            | 1.56%            | 2.45%            |
| Total non-performing assets to total assets   | 1.52%                  | 2.22%            | 2.79%            | 4.01%            | 5.11%            |
| Total non-performing assets and performing troubled debt restructurings to total assets | 1.52%                  | 2.25%            | 2.79%            | 4.14%            | 5.15%            |

At September 30, 2018, our portfolio of commercial business, commercial real estate and construction loans totaled \$303.1 million, or 59.1% of our total loans, compared to \$270.9 million, or 57.1% of our total loans, at September 30, 2017. Commercial business, commercial real estate and construction loans generally have more risk than one-to four-family residential mortgage loans. As shown in the table above, our troubled debt restructurings and total

non-performing assets decreased \$4.1 million to \$9.5 million at September 30, 2018 from \$13.6 million at September 30, 2017, and decreased \$6.8 million from \$16.3 million at September 30, 2016.

Additional interest income of approximately \$40,000 and \$106,000 would have been recorded during the fiscal years ended September 30, 2018 and 2017, respectively, if the non-accrual loans summarized in the above table had performed in accordance with their original terms.

The Company accounts for its impaired loans in accordance with generally accepted accounting principles, which require that a creditor measure impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate except that, as a practical expedient, a creditor may measure impairment based on a loan's observable market price less estimated costs of disposal, or the fair value of the collateral less estimated costs of disposal if the loan is collateral dependent. Regardless of the measurement method, a creditor may measure impairment based on the fair value of the collateral when the creditor determines that foreclosure is probable.

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The Company records cash receipts on impaired loans that are non-performing as a reduction to principal before applying amounts to interest or late charges unless specifically directed by the Bankruptcy Court to apply payments otherwise. The Company continues to recognize interest income on impaired loans that are performing.

Troubled debt restructurings (“TDRs”) occur when a creditor, for economic or legal reasons related to a debtor’s financial condition, grants a concession to the debtor that it would not otherwise consider, such as a below market interest rate, extending the maturity of a loan, or a combination of both. There were no new TDR loans during the fiscal year ended September 30, 2018 and there was one TDR loan for the fiscal year ended September 30, 2017.

**Delinquent Loans.** The following table sets forth certain information with respect to our loan portfolio delinquencies at the dates indicated. Loans delinquent more than three months are generally classified as non-accrual loans.

|                                | Loans Delinquent For |        |                  |          |        |          |
|--------------------------------|----------------------|--------|------------------|----------|--------|----------|
|                                | 60-89 Days           |        | 90 Days and Over |          | Total  |          |
|                                | Number               | Amount | Number           | Amount   | Number | Amount   |
| (Dollars in thousands)         |                      |        |                  |          |        |          |
| At September 30, 2018          |                      |        |                  |          |        |          |
| One-to four-family residential | —                    | \$ —   | 1                | \$ 138   | 1      | \$ 138   |
| Commercial real estate         | —                    | —      | 3                | 455      | 3      | 455      |
| Home equity lines of credit    | —                    | —      | 3                | 90       | 3      | 90       |
| Commercial business            | —                    | —      | 2                | 223      | 2      | 223      |
| Total                          | —                    | \$ —   | 9                | \$ 906   | 9      | \$ 906   |
| At September 30, 2017          |                      |        |                  |          |        |          |
| One-to four-family residential | 1                    | \$ 127 | 8                | \$ 1,663 | 9      | \$ 1,790 |
| Commercial real estate         | —                    | —      | 3                | 482      | 3      | 482      |
| Home equity lines of credit    | 1                    | 192    | —                | —        | 1      | 192      |
| Commercial business            | 1                    | 80     | 1                | 213      | 2      | 293      |
| Total                          | 3                    | \$ 399 | 12               | \$ 2,358 | 15     | \$ 2,757 |
| At September 30, 2016          |                      |        |                  |          |        |          |
| One-to four-family residential | 1                    | \$ 44  | 10               | \$ 2,486 | 11     | \$ 2,530 |
| Commercial real estate         | 1                    | 490    | 3                | 443      | 4      | 933      |
| Home equity lines of credit    | —                    | —      | 3                | 281      | 3      | 281      |
| Commercial business            | 1                    | 3      | 1                | 997      | 2      | 1,000    |
| Total                          | 3                    | \$ 537 | 17               | \$ 4,207 | 20     | \$ 4,744 |
| At September 30, 2015          |                      |        |                  |          |        |          |
| One-to four-family residential | 4                    | \$ 730 | 14               | \$ 2,058 | 18     | \$ 2,788 |
| Commercial real estate         | —                    | —      | 4                | 1,895    | 4      | 1,895    |
| Home equity lines of credit    | —                    | —      | 3                | 255      | 3      | 255      |
| Commercial business            | 1                    | 19     | 1                | 1,690    | 2      | 1,709    |



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|       |   |        |    |          |    |          |
|-------|---|--------|----|----------|----|----------|
| Total | 5 | \$ 749 | 22 | \$ 5,898 | 27 | \$ 6,647 |
|-------|---|--------|----|----------|----|----------|

At September 30, 2014

|                                |    |          |    |          |    |           |
|--------------------------------|----|----------|----|----------|----|-----------|
| One-to four-family residential | 6  | \$ 256   | 18 | \$ 4,179 | 24 | \$ 4,435  |
| Commercial real estate         | 3  | 918      | 6  | 2,171    | 9  | 3,089     |
| Construction                   | —  | —        | 2  | 2,278    | 2  | 2,278     |
| Home equity lines of credit    | —  | —        | 7  | 883      | 7  | 883       |
| Commercial business            | 2  | 56       | 3  | 274      | 5  | 330       |
| Total                          | 11 | \$ 1,230 | 36 | \$ 9,785 | 47 | \$ 11,015 |

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**Real Estate Owned.** Real estate we acquire as a result of foreclosure or by deed in lieu of foreclosure is classified as other real estate owned (“OREO”) until sold. When property is acquired it is recorded at fair value less estimated cost to sell at the date of foreclosure, establishing a new cost basis. Holding costs and declines in fair value result in charges to expense after acquisition.

The Company held \$8.6 million of OREO properties at September 30, 2018, a decrease of \$2.5 million from \$11.1 million at September 30, 2017. The Company was able to successfully dispose of ten properties with an aggregate carrying value of \$2.7 million for a net gain of \$184,000 while the Company was also able to secure the title for one other property totaling \$323,000 during the year ended September 30, 2018.

OREO at September 30, 2018 consisted of four residential properties (three of which were leased), four real estate properties approved for the construction of residential homes, and five commercial real estate buildings. The Bank is determining the proper course of action for its OREO properties, which may include holding the properties until the real estate market improves, selling the properties to a developer or marketing the properties for individual sale.

The Company recorded \$418,000 in valuation allowances against three properties during the year ended September 30, 2018 based on either updated appraisals or contracts of sale. Further declines in real estate values may result in a charge to expense in the future. Routine holding costs are charged to expense as incurred and improvements to OREO that enhance the value of the real estate are capitalized.

**Classified Assets.** Federal banking regulations provide that loans and other assets of lesser quality should be classified 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” we 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 “un-collectible” and of such little value their continuance as assets without the establishment of a specific loss reserve is not warranted. We classify an asset as “special mention” if the asset has a potential weakness that warrants management’s close attention. While such assets are not impaired, management has concluded that if the potential weakness in the asset is not addressed, the value of the asset may deteriorate, adversely affecting the repayment of the asset. On the basis of our review of assets at September 30, 2018, classified loans consisted of \$753,000 of special mention assets and \$1.4 million of substandard assets.

We are required to establish an allowance for loan losses in an amount deemed prudent by management for loans classified substandard or doubtful, as well as for other problem loans. General allowances represent loss allowances which have been established to recognize the inherent losses associated with lending activities, but which, unlike impairment allowances, have not been allocated to particular problem assets. When we classify problem assets, we are required to determine whether or not impairment exists. A loan is impaired when, based on current information and events, it is probable that Magyar Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. When it is determined that impairment exists, a specific allowance for loss is established. For

collateral-dependent loans, the loan is reduced by the impairment amount via a reduction to the loan and the allowance for loan loss. Our determination as to the classification of our assets and the amount of our valuation allowances is subject to review by the NJDBI and the FDIC, which can direct us to establish additional loss allowances.

The loan portfolio is reviewed on a regular basis to determine whether any loans require classification in accordance with applicable regulations. Not all classified assets constitute non-performing assets.

#### Allowance for Loan Losses

Our allowance for loan losses is maintained at a level management deems necessary to absorb loan losses that are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses in our loan portfolio both probable and reasonably estimable, and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. The allowance for loan losses as of September 30, 2018 was maintained at a level that represents management's best estimate of losses in the loan portfolio both probable and reasonably estimable. However, this analysis process is inherently subjective, as it requires us to make estimates that are susceptible to revisions as more information becomes available. Although we believe we have established the allowance at levels to absorb probable and estimable losses, future additions may be necessary if economic or other conditions in the future differ from the current environment.

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In addition, as an integral part of their examination process, the NJDBI and the FDIC will periodically review our allowance for loan losses. Such agencies may require us to recognize additions to the allowance based on their judgments of information available to them at the time of their examination.

**Allowance for Loan Losses.** The following table sets forth activity in our allowance for loan losses for the periods indicated.

|  | September 30,          |         |         |         |         |
|--|------------------------|---------|---------|---------|---------|
|  | 2018                   | 2017    | 2016    | 2015    | 2014    |
|  | (Dollars in thousands) |         |         |         |         |
| Balance at beginning of period   | \$3,475                | \$3,056 | \$2,886 | \$2,835 | \$3,013 |
| Charge-offs:   |                        |         |         |         |         |
| One-to four-family residential   | 213                    | 295     | 134     | 176     | 665     |
| Commercial real estate   | —                      | 23      | 61      | 396     | —       |
| Construction   | —                      | —       | —       | 342     | 189     |
| Home equity lines of credit  | —                      | —       | 98      | 461     | 75      |
| Commercial business  | 170                    | 672     | 1,118   | 274     | 804     |
| Other  | 3                      | —       | —       | 2       | —       |
| Total charge-offs  | 386                    | 990     | 1,411   | 1,651   | 1,733   |
| Recoveries:  |                        |         |         |         |         |
| One-to four-family residential   | 87                     | 35      | —       | 400     | 52      |
| Commercial real estate   | 23                     | —       | 100     | —       | —       |
| Construction   | 3                      | 12      | 7       | 38      | 113     |
| Home equity lines of credit  | 1                      | 15      | 82      | —       | —       |
| Commercial business  | —                      | 4       | 26      | —       | 3       |
| Total recoveries   | 114                    | 66      | 215     | 438     | 168     |
| Net charge-offs  | 272                    | 924     | 1,196   | 1,213   | 1,565   |
| Provision for loan losses  | 997                    | 1,343   | 1,366   | 1,264   | 1,387   |
| Balance at end of period   | \$4,200                | \$3,475 | \$3,056 | \$2,886 | \$2,835 |
| Ratios:  |                        |         |         |         |         |
| Net charge-offs to average loans outstanding                             | 0.06%                  | 0.20%   | 0.28%   | 0.29%   | 0.39%   |
| Allowance for loan losses to total non-performing loans at end of period | 463.57%                | 147.37% | 72.64%  | 48.93%  | 28.97%  |
| Allowance for loan losses to total loans at end of period                | 0.82%                  | 0.73%   | 0.67%   | 0.68%   | 0.70%   |

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**Allocation of Allowance for Loan Losses.** The following table sets forth the allowance for loan losses allocated by loan category, the percent of the allowance to the total allowance and the percent of loans in each category to total loans at the dates indicated. The allowance for loan losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

|                                 | Amount  | % of<br>Allowance<br>In<br>Category<br>to<br>Total<br>Allowance | % of<br>Loans<br>In<br>Category<br>to<br>Total<br>Loans |
|---------------------------------|---------|---|---|
| (Dollars in thousands)          |         |   |   |
| At September 30, 2018           |         |   |   |
| One-to four-family residential  | \$687   | 16.36%  | 36.15%  |
| Commercial real estate          | 1,540   | 36.67%  | 42.80%  |
| Construction                    | 493     | 11.74%  | 5.93%   |
| Home equity lines of credit     | 109     | 2.60%   | 3.51%   |
| Commercial business             | 1,151   | 27.40%  | 10.40%  |
| Other                           | 25      | 0.60%   | 1.20%   |
| Unallocated                     | 195     | 4.63%   | 0.00%   |
| Total allowance for loan losses | \$4,200 | 100.00%   | 100.00%   |
| At September 30, 2017           |         |   |   |
| One-to four-family residential  | \$587   | 16.89%  | 37.62%  |
| Commercial real estate          | 1,277   | 36.75%  | 43.70%  |
| Construction                    | 490     | 14.10%  | 4.77%   |
| Home equity lines of credit     | 57      | 1.64%   | 3.91%   |
| Commercial business             | 956     | 27.51%  | 8.67%   |
| Other                           | 6       | 0.17%   | 1.32%   |
| Unallocated                     | 102     | 2.94%   | 0.00%   |
| Total allowance for loan losses | \$3,475 | 100.00%   | 100.00%   |
| At September 30, 2016           |         |   |   |
| One-to four-family residential  | \$542   | 17.74%  | 37.83%  |
| Commercial real estate          | 1,075   | 35.18%  | 43.57%  |
| Construction                    | 361     | 11.81%  | 3.26%   |
| Home equity lines of credit     | 71      | 2.32%   | 4.80%   |
| Commercial business             | 976     | 31.94%  | 8.49%   |
| Other                           | 9       | 0.29%   | 2.04%   |
| Unallocated                     | 22      | 0.72%   | 0.00%   |
| Total allowance for loan losses | \$3,056 | 100.00%   | 100.00%   |
| At September 30, 2015           |         |   |   |
| One-to four-family residential  | \$395   | 13.69%  | 40.10%  |
| Commercial real estate          | 931     | 32.26%  | 41.00%  |
| Construction                    | 452     | 15.66%  | 1.60%   |

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|                                 |         |         |         |
|---------------------------------|---------|---------|---------|
| Home equity lines of credit     | 53      | 1.84%   | 5.00%   |
| Commercial business             | 969     | 33.58%  | 9.80%   |
| Other                           | 7       | 0.24%   | 2.50%   |
| Unallocated                     | 79      | 2.73%   | 0.00%   |
| Total allowance for loan losses | \$2,886 | 100.00% | 100.00% |

At September 30, 2014

|                                 |         |         |         |
|---------------------------------|---------|---------|---------|
| One-to four-family residential  | \$402   | 14.18%  | 39.40%  |
| Commercial real estate          | 826     | 29.14%  | 41.60%  |
| Construction                    | 784     | 27.65%  | 3.00%   |
| Home equity lines of credit     | 62      | 2.19%   | 4.80%   |
| Commercial business             | 643     | 22.68%  | 8.60%   |
| Other                           | 9       | 0.32%   | 2.60%   |
| Unallocated                     | 109     | 3.84%   | 0.00%   |
| Total allowance for loan losses | \$2,835 | 100.00% | 100.00% |

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## Investments

Our Board of Directors has adopted our Investment Policy. This policy determines the types of securities in which we may invest. The Investment Policy is reviewed annually by the Board of Directors and changes to the policy are subject to approval by our Board of Directors. While general investment strategies are developed by the Asset and Liability Committee, the execution of specific actions rests primarily with our President and our Chief Financial Officer. They are responsible for ensuring the guidelines and requirements included in the Investment Policy are followed and only prudent securities are considered for investment. They are authorized to execute transactions that fall within the scope of the established Investment Policy up to \$2.5 million per transaction individually or \$5.0 million per transaction jointly. Investment transactions in excess of \$5.0 million must be approved by the Asset and Liability Committee. Investment transactions are reviewed and ratified by the Board of Directors at their regularly scheduled meetings.

Our investments portfolio may include U.S. Treasury obligations, debt and equity securities issued by various government-sponsored enterprises, including Fannie Mae and Freddie Mac, mortgage-backed securities, certain certificates of deposit of insured financial institutions, overnight and short-term loans to other banks, investment-grade corporate debt instruments, and municipal securities. In addition, we may invest in equity securities subject to certain limitations and not in excess of Magyar Bank's Tier 1 capital.

The Investment Policy requires that securities transactions be conducted in a safe and sound manner, and purchase and sale decisions be based upon a thorough analysis of each security to determine its quality and inherent risks and fit within our overall asset/liability management objectives. The analysis must consider the effect of an investment or sale on our risk-based capital and prospects for yield and appreciation.

At September 30, 2018, our securities portfolio totaled \$56.1 million, or 9.0% of our total assets. Securities are classified as held-to-maturity or available-for-sale when purchased. At September 30, 2018, \$33.6 million of our securities were classified as held-to-maturity and reported at amortized cost, and \$22.5 million were classified as available-for-sale and reported at fair value. At September 30, 2018, we held no investment securities classified as held-for-trading.

***U.S. Government Agency and Government-Sponsored Enterprise Obligations.*** At September 30, 2018, our U.S. Government Agency and Government-Sponsored Enterprise Obligations totaled \$52.7 million, or 94.0% of our total securities portfolio. Of this amount, \$47.9 million were mortgage-backed securities and \$4.8 million were debt securities. While these securities generally provide lower yields than other securities in our securities portfolio, we hold these securities, to the extent appropriate, for liquidity purposes and as collateral for certain deposits or borrowings. We invest in these securities to achieve positive interest rate spreads with minimal administrative expense, and to lower our credit risk as a result of the guarantees provided by these issuers.

***Mortgage-Backed Securities.*** We purchase mortgage-backed pass through and collateralized mortgage obligation ("CMO") securities insured or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. To a lesser extent, we also invest in mortgage-backed securities issued or sponsored by private issuers. At September 30, 2018, our mortgage-backed securities, including CMOs, totaled \$48.3 million, or 86.1% of our total securities portfolio. Included in this balance was \$393,000 of mortgage-backed securities issued by private issuers. Our policy is to limit purchases of privately issued mortgage-backed securities to non-high risk securities rated "A" or higher by a nationally recognized credit rating agency. High risk securities generally are defined as those exhibiting significantly greater volatility of estimated average life and price due to changes in interest rates than 30-year fixed rate securities.

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Mortgage-backed pass through securities are created by pooling mortgages and issuing a security with an interest rate less than the interest rate on the underlying mortgages. Mortgage-backed pass through securities represent a participation interest in a pool of single-family or multi-family mortgages. As loan payments are made by the borrowers, the principal and interest portion of the payment is passed through to the investor as received. CMOs are also backed by mortgages. However they differ from mortgage-backed pass through securities because the principal and interest payments on the underlying mortgages are structured so that they are paid to the security holders of pre-determined classes or tranches at a faster or slower pace. The receipt of these principal and interest payments, which depends on the estimated average life for each class, is contingent on a prepayment speed assumption assigned to the underlying mortgages. Variances between the assumed payment speed and actual payments can significantly alter the average lives of such securities. Mortgage-backed securities and CMOs generally yield less than the loans that underlie such securities because of the cost of payment guarantees and credit enhancements. However, mortgage-backed securities are usually more liquid than individual mortgage loans and may be used to collateralize borrowings and other liabilities.

Mortgage-backed securities present a risk that actual prepayments may differ from estimated prepayments over the life of the security, which may require adjustments to the amortization of any premium or accretion of any discount relating to such instruments that can change the net yield on the securities. There is also reinvestment risk associated with the cash flows from such securities or if the securities are redeemed by the issuer. In addition, the market value of such securities may be adversely affected by changes in interest rates.

Our mortgage-backed securities portfolio had a weighted average yield of 2.56% at September 30, 2018. The estimated fair value of our mortgage-backed securities portfolio at September 30, 2018 was \$47.3 million, which was \$1.6 million less than the amortized cost. Mortgage-backed securities in Magyar Bank's portfolio do not contain sub-prime mortgage loans.

**Corporate and Other Securities.** At September 30, 2018, the Bank held one corporate note at amortized value issued by Wells Fargo Bank totaling \$3.0 million. Our Investment Policy allows for the purchase of such instruments and requires that corporate debt obligations be rated in one of the four highest categories by a nationally recognized rating service. We may invest up to 25% of Magyar Bank's investment portfolio in corporate debt obligations and up to 15% of Magyar Bank's capital in any one issuer.

**Equity Securities.** At September 30, 2018, we held no equity securities other than \$2.2 million in Federal Home Loan Bank of New York stock. The investment in Federal Home Loan Bank of New York stock is classified as a restricted security, carried at cost and evaluated for impairment. Equity securities are not insured or guaranteed investments and are affected by market interest rates and stock market fluctuations. Such investments other than the Federal Home Loan Bank of New York are carried at their fair value and fluctuations in the fair value of such investments, including temporary declines in value, directly affect our net capital position.

**Securities Portfolios.** The following tables set forth the composition of our securities portfolio (excluding Federal Home Loan Bank of New York common stock) at the dates indicated.

|                                | At September 30, 2018 |            |            |       | At September 30, 2017 |            |            |       | At September 30, 2016 |            |            |       |
|--------------------------------|-----------------------|------------|------------|-------|-----------------------|------------|------------|-------|-----------------------|------------|------------|-------|
|                                | Gross                 |            | Gross      |       | Gross                 |            | Gross      |       | Gross                 |            | Gross      |       |
|                                | Amortized             | Unrealized | Unrealized | Fair  | Amortized             | Unrealized | Unrealized | Fair  | Amortized             | Unrealized | Unrealized | Fair  |
|                                | Cost                  | Gains      | Losses     | Value | Cost                  | Gains      | Losses     | Value | Cost                  | Gains      | Losses     | Value |
| Securities available for sale: | (In thousands)        |            |            |       |                       |            |            |       |                       |            |            |       |



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|   |          |      |         |          |          |     |         |          |         |      |       |         |
|---|----------|------|---------|----------|----------|-----|---------|----------|---------|------|-------|---------|
| Obligations of U.S. government agencies:              |          |      |         |          |          |     |         |          |         |      |       |         |
| Mortgage backed securities-residential                | \$1,463  | \$40 | \$(8 )  | \$1,495  | \$—      | \$— | \$—     | \$—      | \$—     | \$—  | \$—   | \$—     |
| Obligations of U.S. government-sponsored enterprises: |          |      |         |          |          |     |         |          |         |      |       |         |
| Mortgage-backed securities-residential                | 19,262   | 13   | (662)   | 18,613   | \$9,442  | \$9 | \$(125) | \$9,326  | \$5,075 | \$52 | \$—   | \$5,127 |
| Debt securities                                       | 2,500    | —    | (139)   | 2,361    | 2,500    | —   | (51 )   | 2,449    | —       | —    | —     | —       |
| Private label mortgage-backed securities-residential  | —        | —    | —       | —        | 40       | —   | —       | 40       | 108     | —    | (1)   | 107     |
| Total securities available for sale                   | \$23,225 | \$53 | \$(809) | \$22,469 | \$11,982 | \$9 | \$(176) | \$11,815 | \$5,183 | \$52 | \$(1) | \$5,234 |

|   | At September 30, 2018 |                        |                         |            | At September 30, 2017 |                        |                         |            | At September 30, 2016 |                        |                         |            |
|---|-----------------------|------------------------|-------------------------|------------|-----------------------|------------------------|-------------------------|------------|-----------------------|------------------------|-------------------------|------------|
|   | Amortized Cost        | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Amortized Cost        | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Amortized Cost        | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Securities held to maturity:                          | (In thousands)        |                        |                         |            |                       |                        |                         |            |                       |                        |                         |            |
| Obligations of U.S. government agencies:              |                       |                        |                         |            |                       |                        |                         |            |                       |                        |                         |            |
| Mortgage backed securities-residential                | \$568                 | \$—                    | \$(93 )                 | \$475      | \$3,466               | \$123                  | \$(96 )                 | \$3,493    | \$4,383               | \$171                  | \$(90 )                 | \$4,464    |
| Mortgage backed securities-commercial                 | 904                   | —                      | (9 )                    | 895        | 968                   | —                      | (10 )                   | 958        | 1,034                 | —                      | (1 )                    | 1,033      |
| Obligations of U.S. government-sponsored enterprises: |                       |                        |                         |            |                       |                        |                         |            |                       |                        |                         |            |
| Mortgage backed securities-residential                | 26,316                | 4                      | (867 )                  | 25,453     | 39,016                | 349                    | (251)                   | 39,114     | 40,024                | 1,098                  | (16 )                   | 41,106     |
| Debt securities                                       | 2,464                 | —                      | (142 )                  | 2,322      | 4,461                 | —                      | (24 )                   | 4,437      | 4,000                 | 1                      | —                       | 4,038      |
| Private label mortgage-backed securities-residential  | 393                   | 1                      | —                       | 394        | 457                   | —                      | (2 )                    | 455        | 493                   | —                      | (6 )                    | 487        |
| Corporate securities                                  | 3,000                 | —                      | (388 )                  | 2,612      | 3,000                 | —                      | (216)                   | 2,784      | 3,000                 | —                      | (242)                   | 2,758      |
| Total securities held to maturity                     | \$33,645              | \$5                    | \$(1,499)               | \$32,151   | \$51,368              | \$472                  | \$(599)                 | \$51,241   | \$52,934              | \$1,270                | \$(355)                 | \$53,849   |

At September 30, 2018, a total of forty-four securities with an aggregate fair value of \$51.2 million had gross unrealized losses of \$2.3 million, or approximately 4.5% of fair value. None of these unrealized losses were considered other-than-temporary.

**Portfolio Maturities and Yields.** The composition, maturities and weighted average yields of the investment debt securities portfolio and the mortgage-backed securities portfolio at September 30, 2018 are summarized in the

following tables. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur.

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|   | September 30, 2018     |       |                      |       |  |       |                     |       |                  |       |
|---|------------------------|-------|----------------------|-------|--|-------|---------------------|-------|------------------|-------|
|   | One Year or Less       |       | Less Than Five Years |       | More Than Five Years Through Ten Years |       | More Than Ten Years |       | Total Securities |       |
|   | Amortized Cost         | Yield | Amortized Cost       | Yield | Amortized Cost                         | Yield | Amortized Cost      | Yield | Amortized Cost   | Yield |
|   | (Dollars in thousands) |       |                      |       |  |       |                     |       |                  |       |
| Securities available for sale:                        |                        |       |                      |       |  |       |                     |       |                  |       |
| Obligations of U.S. government agencies:              |                        |       |                      |       |  |       |                     |       |                  |       |
| Mortgage backed securities - residential              | \$—                    | —%    | \$—                  | —%    | \$—                                    | —%    | \$1,463             | 4.13% | \$1,463          | 4.13% |
| Obligations of U.S. government-sponsored enterprises: |                        |       |                      |       |  |       |                     |       |                  |       |
| Mortgage-backed securities-residential                | —                      | —%    | 6,671                | 2.86% | 5,171                                  | 2.60% | 7,420               | 2.41% | \$19,262         | 2.62% |
| Debt securities                                       | —                      | —%    | —                    | —%    | 2,500                                  | 2.08% | —                   | —%    | 2,500            | 2.08% |
| Total securities available for sale                   | \$—                    | —%    | \$6,671              | 2.86% | \$7,671                                | 2.43% | \$8,883             | 2.69% | \$23,225         | 2.66% |

|   | September 30, 2018     |       |                      |       |  |       |                     |       |                  |       |
|---|------------------------|-------|----------------------|-------|--|-------|---------------------|-------|------------------|-------|
|   | One Year or Less       |       | Less Than Five Years |       | More Than Five Years Through Ten Years |       | More Than Ten Years |       | Total Securities |       |
|   | Amortized Cost         | Yield | Amortized Cost       | Yield | Amortized Cost                         | Yield | Amortized Cost      | Yield | Amortized Cost   | Yield |
|   | (Dollars in thousands) |       |                      |       |  |       |                     |       |                  |       |
| Securities held to maturity:                          |                        |       |                      |       |  |       |                     |       |                  |       |
| Obligations of U.S. government agencies:              |                        |       |                      |       |  |       |                     |       |                  |       |
| Mortgage-backed securities - residential              | \$—                    | —%    | \$—                  | —%    | \$—                                    | —%    | \$568               | 2.53% | \$568            | 2.53% |
| Mortgage-backed securities - commercial               | —                      | —%    | —                    | —%    | —                                      | —%    | 904                 | 2.41% | 904              | 2.41% |
| Obligations of U.S. government-sponsored enterprises: |                        |       |                      |       |  |       |                     |       |                  |       |
| Mortgage backed securities - residential              | 1,302                  | 2.30% | 9,185                | 2.05% | 7,323                                  | 2.46% | 8,506               | 2.80% | 26,316           | 2.42% |
| Debt securities                                       | —                      | —%    | —                    | —%    | 1,499                                  | 2.69% | 965                 | 2.34% | 2,464            | 2.55% |
|   | —                      | —%    | —                    | —%    | —                                      | —%    | 393                 | 4.06% | 393              | 4.06% |

|  |         |       |         |       |          |       |          |       |          |       |
|--|---------|-------|---------|-------|----------|-------|----------|-------|----------|-------|
| Private label<br>mortgage-backed<br>securities - residential |         |       |         |       |          |       |          |       |          |       |
| Corporate securities   | —       | —%    | —       | —%    | 3,000    | 2.40% | —        | —%    | 3,000    | 2.40% |
| Total securities<br>held to maturity                         | \$1,302 | 2.30% | \$9,185 | 2.05% | \$11,822 | 2.48% | \$11,336 | 2.76% | \$33,645 | 2.45% |

## Sources of Funds

**General.** Deposits, including certificates of deposit, demand, savings, NOW and money market accounts, have traditionally been the primary source of funds used for our lending and investment activities. We obtain certificates of deposit primarily through our branch network and to a lesser extent via the brokered CD market. We also use borrowings, primarily Federal Home Loan Bank advances, to supplement cash flow needs, to lengthen the maturities of liabilities for interest rate risk management and to manage our cost of funds. Additional sources of funds include principal and interest payments from loans and securities, loan and security prepayments and maturities, income on other earning assets and stockholders' equity. While cash flows from loans and securities payments can be relatively stable sources of funds, deposit inflows and outflows can vary widely and are influenced by prevailing interest rates, market conditions and levels of competition.

**Deposits.** Our deposits are generated primarily from residents within our primary market area. We offer a selection of deposit accounts, including demand accounts, NOW accounts, money market accounts, savings accounts, retirement accounts and certificates of deposit. Deposit account terms vary, with the principal differences being the minimum balance required, the amount of time the funds must remain on deposit and the interest rate. We also accept brokered deposits when attractive rates and terms are available. At September 30, 2018, we had \$14.8 million in brokered deposits as compared to \$10.3 million at September 30, 2017.

Interest rates, maturity terms, service fees and withdrawal penalties are established on a periodic basis. Deposit rates and terms are based primarily on current operating strategies and market rates, liquidity requirements, rates paid by competitors and growth goals. Personalized customer service, long-standing relationships with customers and an active marketing program are relied upon to attract and retain deposits.

The flow of deposits is influenced significantly by general economic conditions, changes in money market and other prevailing interest rates and competition. The variety of deposit accounts offered allows us to be competitive in obtaining funds and responding to changes in consumer demand. Based on experience, we believe that our deposits are relatively stable. However, the ability to attract and maintain deposits, and the rates paid on these deposits, has been and will continue to be significantly affected by market conditions. At September 30, 2018, \$130.3 million, or 24.6% of our deposit accounts, were certificates of deposit (including individual retirement accounts).

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The following table sets forth the distribution of total deposit accounts, by account type, at the dates indicated.

| Deposit Type            | September 30,<br>2018             |         |                             | 2017       |         |                             | 2016       |         |                             |
|-------------------------|-----------------------------------|---------|-----------------------------|------------|---------|-----------------------------|------------|---------|-----------------------------|
|                         | Balance<br>(Dollars in thousands) | Percent | Weighted<br>Average<br>Rate | Balance    | Percent | Weighted<br>Average<br>Rate | Balance    | Percent | Weighted<br>Average<br>Rate |
| Demand accounts         | \$ 104,745                        | 19.76%  | 0.00%                       | \$98,728   | 19.16%  | 0.00%                       | \$94,462   | 19.17%  | 0.00%                       |
| Savings accounts        | 81,373                            | 15.35%  | 0.65%                       | 107,362    | 20.84%  | 0.74%                       | 100,706    | 20.44%  | 0.72%                       |
| NOW accounts            | 46,336                            | 8.74%   | 0.32%                       | 43,556     | 8.45%   | 0.25%                       | 49,045     | 9.96%   | 0.20%                       |
| Money market accounts   | 167,340                           | 31.57%  | 1.27%                       | 137,527    | 26.69%  | 0.77%                       | 114,458    | 23.23%  | 0.41%                       |
| Certificates of deposit | 112,014                           | 21.13%  | 1.66%                       | 108,740    | 21.11%  | 1.20%                       | 114,355    | 23.21%  | 1.16%                       |
| Retirement accounts     | 18,329                            | 3.46%   | 1.41%                       | 19,288     | 3.74%   | 1.24%                       | 19,624     | 3.98%   | 1.19%                       |
| Total deposits          | \$ 530,137                        | 100.00% | 0.93%                       | \$ 515,201 | 100.00% | 0.68%                       | \$ 492,650 | 100.00% | 0.58%                       |

As of September 30, 2018, the aggregate amount of outstanding certificates of deposit (including retirement and brokered accounts) in amounts greater than or equal to \$100,000 was \$90.1 million. The following table sets forth the maturity of these certificates as of September 30, 2018 (in thousands):

|                                      |           |
|--------------------------------------|-----------|
| Three months or less                 | \$ 10,078 |
| Over three months through six months | 16,685    |
| Over six months through one year     | 16,278    |
| Over one year to three years         | 39,374    |
| Over three years                     | 7,712     |
| Total                                | \$ 90,127 |

At September 30, 2018, \$66.0 million of our certificates of deposit had maturities of one year or less. We monitor activity on these accounts and, based on historical experience and our current pricing strategy, we believe we will retain a large portion of these accounts upon maturity.

The following table sets forth the interest-bearing deposit activities for the periods indicated.

|                                       | September 30,  |           |           |
|---------------------------------------|----------------|-----------|-----------|
|                                       | 2018           | 2017      | 2016      |
|                                       | (In thousands) |           |           |
| Beginning balance                     | \$416,473      | \$398,188 | \$378,354 |
| Net deposits before interest credited | 5,242          | 15,434    | 17,233    |
| Interest credited                     | 3,677          | 2,851     | 2,601     |
| Ending balance                        | \$425,392      | \$416,473 | \$398,188 |

**Borrowings.** Our borrowings consist of short-and long-term advances from the Federal Home Loan Bank of New York.

As of September 30, 2018, we had long term advances from the Federal Home Loan Bank in the amount of \$35.5 million. These aggregate borrowings represent 6.2% of total liabilities and had a weighted average rate of 2.09% at September 30, 2018. Based on eligible collateral pledged to the Federal Home Loan Bank of New York at September 30, 2018, we had an aggregate borrowing capacity of \$134.3 million with the Federal Home Loan Bank.

Repurchase agreements are recorded as financing transactions as we maintain effective control over the transferred or pledged securities. The dollar amount of the securities underlying the agreements continues to be carried in our securities portfolio while the obligations to repurchase the securities are reported as liabilities in our Consolidated Balance Sheets. The securities underlying the agreements are delivered to the party with whom each transaction is executed. Those parties agree to resell to us the identical securities we delivered to them at the maturity or call period of the agreement.

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Long-term Federal Home Loan Bank of New York advances as of September 30, 2018 mature as follows (in thousands):

| Year Ending September 30, |          |
|---------------------------|----------|
| 2019                      | \$8,940  |
| 2020                      | 10,294   |
| 2021                      | 2,500    |
| 2022                      | 7,731    |
| 2023                      | 3,650    |
| Thereafter                | 2,409    |
|                           | \$35,524 |

Information concerning overnight line of credit advances with the Federal Home Loan Bank of New York is summarized as follows:

|   | September 30,          |          |
|---|------------------------|----------|
|   | 2018                   | 2017     |
|   | (Dollars in thousands) |          |
| Balance at end of year                    | \$—                    | \$—      |
| Weighted average balance during the year  | \$3,418                | \$966    |
| Maximum month-end balance during the year | \$25,175               | \$11,150 |
| Average interest rate during the year     | 2.16%                  | 1.00%    |

Subsidiary Activities

Magyar Bank organized Magbank Investment Company on August 15, 2006 as a New Jersey investment corporation subsidiary for the purpose of buying, selling and holding investment securities. The income earned on Magbank Investment Company's investment securities is subject to a significantly lower state tax than that assessed on income earned on investment securities maintained at Magyar Bank.

Hungaria Urban Renewal, LLC is a Delaware limited-liability corporation established in 2002 as a qualified intermediary operating for the purpose of acquiring and developing Magyar Bank's main office. On January 24, 2006, Magyar Bank exercised a purchase option within its lease from Hungaria Urban Renewal, LLC allowing Magyar Bank to purchase the land and building from this entity. Magyar Bank acquired a 100% interest in Hungaria Urban Renewal, LLC, which has no other business other than owning Magyar Bank's main office site. As part of a tax abatement agreement with the City of New Brunswick, Magyar Bank's new office will remain in Hungaria Urban

Renewal, LLC's name.

Magyar Service Corp., a New Jersey corporation, is a wholly owned subsidiary of Magyar Bank. Magyar Service Corp. offers Magyar Bank customers and others a complete range of non-deposit investment products and financial planning services, including insurance products, fixed and variable annuities, and retirement planning for individual and commercial customers.

#### Personnel

At September 30, 2018 we employed 97 full-time employees and 10 part-time employees. Our employees are not represented by any collective bargaining group. Management believes that we have good relations with our employees.

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FEDERAL AND STATE TAXATION

Federal Taxation

**General.** Magyar Bancorp, Inc. and Magyar Bank are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. The most recent audit of Magyar Bank's federal tax returns by the Internal Revenue Service was for the period ended September 30, 2013. The audit did not result in any material adjustments to the Company's tax returns or the Company's financial statements. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to Magyar Bancorp, Inc. or Magyar Bank.

**Method of Accounting.** For federal income tax purposes, Magyar Bancorp, Inc. reports its income and expenses on the accrual method of accounting and uses a tax year ending September 30th for filing its federal and state income tax returns.

**Bad Debt Reserves.** Historically, Magyar Bank has been subject to special provisions in the tax law regarding allowable tax bad debt deductions and related reserves. Tax law changes were enacted in 1996, pursuant to the Small Business Protection Act of 1996 (the "1996 Act"), that eliminated the use of the percentage of taxable income method for computing tax bad debt deductions for tax years after 1995, and required recapture into taxable income over a six-year period all applicable excess bad debt reserves accumulated after 1988.

Currently, Magyar Bank uses the direct charge off method to account for bad debt deductions for income tax purposes.

**Taxable Distributions and Recapture.** Prior to the 1996 Act, bad debt reserves created prior to January 1, 1988 (pre-base year reserves) were subject to recapture into taxable income if Magyar Bank failed to meet certain thrift asset and definitional tests.

At September 30, 2018, our total federal pre-base year reserve was approximately \$1.3 million. However, under current law, pre-base year reserves remain subject to recapture if Magyar Bank makes certain non-dividend distributions, repurchases any of its stock, pays dividends in excess of tax earnings and profits, or ceases to maintain a bank charter.

**Alternative Minimum Tax.** The Internal Revenue Code imposes an alternative minimum tax ("AMT") at a rate of 20% on a base of regular taxable income plus certain tax preferences ("alternative minimum taxable income" or "AMTI"). The AMT is payable to the extent such AMTI is in excess of an exemption amount and the AMT exceeds the regular income tax. Generally, AMT net operating losses can offset no more than 90% of AMTI. Certain payments of AMT may be used as credits against regular tax liabilities in future years. Magyar Bancorp, Inc. and Magyar Bank have been subject to the AMT in prior periods but have subsequently used most of these credits against regular tax liabilities.

**Net Operating Loss Carryovers.** At September 30, 2018, a financial institution was able to carry back net operating losses to the preceding five taxable years and forward to the succeeding 20 taxable years. At September 30, 2018, the Company did not have any federal or state net operating loss carry forwards available to offset future taxable income for tax reporting purposes.

**Corporate Dividends-Received Deduction.** Magyar Bancorp, Inc. may exclude from its federal taxable income 100% of dividends received from Magyar Bank as a wholly owned subsidiary. The corporate dividends-received deduction is 80% when the dividend is received from a corporation having at least 20% of its stock owned by the recipient corporation. A 70% dividends-received deduction is available for dividends received from corporations owned less than 20% by the recipient corporation.

#### State Taxation

**New Jersey State Taxation.** The income of savings institutions in New Jersey, which is calculated based on federal taxable income, subject to certain adjustments, is subject to New Jersey tax. Magyar Bank, Magyar Service Corporation, and MagBank Investment Company file New Jersey corporate income tax returns. Magyar Bank, Magyar Service Corp., and MagBank Investment Company are not currently under audit with respect to their New Jersey income tax returns. Their respective state tax returns have been audited within the past year.

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New Jersey tax law does not and has not allowed for a taxpayer to file a tax return on a combined or consolidated basis with another member of the affiliated group where there is common ownership. However, under recent tax legislation, if the taxpayer cannot demonstrate by clear and convincing evidence that the tax filing discloses the true earnings of the taxpayer on its business carried on in the State of New Jersey, the New Jersey Director of the Division of Taxation may, at the director's discretion, require the taxpayer to file a consolidated return of the entire operations of the affiliated group or controlled group, including its own operations and income.

***Delaware and New Jersey State Taxation.*** As a Delaware holding company not earning income in Delaware, Magyar Bancorp, Inc. is exempt from Delaware corporate income tax, but is required to file annual returns and pay annual fees and a franchise tax to the State of Delaware.

Magyar Bancorp, Inc. is subject to New Jersey corporate income taxes in the same manner as described above for Magyar Bank.

## SUPERVISION AND REGULATION

### General

Magyar Bank is a New Jersey-chartered savings bank, and its deposit accounts are insured up to applicable limits by the FDIC under the Deposit Insurance Fund ("DIF"). Magyar Bank is subject to extensive regulation, examination and supervision by the Commissioner of the New Jersey Department of Banking and Insurance (the "Commissioner") as the issuer of its charter, and by the FDIC as deposit insurer and its primary federal regulator. Magyar Bank must file reports with the Commissioner and the FDIC concerning its activities and financial condition, and it must obtain regulatory approval prior to entering into certain transactions, such as mergers with, or acquisitions of, other depository institutions and opening or acquiring branch offices. The Commissioner and the FDIC conduct periodic examinations to assess Magyar Bank's compliance with various regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which a savings bank can engage and is intended primarily for the protection of the deposit insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes.

Magyar Bancorp, Inc., as a bank holding company controlling Magyar Bank, is subject to the Bank Holding Company Act of 1956, as amended ("BHCA"), and the rules and regulations of the FRB under the BHCA and to the provisions of the New Jersey Banking Act of 1948 (the "New Jersey Banking Act"), and to the regulations of the Commissioner under the New Jersey Banking Act applicable to bank holding companies. Magyar Bank and Magyar Bancorp, Inc. are required to file reports with, and otherwise comply with the rules and regulations of the FRB and the Commissioner. Magyar Bancorp, Inc. is required to file certain reports with, and otherwise comply with, the rules and regulations of the Securities and Exchange Commission under the federal securities laws.

Any change in such laws and regulations, whether by the Commissioner, the Federal Deposit Insurance Corporation, the Federal Reserve Board or through legislation, could have a material adverse impact on Magyar Bank and Magyar Bancorp, Inc. and their operations and stockholders.

Certain of the laws and regulations applicable to Magyar Bank and Magyar Bancorp, Inc. are summarized below. These summaries do not purport to be complete and are qualified in their entirety by reference to such laws and regulations.

## **Federal Legislation**

In May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the “Economic Growth Act”), was enacted to modify or remove certain financial reform rules and regulations, including some of those implemented under the Dodd-Frank Act. While the Economic Growth Act maintains most of the regulatory structure established by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”), it amends certain aspects of the regulatory framework for small depository institutions with assets of less than \$10 billion and for large banks with assets of more than \$50 billion. Many of these changes could result in meaningful regulatory changes for community banks such as the Bank and their holding companies.

The Economic Growth Act, among other matters, expands the definition of qualified mortgages which may be held by a financial institution and simplifies the regulatory capital rules for financial institutions and their holding companies with total consolidated assets of less than \$10 billion by instructing the federal banking regulators to establish a single “Community Bank Leverage Ratio” of between 8 and 10%. Any qualifying depository institution or its holding company that exceeds the “community bank leverage ratio” will be considered to have met generally applicable leverage and risk-based regulatory capital requirements and any qualifying depository institution that exceeds the new ratio will be considered to be “well capitalized” under the prompt corrective action rules. In addition, the Economic Growth Act includes regulatory relief for community banks regarding regulatory examination cycles, call reports, the Volcker Rule (proprietary trading prohibitions), mortgage disclosures and risk weights for certain high-risk commercial real estate loans.

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It is difficult at this time to predict when or how any new standards under the Economic Growth Act will ultimately be applied to us or what specific impact the Economic Growth Act and the yet-to-be-written implementing rules and regulations will have on community banks.

New Jersey Banking Regulation

**Activity Powers.** Magyar Bank derives its lending, investment and other activity powers primarily from the applicable provisions of the New Jersey Banking Act and its related regulations. Under these laws and regulations, savings banks, including Magyar Bank, generally may invest in:

real estate mortgages;

consumer and commercial loans;

specific types of debt securities, including certain corporate debt securities and obligations of federal, state and local governments and agencies;

certain types of corporate equity securities; and

certain other assets.

A savings bank may also make other investments pursuant to “leeway” authority that permits investments not otherwise permitted by the New Jersey Banking Act. “Leeway” investments must comply with a number of limitations on the individual and aggregate amounts of “leeway” investments. A savings bank may also exercise trust powers upon approval of the Commissioner. New Jersey savings banks may exercise those powers, rights, benefits or privileges authorized for national banks or out-of-state banks or for federal or out-of-state savings banks or savings associations, provided that before exercising any such power, right, benefit or privilege, prior approval by the Commissioner by regulation or by specific authorization is required. The exercise of these lending, investment and activity powers are limited by federal law and regulations. See “Federal Banking Regulation-Activity Restrictions on State-Chartered Banks” below.

**Loans-to-One-Borrower Limitations.** With certain specified exceptions, a New Jersey-chartered savings bank may not make loans or extend credit to a single borrower or to entities related to the borrower in an aggregate amount that would exceed 15% of the bank’s capital funds. A savings bank may lend an additional 10% of the bank’s capital funds if secured by collateral meeting the requirements of the New Jersey Banking Act. Magyar Bank currently complies with applicable loans-to-one-borrower limitations.

**Dividends.** Under the New Jersey Banking Act, a stock savings bank may declare and pay a dividend on its capital stock only to the extent that the payment of the dividend would not impair the capital stock of the savings bank. In addition, a stock savings bank may not pay a dividend unless the savings bank would, after the payment of the dividend, have a surplus of not less than 50% of its capital stock, or alternatively, the payment of the dividend would not reduce the surplus. Federal law may also limit the amount of dividends that may be paid by Magyar Bank. See “Federal Banking Regulation-Prompt Corrective Action” below.

**Minimum Capital Requirements.** Regulations of the Commissioner impose on New Jersey-chartered depository institutions, including Magyar Bank, minimum capital requirements similar to those imposed by the Federal Deposit Insurance Corporation on insured state banks. See “Federal Banking Regulation-Capital Requirements.”

**Examination and Enforcement.** The NJDBI may examine Magyar Bank whenever it deems an examination advisable. The NJDBI examines Magyar Bank at least every two years. The Commissioner may order any savings

bank to discontinue any violation of law or unsafe or unsound business practice and may direct any director, officer, attorney or employee of a savings bank engaged in an objectionable activity, after the Commissioner has ordered the activity to be terminated, to show cause at a hearing before the Commissioner why such person should not be removed. The Commissioner also has authority to appoint a conservator or receiver for a savings bank under certain circumstances such as insolvency or unsafe or unsound condition to transact business.

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Federal Banking Regulation

**Capital Requirements.** Federal regulations require FDIC insured depository institutions to meet several minimum capital standards: a common equity Tier 1 capital to risk-based assets ratio, a Tier 1 capital to risk-based assets ratio, a total capital to risk-based assets, and a Tier 1 capital to total assets leverage ratio. The existing capital requirements were effective January 1, 2015 and are the result of a final rule implementing regulatory amendments based on recommendations of the Basel Committee on Banking Supervision and certain requirements of the Dodd-Frank Act.

The capital standards require the maintenance of common equity Tier 1 capital, Tier 1 capital and total capital to risk-weighted assets of at least 4.5%, 6% and 8%, respectively, and a leverage ratio of at least 4% Tier 1 capital. Common equity Tier 1 capital is generally defined as common stockholders' equity and retained earnings. Tier 1 capital is generally defined as common equity Tier 1 and additional Tier 1 capital. Additional Tier 1 capital includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital (common equity Tier 1 capital plus additional Tier 1 capital) and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus, meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory convertible securities, intermediate preferred stock and subordinated debt. Also included in Tier 2 capital is the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and, for institutions that have exercised an opt-out election regarding the treatment of Accumulated Other Comprehensive Income ("AOCI"), up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Institutions that have not exercised the AOCI opt-out have AOCI incorporated into common equity Tier 1 capital (including unrealized gains and losses on available-for-sale securities). Calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations.

In determining the amount of risk-weighted assets for purposes of calculating risk-based capital ratios, all assets, including certain off-balance sheet assets (e.g., recourse obligations, direct credit substitutes, residual interests) are multiplied by a risk weight factor assigned by the regulations based on the risks believed inherent in the type of asset. Higher levels of capital are required for asset categories believed to present greater risk. For example, a risk weight of 0% is assigned to cash and U.S. government securities, a risk weight of 50% is generally assigned to prudently underwritten first lien one-to four-family residential mortgages, a risk weight of 100% is assigned to commercial and consumer loans, a risk weight of 150% is assigned to certain past due loans and a risk weight of between 0% to 600% is assigned to permissible equity interests, depending on certain specified factors.

In addition to establishing the minimum regulatory capital requirements, the regulations limit capital distributions and certain discretionary bonus payments to management if the institution does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted asset above the amount necessary to meet its minimum risk-based capital requirements. The capital conservation buffer requirement began being phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increases each year until fully implemented at 2.5% on January 1, 2019.

In assessing an institution's capital adequacy, the FDIC takes into consideration, not only these numeric factors, but qualitative factors as well, and has the authority to establish higher capital requirements for individual institutions where deemed necessary.

At September 30, 2018, Magyar Bank's common equity Tier 1 capital to risk-based assets ratio was 11.53%, total capital to risk-based assets was 12.44%, and Tier 1 capital to total assets leverage ratio was 8.61%.

**Prompt Corrective Action.** The FDIC Improvement Act established a system of prompt corrective action to resolve the problems of undercapitalized institutions. The FDIC has adopted regulations to implement the prompt corrective action legislation. The regulations were amended to incorporate the previously mentioned increased regulatory capital standards that were effective January 1, 2015. An institution is deemed to be “well capitalized” if it has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, a leverage ratio of 5.0% or greater and a common equity Tier 1 ratio of 6.5% or greater. An institution is “adequately capitalized” if it has a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, a leverage ratio of 4.0% or greater and a common equity Tier 1 ratio of 4.5% or greater. An institution is “undercapitalized” if it has a total risk-based capital ratio of less than 8.0%, a Tier 1 risk-based capital ratio of less than 6.0%, a leverage ratio of less than 4.0% or a common equity Tier 1 ratio of less than 4.5%. An institution is deemed to be “significantly undercapitalized” if it has a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 4.0%, a leverage ratio of less than 3.0% or a common equity Tier 1 ratio of less than 3.0%. An institution is considered to be “critically undercapitalized” if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2.0%.



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Undercapitalized institutions are subject to a variety of mandatory supervisory measures including the requirement to file a capital plan for the FDIC's approval and dividend restrictions as well as other discretionary actions by the regulator.

The FDIC is required, with some exceptions, to appoint a receiver or conservator for an insured state bank if that bank is "critically undercapitalized." For this purpose, "critically undercapitalized" means having a ratio of tangible capital to total assets of less than 2%. The FDIC may also appoint a conservator or receiver for a state bank on the basis of the institution's financial condition or upon the occurrence of certain events, including:

- insolvency, or when the assets of the bank are less than its liabilities to depositors and others;
- substantial dissipation of assets or earnings through violations of law or unsafe or unsound practices;
- existence of an unsafe or unsound condition to transact business;
- likelihood that the bank will be unable to meet the demands of its depositors or to pay its obligations in the normal course of business; and
- insufficient capital, or the incurring or likely incurring of losses that will deplete substantially all of the institution's capital with no reasonable prospect of replenishment of capital without federal assistance.

**Activity Restrictions on State-Chartered Banks.** Federal law and FDIC regulations generally limit the activities and investments of state-chartered Federal Deposit Insurance Corporation-insured banks and their subsidiaries to those permissible for national banks and their subsidiaries, unless such activities and investments are specifically exempted by law or consented to by the Federal Deposit Insurance Corporation.

Before making a new investment or engaging in a new activity that is not permissible for a national bank or otherwise permissible under federal law or the FDIC regulations, an insured bank must seek approval from the FDIC to make such investment or engage in such activity. The FDIC will not approve the activity unless the bank meets its minimum capital requirements and the FDIC determines that the activity does not present a significant risk to the DIF. Certain activities of subsidiaries that are engaged in activities permitted for national banks only through a "financial subsidiary" are subject to additional restrictions.

Federal law permits a state-chartered savings bank to engage, through financial subsidiaries, in any activity in which a national bank may engage through a financial subsidiary and on substantially the same terms and conditions. In general, the law permits a national bank that is well-capitalized and well-managed to conduct, through a financial subsidiary, any activity permitted for a financial holding company other than insurance underwriting, insurance investments, real estate investment or development or merchant banking. The total assets of all such financial subsidiaries may not exceed the lesser of 45% of the bank's total assets or \$50 million. The bank must have policies and procedures to assess the financial subsidiary's risk and protect the bank from such risk and potential liability, must not consolidate the financial subsidiary's assets with the bank's and must exclude from its own assets and equity all equity investments, including retained earnings, in the financial subsidiary. State-chartered savings banks may retain subsidiaries in existence as of March 11, 2000 and may engage in activities that are not authorized under federal law. Although Magyar Bank meets all conditions necessary to establish and engage in permitted activities through financial subsidiaries, it has not yet determined to engage in such activities.

**Federal Home Loan Bank System.** Magyar Bank is a member of the Federal Home Loan Bank system, which consists of eleven regional federal home loan banks, each subject to supervision and regulation by the Federal Housing Finance Board ("FHFB"). The federal home loan banks provide a central credit facility primarily for member thrift institutions as well as other entities involved in home mortgage lending. Magyar Bank, as a member of the Federal Home Loan Bank of New York, is required to purchase and hold shares of capital stock in the Federal Home Loan Bank of New York in specified amounts.

As of September 30, 2018, Magyar Bank was in compliance with these requirements.

**Enforcement.** The Federal Deposit Insurance Corporation has extensive enforcement authority over insured savings banks, including Magyar Bank. This enforcement authority includes, among other things, the ability to assess civil money penalties, issue cease and desist orders and remove directors and officers. In general, these enforcement actions may be initiated in response to violations of laws and regulations and to unsafe or unsound practices.

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**Deposit Insurance.** Magyar Bank is a member of the Deposit Insurance Fund, which is administered by the Federal Deposit Insurance Corporation. Deposit accounts at Magyar Bank are insured by the Federal Deposit Insurance Corporation, generally up to a maximum of \$250,000 for each separately insured depositor.

The FDIC assesses insurance premiums based on the category to which an institution is assigned. Under this assessment system, the FDIC evaluates the risk of each financial institution based on its supervisory rating and certain financial ratios for purposes of assigning institutions to a category. Assessments are based on the institution's category, subject to specified adjustments, with institutions perceived as less risky to the deposit insurance fund paying lower assessments.

Effective April 1, 2011, the FDIC Board changed the assessment base from adjusted domestic deposits to a bank's average consolidated total assets minus average Tier 1 capital, as required by the Dodd-Frank Act. The FDIC lowered assessment rates to between 2.5 and 9 basis points on the broader base for banks in the lowest risk category and 30 to 45 basis points for banks in the highest risk category. The final rule eliminated the adjustment to the rate paid for secured liabilities, including Federal Home Loan Bank advances, since these are now part of the new assessment base.

On April 26, 2016, the FDIC Board adopted a rule in accordance with provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act that requires large institutions (those greater than \$10 billion in assets) to bear the burden of raising the Reserve Ratio from 1.15% to 1.35%. The rule also amended small institution pricing for deposit insurance which was effective the quarter after the Reserve Ratio reaches 1.15%. The Reserve Ratio is the total of the Deposit Insurance Fund ("DIF") divided by the total estimated insured deposits of the industry. The Reserve Ratio reached 1.15% effective as of June 30, 2016, lowering small institution assessment rates to between 1.5 and 16 basis points for banks in the lowest risk category and 3 to 30 basis points for banks in the higher risk categories. Once the reserve ratio reaches 1.38%, small institutions will receive credits to offset their contribution to raising the Reserve Ratio to 1.35%. The rule also eliminated the previous risk categories in favor of an assessment schedule based on examination ratings and financial modeling.

The deposit insurance assessment rates are in addition to the assessments for payments on the bonds issued in the late 1980s by the Financing Corporation, or FICO, to recapitalize the now defunct Federal Savings and Loan Insurance Corporation. The FICO payments will continue until the FICO bonds mature in 2018 through 2019. Our expense for the assessment of deposit insurance and the FICO payments was \$426,000 for the year ended September 30, 2018 and \$498,000 for the year ended September 30, 2017.

Insurance of deposits may be terminated by the Federal Deposit Insurance Corporation upon a finding that an institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the Federal Deposit Insurance Corporation. The Bank does not believe that it is taking or is subject to any action, condition or violation that could lead to termination of its deposit insurance.

***Transactions with Affiliates of Magyar Bank.*** Magyar Bank's authority to engage in transactions with its affiliates is limited by Sections 23A and 23B of the Federal Reserve Act and its implementing Regulation W promulgated by the Board of Governors of the Federal Reserve System. An affiliate is a company that controls, is controlled by, or is under common control with an insured depository institution such as Magyar Bancorp, Inc. and Magyar Bancorp, MHC. In general, loan transactions between an insured depository institution and its affiliates are subject to certain quantitative and collateral requirements. In this regard, transactions between an insured depository institution and its affiliates are limited to 10% of the institution's unimpaired capital and unimpaired surplus for transactions with any one affiliate and 20% of unimpaired capital and unimpaired surplus for transactions in the aggregate with all affiliates. Collateral of specific types and in specified amounts ranging from 100% to 130% of the amount of the transaction must usually be provided by affiliates in order to receive loans from the savings association. In addition, transactions with affiliates must be consistent with safe and sound banking practices, not involve low-quality assets and be on terms that are as favorable to the institution as comparable transactions with non-affiliates. Magyar Bank is in compliance with these requirements.

***Prohibitions Against Tying Arrangements.*** Banks are subject to the prohibitions of 12 U.S.C. Section 1972 on certain tying arrangements. A depository institution is prohibited, subject to some exceptions, from extending credit to or offering any other service, or fixing or varying the consideration for such extension of credit or service, on the condition that the customer obtain some additional service from the institution or its affiliates or not obtain services of a competitor of the institution.

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**Community Reinvestment Act and Fair Lending Laws.** All FDIC insured institutions have a responsibility under the Community Reinvestment Act (“CRA”) and related regulations to help meet the credit needs of their communities, including low- and moderate-income neighborhoods. In connection with its examination of a state chartered savings bank, the FDIC is required to assess the institution’s record of compliance with the CRA. Among other things, the current CRA regulations replace the prior process-based assessment factors with a new evaluation system that rates an institution based on its actual performance in meeting community needs. In particular, the current evaluation system focuses on three tests:

- a lending test, to evaluate the institution’s record of making loans in its service areas;
- an investment test, to evaluate the institution’s record of investing in community development projects, affordable housing, and programs benefiting low or moderate income individuals and businesses; and
- a service test, to evaluate the institution’s delivery of services through its service channels.

An institution’s failure to comply with the provisions of the CRA could, at a minimum, result in regulatory restrictions on its activities. We received an “outstanding” CRA rating in our most recently completed federal examination, which was conducted by the FDIC in 2016.

In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. The failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions by the FDIC, as well as other federal regulatory agencies and the Department of Justice.

## Loans to a Bank’s Insiders

**Federal Regulation.** A bank’s loans to its executive officers, directors, any owner of 10% or more of its stock (each, an insider) and any of certain entities affiliated with any such person (an insider’s related interest) are subject to the conditions and limitations imposed by Section 22(h) of the Federal Reserve Act and its implementing regulations. Under these restrictions, the aggregate amount of the loans to any insider and the insider’s related interests may not exceed the loans-to-one-borrower limit applicable to national banks, which is comparable to the loans-to-one-borrower limit applicable to Magyar Bank’s loans. See “New Jersey Banking Regulation—Loans-to-One Borrower Limitations.” All loans by a bank to all insiders and insiders’ related interests in the aggregate may not exceed the bank’s unimpaired capital and unimpaired surplus. With certain exceptions, loans to an executive officer, other than loans for the education of the officer’s children and certain loans secured by the officer’s residence, may not exceed the lesser of (1) \$100,000 or (2) the greater of \$25,000 or 2.5% of the bank’s unimpaired capital and surplus. Federal regulation also requires that any proposed loan to an insider or a related interest of that insider be approved in advance by a majority of the Board of Directors of the bank, with any interested directors not participating in the voting, if such loan, when aggregated with any existing loans to that insider and the insider’s related interests, would exceed either (1) \$250,000 or (2) the greater of \$25,000 or 5% of the bank’s unimpaired capital and surplus. Generally, such loans must be made on substantially the same terms as, and follow credit underwriting procedures that are not less stringent than, those that are prevailing at the time for comparable transactions with other persons.

An exception is made for extensions of credit made pursuant to a benefit or compensation plan of a bank that is widely available to employees of the bank and that does not give any preference to insiders of the bank over other employees of the bank.

In addition, federal law prohibits extensions of credit to a bank's insiders and their related interests by any other institution that has a correspondent banking relationship with the bank, unless such extension of credit is on substantially the same terms as those prevailing at the time for comparable transactions with other persons and does not involve more than the normal risk of repayment or present other unfavourable features.

***New Jersey Regulation.*** Provisions of the New Jersey Banking Act impose conditions and limitations on the liabilities to a savings bank of its directors and executive officers and of corporations and partnerships controlled by such persons, that are comparable in many respects to the conditions and limitations imposed on the loans and extensions of credit to insiders and their related interests under federal law, as discussed above. The New Jersey Banking Act also provides that a savings bank that is in compliance with federal law is deemed to be in compliance with such provisions of the New Jersey Banking Act.

#### Federal Reserve System

Federal Reserve Board regulations require all depository institutions to maintain reserves at specified levels against their transaction accounts (primarily NOW and regular checking accounts). At September 30, 2018, Magyar Bank was in compliance with the Federal Reserve Board's reserve requirements. Savings banks, such as Magyar Bank, are authorized to borrow from the Federal Reserve Bank "discount window." Magyar Bank is deemed by the Federal Reserve Board to be generally sound and thus is eligible to obtain secondary credit from its Federal Reserve Bank. Generally, secondary credit is extended on a very short-term basis to meet the liquidity needs of the institution. Loans must be secured by acceptable collateral and carry a rate of interest above the Federal Open Market Committee's federal funds target rate.

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### The USA PATRIOT Act

The USA PATRIOT Act gives the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. The USA PATRIOT Act also requires the federal banking agencies to take into consideration the effectiveness of controls designed to combat money laundering activities in determining whether to approve a merger or other acquisition application of a member institution. Accordingly, if we engage in a merger or other acquisition, our controls designed to combat money laundering would be considered as part of the application process. We have established policies, procedures and systems designed to comply with these regulations.

### Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 (“SOX”) is a law that addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. As directed by Section 302(a) of SOX, Magyar Bancorp, Inc.’s Chief Executive Officer and Chief Financial Officer each are required to certify that its quarterly and annual reports do not contain any untrue statement of a material fact. The rules have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our internal controls; they have made certain disclosures to our auditors and the audit committee of the Board of Directors about our internal controls; and they have included information in our quarterly and annual reports about their evaluation and whether there have been significant changes in our internal controls or in other factors that could significantly affect internal controls. Magyar Bancorp, Inc. has existing policies, procedures and systems designed to comply with these regulations, and is further enhancing and documenting such policies, procedures and systems to ensure continued compliance with these regulations.

Section 404(b) requires independent auditors to report on management’s assessment of internal controls over financial reporting. The 2010 Dodd-Frank Act provided an exemption on compliance with SOX Section 404(b) for registrants that are neither accelerated nor large accelerated filers as defined by Rule 12b-2 of the Securities and Exchange Act of 1934. The inclusion of the exemption in the final reform legislation permanently exempted the auditor attestation requirement and significantly reduced the compliance burdens of smaller reporting companies. Disclosure of management attestations on internal control over financial reporting continues to be required for smaller reporting companies.

### Holding Company Regulation

**Federal Regulation.** Magyar Bancorp, Inc. is regulated as a bank holding company. Bank holding companies are subject to examination, regulation and periodic reporting under the Bank Holding Company Act, as administered by the Federal Reserve Board. Bank holding companies are generally subject to consolidated capital requirements

established by the FRB. The Dodd-Frank Act required the FRB to amend its consolidated minimum capital requirements for bank holding companies to make them no less stringent than those applicable to insured depository institutions themselves. However, legislation was enacted in December 2014 which required the FRB to amend its “Small Bank Holding Company” exemption from consolidated holding company capital requirements to generally extend the applicability of the exemption from \$500 million to \$1 billion in assets. Furthermore, the Economic Growth Act expanded the category of holding companies that may rely on the policy statement by raising the maximum amount of assets a qualifying holding company may have from \$1 billion to \$3 billion. Consequently, bank holding companies of under \$3 billion in consolidated assets remain exempt from consolidated regulatory capital requirements, unless the Federal Reserve determines otherwise in particular cases.

Regulations of the FRB provide that a bank holding company must serve as a source of strength to any of its subsidiary banks and must not conduct its activities in an unsafe or unsound manner. The Dodd-Frank Act codified the source of strength policy and requires the promulgation of implementing regulations. Under the prompt corrective action provisions of the Act, a bank holding company parent of an undercapitalized subsidiary bank would be directed to guarantee, within limitations, the capital restoration plan that is required of such an undercapitalized bank. See “Federal Banking Regulation—Prompt Corrective Action.” If the undercapitalized bank fails to file an acceptable capital restoration plan or fails to implement an accepted plan, the FRB may prohibit the bank holding company parent of the undercapitalized bank from paying any dividend or making any other form of capital distribution without the prior approval of the FRB.



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As a bank holding company, Magyar Bancorp, Inc. is required to obtain the prior approval of the FRB to acquire all, or substantially all, of the assets of any bank or bank holding company. Prior FRB approval is required for Magyar Bancorp, Inc. to acquire direct or indirect ownership or control of any voting securities of any bank or bank holding company if, after giving effect to such acquisition, it would, directly or indirectly, own or control more than 5% of any class of voting shares of such bank or bank holding company.

A bank holding company is required to give the FRB prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, will be equal to 10% or more of the company's consolidated net worth. The FRB may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe and unsound practice, or would violate any law, regulation, FRB order or directive, or any condition imposed by, or written agreement with, the FRB. Such notice and approval is not required for a bank holding company that would be treated as "well capitalized" under applicable regulations of the FRB, that has received a composite "1" or "2" rating, as well as a "satisfactory" rating for management, at its most recent bank holding company inspection by the FRB, and that is not the subject of any unresolved supervisory issues.

In addition, a bank holding company that does not elect to be a financial holding company under federal regulation, is generally prohibited from engaging in, or acquiring direct or indirect control of any company engaged in non-banking activities. One of the principal exceptions to this prohibition is for activities found by the FRB to be so closely related to banking or managing or controlling banks as to be permissible. Some of the principal activities that the FRB has determined by regulation to be so closely related to banking as to be permissible are:

- making or servicing loans;
- performing certain data processing services;
- providing discount brokerage services, or acting as fiduciary, investment or financial advisor;
- leasing personal or real property;
- making investments in corporations or projects designed primarily to promote community welfare; and
- acquiring a savings and loan association.

Bank holding companies that elect to be a financial holding company may engage in activities that are financial in nature or incident to activities which are financial in nature, including investment banking and insurance underwriting. Magyar Bancorp, Inc. has not elected to be a financial holding company, although it may seek to do so in the future. Bank holding companies may elect to become a financial holding company if:

- each of its depository institution subsidiaries is "well capitalized;"
- each of its depository institution subsidiaries is "well managed;"
- each of its depository institution subsidiaries has at least a "satisfactory" Community Reinvestment Act rating at its most recent examination; and
- the bank holding company has filed a certification with the FRB stating that it elects to become a financial holding company.

Under federal law, depository institutions are liable to the FDIC for losses suffered or anticipated by the FDIC in connection with the default of a commonly controlled depository institution or any assistance provided by the FDIC to such an institution in danger of default. This law would be applicable potentially to Magyar Bancorp, Inc. if it ever acquired as a separate subsidiary a depository institution in addition to Magyar Bank.

It has been the policy of many mutual holding companies to waive the receipt of dividends declared by its subsidiary. In connection with its approval of the reorganization, however, the FRB required Magyar Bancorp, MHC to obtain prior FRB approval before it may waive any dividends. As of the date hereof, FRB policy is to prohibit a mutual bank holding company from waiving the receipt of dividends from its holding company or bank subsidiary, and management is not aware of any instance in which the FRB has given its approval for a mutual bank holding company to waive dividends. It is not currently intended that Magyar Bancorp, MHC will waive dividends declared by Magyar Bancorp, Inc. as long as Magyar Bancorp, MHC is regulated by the Federal Reserve Board.

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**Conversion of Magyar Bancorp, MHC to Stock Form.** Magyar Bancorp, MHC is permitted to convert from the mutual form of organization to the capital stock form of organization (a “Conversion Transaction”). There can be no assurance when, if ever, a Conversion Transaction will occur, and the Board of Directors has no current intention or plan to undertake a Conversion Transaction. In a Conversion Transaction a new stock holding company may be formed as the successor to Magyar Bancorp, Inc. (the “New Holding Company”), Magyar Bancorp, MHC’s corporate existence would end, and certain depositors of Magyar Bank would receive the right to subscribe for additional shares of the New Holding Company. In a Conversion Transaction, each share of common stock held by stockholders other than Magyar Bancorp, MHC (“Minority Stockholders”) would be converted into a number of shares of common stock of the New Holding Company determined pursuant to an exchange ratio that ensures that Minority Stockholders own the same percentage of common stock in the New Holding Company as they owned in Magyar Bancorp, Inc. immediately before the Conversion Transaction, subject to any adjustment required by regulation or regulatory policy. The total number of shares held by Minority Stockholders after a Conversion Transaction also would be increased by any purchases by Minority Stockholders in the stock offering conducted as part of the Conversion Transaction.

Any Conversion Transaction would require the approval of a majority of the outstanding shares of Magyar Bancorp, Inc. common stock held by Minority Stockholders and the approval of a majority of the eligible votes of depositors of Magyar Bank.

**New Jersey Regulation.** Under the New Jersey Banking Act, a company owning or controlling a savings bank is regulated as a bank holding company. The New Jersey Banking Act defines the terms “company” and “bank holding company” as such terms are defined under the BHCA. Each bank holding company controlling a New Jersey-chartered bank or savings bank must file certain reports with the Commissioner and is subject to examination by the Commissioner.

**Acquisition of Magyar Bancorp, Inc.** Under federal law and under the New Jersey Banking Act, no person may acquire control of Magyar Bancorp, Inc. without first obtaining approval of such acquisition of control by the Federal Reserve Board and the Commissioner.

**Federal Securities Laws.** Magyar Bancorp, Inc. common stock is registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended. Magyar Bancorp, Inc. is subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Securities Exchange Act of 1934.

ITEM 1A.

Risk Factors

Changes in Interest Rates May Hurt our Profits and Asset Values.

Our earnings largely depend on our net interest income, which could be negatively affected by changes in interest rates. Net interest income is the difference between:

- the interest income we earn on our interest-earning assets, such as loans and securities; and
- the interest expense we pay on our interest-bearing liabilities, such as deposits and borrowings.

The rates we earn on our assets and the rates we pay on our liabilities are generally fixed for a contractual period of time. While we have taken steps to attempt to reduce our exposure to increases in interest rates, historically our liabilities generally have shorter contractual maturities than our assets. This imbalance can create significant earnings volatility, because market interest rates change over time. In a period of rising interest rates, the interest income earned on our assets may not increase as rapidly as the interest paid on our liabilities. Likewise, in a period of falling interest rates, the interest expense paid on our liabilities may not decrease as rapidly as the interest income received on our assets. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations-Management of Market Risk.”

In addition, changes in interest rates can affect the average life of loans and mortgage-backed securities. A reduction in interest rates causes increased prepayments of loans and mortgage-backed securities as borrowers tend to refinance their debt to reduce their borrowing costs. This creates reinvestment risk, which is the risk that we may not be able to reinvest the funds from faster prepayments at rates that are comparable to the rates we earned on the prepaid loans or securities. Additionally, increases in interest rates may decrease loan demand and/or make it more difficult for borrowers to repay adjustable-rate loans.

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Changes in interest rates also affect the current market value of our interest-earning securities portfolio. Generally, the value of securities moves inversely with changes in interest rates. At September 30, 2018, the fair value of our total securities portfolio was \$54.6 million. The unrealized net loss on securities totaled \$2.3 million on a pre-tax basis at September 30, 2018.

We evaluate interest rate sensitivity using models that estimate the change in Magyar Bank's net interest income over a range of interest rate scenarios. At September 30, 2018, in the event of an immediate 200 basis point increase in interest rates, the model projects that we would experience a \$747,000, or 3.72%, decrease in net interest income in the first year following the change in interest rates, and a \$442,000, or 2.13%, decrease in net interest income in the second year following the change in interest rates. At September 30, 2018, in the event of an immediate 100 basis point decrease in interest rates, the model projects that we would experience a \$544,000, or 2.71%, decrease in net interest income in the first year following the change in interest rates, and a \$886,000, or 4.27%, decrease in net interest income in the second year following the change in interest rates.

At September 30, 2018, our available-for-sale securities portfolio totaled \$22.5 million, which included \$20.1 million mortgage-backed securities. To the extent interest rates increase and the value of our available-for-sale portfolio decreases, our stockholders' equity will be adversely affected.

**Because We Intend to Continue our Emphasis on the Origination of Commercial Business Loans and Commercial Real Estate Loans, Our Lending Risk Has Increased in Recent Years and May Increase in Future Years.**

At September 30, 2018, our portfolio of commercial business and commercial real estate loans totaled \$272.7 million, or 53.2% of our total loans, compared to \$248.2 million, or 52.4% of our total loans at September 30, 2017 and \$238.4 million, or 52.1% of our total loans at September 30, 2016. It is our intent to continue to emphasize the origination of commercial business and commercial real estate loans. Commercial business and commercial real estate loans generally have more risk than one-to four-family residential mortgage loans. At September 30, 2018, our non-performing loans decreased to \$906,000 from \$2.4 million at September 30, 2017. Because the repayment of these loans depends on the successful management and operation of the borrower's properties or related businesses, repayment of these loans has been and may continue to be affected by adverse conditions in the real estate market or the local economy. Further, these loans typically have larger loan balances, and several of our borrowers have more than one commercial business and commercial real estate loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan. Finally, if we foreclose on a commercial business or commercial real estate loan, our holding period for the collateral, if any, typically is longer than for one- to four-family residential mortgage loans because there are fewer potential purchasers of the collateral. Because we plan to continue to emphasize the origination of these loans, it may be necessary to increase our allowance for loan losses because of the increased credit risk associated with these types of loans. Any increase to our allowance for loan losses would adversely affect our earnings.

**We may be adversely affected by recent changes in tax laws.**

The Tax Cuts and Jobs Act, which was enacted in December 2017, is likely to have both positive and negative effects on our financial performance. For example, the new legislation resulted in a reduction in the federal corporate tax rate from 35% to 21% beginning in 2018, which will have a favorable impact on our earnings and capital generation abilities. However, the new legislation also enacted limitations on certain deductions that will have an impact on the banking industry, borrowers and the market for single-family residential real estate. These limitations include (1) a lower limit on the deductibility of mortgage interest on single-family residential mortgage loans, (2) the elimination of interest deductions for certain home equity loans, (3) a limitation on the deductibility of business interest expense, and (4) a limitation on the deductibility of property taxes and state and local income taxes.

The recent changes in the federal tax laws may have an adverse effect on the market for, and the valuation of, residential properties, and on the demand for such loans in the future and could make it harder for borrowers to make their loan payments. In addition, these recent changes may also have a disproportionate effect on taxpayers in states with high residential home prices and high state and local taxes, like New Jersey and New York. If home ownership becomes less attractive, demand for mortgage loans could decrease. The value of the properties securing loans in our loan portfolio may be adversely impacted as a result of the changing economics of home ownership, which could require an increase in our provision for loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition and results of operations.

Additionally, legislation in New Jersey that was adopted in July 2018 will increase our state income tax liability and could increase our overall tax expense. The legislation imposes a temporary surtax on corporations earning New Jersey allocated income in excess of \$1 million of 2.5% for tax years beginning on or after January 1, 2018 through December 31, 2019, and of 1.5% for tax years beginning on or after January 1, 2020 through December 31, 2021. The new legislation also requires combined filing for members of an affiliated group for tax years beginning on or after January 1, 2019, changing New Jersey's current status as a separate return state, and limits the deductibility of dividends received. These changes are not temporary. Regulations implementing the legislative changes have not yet been issued, so we cannot yet fully evaluate the impact of the legislation on our overall tax expense. However, the new legislation may cause us to lose the benefit of certain of our tax management strategies and may cause our total tax expense to increase.

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**A Worsening of Economic Conditions Could Reduce Demand for Our Products and Services and/or Result in Increases in Our Level of Non-performing Loans, Which Could Have an Adverse Effect on Our Results of Operations.**

Unlike larger financial institutions that are more geographically diversified, our profitability depends primarily on the general economic conditions in New Jersey and the greater New York metropolitan area. Local economic conditions have a significant impact on our commercial real estate and construction and consumer loans, the ability of the borrowers to repay these loans and the value of the collateral securing these loans. Almost all of our loans are to borrowers located in or secured by collateral located in New Jersey and the New York metropolitan area.

A deterioration in economic conditions could result in the following consequences, any of which could have a material adverse effect on our business, financial condition, liquidity and results of operations:

- demand for our products and services may decline;

- loan delinquencies, problem assets and foreclosures may increase;

- collateral for loans, especially real estate, may decline in value, in turn reducing customers' future borrowing power, and reducing the value of assets and collateral associated with existing loans;

- the value of our securities portfolio may decline; and

- the net worth and liquidity of loan guarantors may decline, impairing their ability to honor commitments to us.

Moreover, a significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, an outbreak of hostilities or other international or domestic calamities, unemployment or other factors beyond our control could further impact these local economic conditions and could further negatively affect the financial results of our banking operations. In addition, deflationary pressures, while possibly lowering our operating costs, could have a significant negative effect on our borrowers, especially our business borrowers, and the values of underlying collateral securing loans, which could negatively affect our financial performance.

**If Our Allowance for Loan Losses is Not Sufficient to Cover Actual Loan Losses, Our Earnings Could Decrease.**

Our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, requiring additions to our allowance, which could materially decrease our net income. Our allowance for loan losses was 0.82% of total loans and 463.6% of total non-performing loans at September 30, 2018. We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. 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. Based on this review, we believe our allowance for loan losses is adequate to absorb losses in our loan

portfolio as of September 30, 2018.

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 will 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 for our first fiscal year after December 15, 2020. 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 may require us to increase our allowance for loan losses, and to greatly increase the types of data we will 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.



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Strong Competition Within Our Market Area May Limit Our Growth and Profitability.

Competition in the banking and financial services industry is intense. In our market area, we compete with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies, and brokerage and investment banking firms operating locally and elsewhere. Some of our competitors have substantially greater resources and lending limits than we, have greater name recognition and market presence that benefit them in attracting business, and offer certain services that we do not or cannot provide. In addition, larger competitors may be able to price loans and deposits more aggressively than we do. Our profitability depends upon our continued ability to successfully compete in our market area. The greater resources and deposit and loan products offered by some of our competitors may limit our ability to increase our interest-earning assets. For additional information see “Business of Magyar Bank-Competition.”

If We Declare Dividends on Our Common Stock, Magyar Bancorp, MHC Will Be Prohibited from Waiving the Receipt of Dividends by Current Federal Reserve Board Policy, Which May Result in Lower Dividends for All Other Stockholders.

The Board of Directors of Magyar Bancorp, Inc. has the authority to declare dividends on its common stock, subject to statutory and regulatory requirements. So long as Magyar Bancorp, MHC is regulated by the FRB, if Magyar Bancorp, Inc. pays dividends to its stockholders, it also will be required to pay dividends to Magyar Bancorp, MHC, unless Magyar Bancorp, MHC is permitted by the FRB to waive the receipt of dividends. The FRB’s current position is to not permit a mutual holding company to waive dividends declared by its subsidiary. Accordingly, because dividends will be required to be paid to Magyar Bancorp, MHC along with all other stockholders, the amount of dividends available for all other shareholders will be less than if Magyar Bancorp, MHC were permitted to waive the receipt of dividends.

Magyar Bancorp, MHC Exercises Voting Control Over Magyar Bancorp, Inc.; Public Stockholders Own a Minority Interest.

Magyar Bancorp, MHC owns a majority of Magyar Bancorp, Inc.’s common stock and, through its Board of Directors, exercises voting control over the outcome of all matters put to a vote of stock holders (including the election of directors), except for matters that require a vote greater than a majority. Public stockholders own a minority of the outstanding shares of Magyar Bancorp, Inc.’s common stock. The same directors and officers who manage Magyar Bancorp, Inc. and Magyar Bank also manage Magyar Bancorp, MHC. In addition, regulatory restrictions applicable to Magyar Bancorp, MHC prohibit the sale of Magyar Bancorp, Inc. unless the mutual holding company first undertakes a second-step conversion.

We Operate In A Highly Regulated Environment and May Be Adversely Affected By Changes In Laws And Regulations.

Magyar Bank is subject to extensive regulation, supervision and examination by the NJDBI, its chartering authority, and by the Federal Deposit Insurance Corporation, which insures Magyar Bank’s deposits. As a bank holding company, Magyar Bancorp, Inc. is subject to regulation and supervision by the Federal Reserve Board. Such regulation and supervision govern the activities in which financial institutions and their holding companies may engage and are intended primarily for the protection of the federal deposit insurance fund and depositors. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities,

including the imposition of restrictions on the operations of financial institutions, the classification of assets by financial institutions and the adequacy of financial institutions' allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, or legislation, could have a material impact on Magyar Bank and Magyar Bancorp, Inc.

Magyar Bank's operations are also subject to extensive regulation by other federal, state and local governmental authorities, and are subject to various laws and judicial and administrative decisions that impose requirements and restrictions on operations. These laws, rules and regulations are frequently changed by legislative and regulatory authorities. There can be no assurance that changes to existing laws, rules and regulations, or any other new laws, rules or regulations, will not be adopted in the future, which could make compliance more difficult or expensive or otherwise adversely affect our business, financial condition or prospects.

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**Non-compliance with the USA PATRIOT Act, Bank Secrecy Act, or Other Laws and Regulations Could Result in Fines or Sanctions.**

The USA PATRIOT and Bank Secrecy Acts require financial institutions to develop programs to prevent financial institutions from being used for money laundering and terrorist activities. If such activities are detected, financial institutions are obligated to file suspicious activity reports with the U.S. Treasury's Office of Financial Crimes Enforcement Network. These rules require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. Failure to comply with these regulations could result in fines or sanctions, including restrictions on conducting acquisitions or establishing new branches. During the last year, several banking institutions have received large fines for non-compliance with these laws and regulations. While we have developed policies and procedures designed to assist in compliance with these laws and regulations, these policies and procedures may not be effective in preventing violations of these laws and regulations.

**System Failure or Breaches of Our Network Security Could Subject Us to Increased Operating Costs as well as Litigation and Other Liabilities.**

The computer systems and network infrastructure we and our third-party service providers use could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from physical theft, fire, power loss, telecommunications failure or a similar catastrophic event, as well as from security breaches, denial of service attacks, viruses, worms and other disruptive problems caused by hackers. Any damage or failure that causes an interruption in our operations could have a material adverse effect on our financial condition and results of operations. Computer break-ins, phishing and other disruptions could also jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us and may cause existing and potential customers to refrain from doing business with us. Although we, with the help of third-party service providers, intend to continue to implement security technology and establish operational procedures designed to prevent such damage, our security measures may not be successful. In addition, advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms we and our third-party service providers use to encrypt and protect customer transaction data. A failure of such security measures could have a material adverse effect on our financial condition and results of operations.

It is possible that a significant amount of time and money may be spent to rectify the harm caused by a breach or hack. While we have general liability insurance, there are limitations on coverage as well as dollar amount. Furthermore, cyber incidents carry a greater risk of injury to our reputation. Finally, depending on the type of incident, banking regulators can impose restrictions on our business and consumer laws may require reimbursement of customer loss.

**Risks Associated with Cyber-Security Could Negatively Affect Our Earnings.**

The financial services industry has experienced an increase in both the number and severity of reported cyber attacks aimed at gaining unauthorized access to bank systems as a way to misappropriate assets and sensitive information, corrupt and destroy data, or cause operational disruptions

We have established policies and procedures to prevent or limit the impact of security breaches, but such events may still occur or may not be adequately addressed if they do occur. Although we rely on security safeguards to secure our data, these safeguards may not fully protect our systems from compromises or breaches.

We also rely on the integrity and security of a variety of third party processors, payment, clearing and settlement systems, as well as the various participants involved in these systems, many of which have no direct relationship with us. Failure by these participants or their systems to protect our customers' transaction data may put us at risk for possible losses due to fraud or operational disruption.

Our customers are also the target of cyber-attacks and identity theft. Large scale identity theft could result in customers' accounts being compromised and fraudulent activities being performed in their name. We have implemented certain safeguards against these types of activities but they may not fully protect us from fraudulent financial losses.

The occurrence of a breach of security involving our customers' information, regardless of its origin, could damage our reputation and result in a loss of customers and business and subject us to additional regulatory scrutiny, and 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.

Table of Contents**ITEM 1B.****Unresolved Staff Comments**

Not required for smaller reporting companies.

**ITEM 2.****Properties**

The following table provides certain information with respect to our seven banking offices as of September 30, 2018:

| Location   | Leased or<br>Owned | Original Year<br>Leased or<br>Acquired | Year of<br>Lease<br>Expiration |
|--|--------------------|--|--------------------------------|
| Main Office:<br>400 Somerset Street<br>New Brunswick, New Jersey, 08901            | Owned              | 2005                                   | -                              |
| Full - Service Branches:<br>3050 State Route 27<br>Kendall Park, New Jersey, 08824 | Owned              | 1969                                   | -                              |
| 582 Milltown Road<br>North Brunswick, New Jersey, 08902                            | Leased             | 2002                                   | 2021                           |
| 1000 Route 202 South<br>Branchburg, New Jersey, 08876                              | Leased             | 2006                                   | 2031                           |
| 475 North Bridge Street<br>Bridgewater, New Jersey, 08807                          | Leased             | 2010                                   | 2025                           |
| 1167 Inman Avenue<br>Edison, New Jersey, 08820                                     | Leased             | 2011                                   | 2026                           |
| 1199 Amboy Avenue<br>Edison, New Jersey, 08837                                     | Leased             | 2017                                   | 2027                           |
| Loan Product Office:<br>46-48 State Route 36<br>Keyport, New Jersey 07735          | Owned              | 2016                                   | -                              |

The net book value of our premises, land and equipment was approximately \$17.0 million at September 30, 2018.

For information regarding Magyar Bancorp, Inc.'s investment in mortgages and mortgage-related securities, see "Item 1. Business" herein.

ITEM 3.

Legal Proceedings

In the ordinary course of business, we are a party to various legal actions which are incidental to the operation of our business. Although the ultimate outcome and amount of liability, if any, with respect to these legal actions cannot presently be ascertained with certainty, in the opinion of management, based upon information currently available to us, any resulting liability is believed to be immaterial to our consolidated financial position, results of operations and cash flows.

ITEM 4.

Mine Safety Disclosures

Not applicable.

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## PART II

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

(a) Our shares of common stock are traded on the NASDAQ Global Market under the symbol "MGYR." At September 30, 2018, Magyar Bancorp, MHC owned 3,200,450 shares, or 54.0% of the issued shares of our common stock. The approximate number of holders of record of Magyar Bancorp, Inc.'s common stock as of September 30, 2018 was 405. Certain shares of Magyar Bancorp, Inc. are held in "nominee" or "street" name and accordingly, the number of beneficial owners of such shares is not known or included in the foregoing number. The following tables present quarterly market information for Magyar Bancorp, Inc. common stock for each quarter of the previous two fiscal years. Magyar Bancorp, Inc. began trading on the NASDAQ Global Market on January 24, 2006. The following information was provided by the NASDAQ Stock Market.

| Fiscal Year Ended<br>September 30, 2018 | High    | Low     | Closing<br>Price | Dividends<br>Declared |
|---|---------|---------|------------------|-----------------------|
| Quarter ended September 30, 2018        | \$12.88 | \$12.10 | \$12.16          | \$ —                  |
| Quarter ended June 30, 2018             | 13.00   | 12.06   | 12.88            | —                     |
| Quarter ended March 31, 2018            | 12.92   | 12.20   | 12.75            | —                     |
| Quarter ended December 31, 2017         | 13.75   | 12.01   | 12.80            | —                     |

| Fiscal Year Ended<br>September 30, 2017 | High    | Low     | Closing<br>Price | Dividends<br>Declared |
|---|---------|---------|------------------|-----------------------|
| Quarter ended September 30, 2017        | \$13.75 | \$12.05 | \$12.25          | \$ —                  |
| Quarter ended June 30, 2017             | 13.95   | 12.25   | 13.12            | —                     |
| Quarter ended March 31, 2017            | 14.95   | 11.60   | 13.00            | —                     |
| Quarter ended December 31, 2016         | 12.11   | 10.09   | 12.00            | —                     |

Dividend payments by Magyar Bancorp, Inc. would be dependent primarily on dividends it receives from Magyar Bank, because Magyar Bancorp, Inc. has no source of income other than dividends from Magyar Bank, earnings from the investment of proceeds from the sale of shares of common stock retained by Magyar Bancorp, Inc., and interest payments with respect to Magyar Bancorp, Inc.'s loan to the Employee Stock Ownership Plan. For more information on regulatory restrictions regarding the payment of dividends, see "Item 1- Business- Supervision and Regulation- New Jersey Banking Regulation-Dividends."

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Other than its Employee Stock Ownership Plan, Magyar Bancorp, Inc. does not have any equity compensation plans that were not approved by stockholders. There were no stock options or shares of restricted stock available for issuance with respect to Magyar Bancorp's equity compensation plans at September 30, 2018.

|     |                    |
|-----|--------------------|
| (b) | Not applicable.    |
| (c) | Share repurchases. |

The Company completed its first stock repurchase program of 130,927 shares in November 2007 and announced in November 2007 a second repurchase program of up to 5% of its publicly-held outstanding shares of common stock, or 129,924 shares, under which 81,000 shares had been repurchased as of September 30, 2018 at an average price of \$8.33.

There were no repurchases of our common stock during the year ended September 30, 2018.



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ITEM 6.

Selected Financial Data

Not required for smaller reporting companies.

ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Magyar Bancorp, Inc. (the "Company") is a Delaware-chartered mid-tier stock holding company whose most significant business activity is ownership of 100% of the common stock of Magyar Bank. Magyar Bank's principal business is attracting retail deposits from the general public and investing those deposits, together with funds generated from operations, principal repayments on loans and securities and borrowed funds, into one-to four-family residential mortgage loans, multi-family and commercial real estate mortgage loans, home equity loans and lines of credit, commercial business loans and construction loans. Our results of operations depend primarily on our net interest income which is the difference between the interest we earn on our interest-earning assets and the interest we pay on our interest-bearing liabilities. Our net interest income is primarily affected by the market interest rate environment, the shape of the U.S. Treasury yield curve, the timing of the placement of interest-earning assets and interest-bearing liabilities, and the prepayment rate on our mortgage-related assets. Other factors that may affect our results of operations are general and local economic and competitive conditions, government policies and actions of regulatory authorities.

During the year ended September 30, 2018, the Company's total assets grew \$20.9 million, or 3.5%, to \$624.0 million. The increase was attributable to a \$37.7 million, or 8.0%, increase in loans receivable, net of allowance of loss. Partially offsetting the growth in loans were decreases in investment securities, which declined \$7.1 million during the year, and other real estate owned, which declined \$2.5 million during the year.

Total deposits increased \$14.9 million, or 2.9%, to \$530.1 million during the year ended September 30, 2018 from \$515.2 million at September 30, 2017. The increases in deposits occurred in money market account balances, which increased \$29.8 million, or 21.7%, in non-interest checking account balances, which increased \$6.0 million, or 6.1%, in interest-bearing checking account balances, which increased \$2.8 million, or 6.4%, and in certificates of deposit (including individual retirement accounts), which increased \$2.3 million, or 1.8%. Partially offsetting these increases was a decrease in savings account balances, which decreased \$26.0 million, or 24.2%. Deposits accounted for 85.0% of assets and 104.3% of net loans receivable at September 30, 2018.

The Company reported net income of \$2.0 million for the year ended September 30, 2018. Net income increased \$607,000, or 42.7%, compared with net income of \$1.4 million for the year ended September 30, 2017. The increase in net income between the twelve month periods was attributable to higher net interest and dividend income, which increased \$1.5 million. Partially offsetting this increase was higher non-interest expenses, which increased \$880,000.

The Company's net interest margin increased by 13 basis points to 3.49% for the year ended September 30, 2018 from 3.36% for the prior year ended September 30, 2017. In addition to growth in its interest earning assets during the year, the Company experienced higher yields on earning assets due to higher market interest rates.

Throughout 2019, we expect to continue increasing our commercial real estate and commercial business loans while managing non-interest expenses in order to increase profitability of the Company.

### **Critical Accounting Policies**

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. Critical accounting policies may involve complex subjective decisions or assessments. We consider the following to be our critical accounting policies.

***Allowance for Loan Loss.*** The allowance for loan losses is the amount estimated by management as necessary to cover credit losses in the loan portfolio both probable and reasonably estimable at the balance sheet date. The allowance is established through the provision for loan losses which is charged against income. In determining the allowance for loan losses, management makes significant estimates and has identified this policy as one of our most critical. Due to the high degree of judgment involved, the subjectivity of the assumptions utilized and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses, the methodology for determining the allowance for loan losses is considered a critical accounting policy by management.

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As a substantial amount of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans and discounted cash flow valuations of properties are critical in determining the amount of the allowance required for specific loans. Assumptions for appraisals and discounted cash flow valuations are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly affect the valuation of a property securing a loan and the related allowance determined. The assumptions supporting such appraisals and discounted cash flow valuations are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable on the related loans.

Management performs a quarterly evaluation of the adequacy of the allowance for loan losses. We consider a variety of factors in establishing this estimate including, but not limited to, current economic conditions, delinquency statistics, geographic and industry concentrations, the adequacy of the underlying collateral, the financial strength of the borrower, results of internal loan reviews and other relevant factors. This evaluation is inherently subjective as it requires material estimates by management that may be susceptible to significant change based on changes in economic and real estate market conditions.

The evaluation has a specific and general component. The specific component relates to loans that are delinquent or otherwise identified as impaired through the application of our loan review process and our loan grading system. All such loans are evaluated individually, with principal consideration given to the value of the collateral securing the loan and discounted cash flows. Specific impairment allowances are established as required by this analysis. However, the Bank's Federal and State regulators generally require that the specific reserve against impaired collateral-dependent loans be charged-off, reducing the carrying balance of the loan and allowance for loan loss. The general component is determined by segregating the remaining loans by type of loan, risk weighting (if applicable) and payment history. We analyze historical loss experience, delinquency trends, general economic conditions and geographic and industry concentrations in establishing the general portion of the reserve. This analysis establishes factors that are applied to the loan groups to determine the amount of the general component of the allowance for loan losses.

Actual loan losses may be significantly greater than the allowances we have established, which could have a material negative effect on our financial results.

**Deferred Income Taxes.** The Company records income taxes using the asset and liability method. Accordingly, deferred tax assets and liabilities: (i) are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns; (ii) are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases; and (iii) are measured using enacted tax rates expected to apply in the years when those temporary differences are expected to be recovered or settled.

Deferred tax assets are likely to be realized and therefore do not have a valuation allowance.

## Comparison of Financial Condition at September 30, 2018 and September 30, 2017

**Total Assets.** Total assets increased \$20.9 million, or 3.5%, during the year ended September 30, 2018. The increase was attributable to a \$37.7 million, or 8.0%, increase in loans receivable, net of allowance of loss. Partially offsetting

the growth in loans were decreases in investment securities, which declined \$7.1 million during the year, and other real estate owned, which declined \$2.5 million during the year.

**Loans Receivable.** Total loans receivable at September 30, 2018 were comprised of \$219.3 million (42.8%) in commercial real estate loans, \$185.3 million (36.2%) in 1-4 family residential mortgage loans, \$53.3 million (10.4%) in commercial business loans, \$30.4 million (5.9%) in construction loans, and \$24.2 million (4.7%) in home equity lines of credit and other loans. Total loans receivable at September 30, 2017 were comprised of \$207.1 million (43.7%) in commercial real estate loans, \$178.3 million (37.6%) in 1-4 family residential mortgage loans, \$41.1 million (8.7%) in commercial business loans, \$24.8 million (5.2%) in home equity lines of credit and other loans, and \$22.6 million (4.8%) in construction loans.

Total non-performing loans decreased by \$1.5 million to \$906,000 during the year ended September 30, 2018 from \$2.4 million at September 30, 2017. At September 30, 2018, non-performing loans consisted of three commercial real estate loans totaling \$455,000, four 1-4 family residential mortgage loans (including home equity lines of credit) totaling \$228,000, and two commercial business loans totaling \$223,000. The ratio of non-performing loans to total loans was 0.18% at September 30, 2018 compared to 0.50% at September 30, 2017.

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Once a loan is deemed non-performing, the value of the collateral securing the loan must be assessed, which is typically done by obtaining an updated third-party appraisal. To the extent that the current appraised value of collateral is insufficient to cover a collateral-dependent loan, the Company reduces the balance of the loan via a charge to the allowance for loan loss.

Non-performing loans secured by one-to four-family residential properties, including home equity lines of credit and other consumer loans, decreased \$1.4 million to \$228,000 at September 30, 2018 from \$1.7 million at September 30, 2017. Magyar Bank had begun foreclosure proceedings on the majority of the properties as of September 30, 2018. Foreclosure of owner-occupied residential properties in the State of New Jersey can take several years. During the year ended September 30, 2018, Magyar Bank charged off \$213,000 from these loans through a reduction of its allowance for loan loss and recovered \$88,000 from prior year charge-offs.

Non-performing commercial real estate loans decreased \$27,000, or 5.6%, to \$455,000 at September 30, 2018 from \$482,000 at September 30, 2017. Magyar Bank had begun foreclosure proceedings on the properties securing these loans at September 30, 2018. There were no charge-offs of non-performing commercial real estate loans while \$23,000 was recovered from a prior year charge off during the year ended September 30, 2018.

Non-performing commercial business loans increased \$10,000 to \$223,000 at September 30, 2018 from \$213,000 at September 30, 2017. During the year ended September 30, 2018, Magyar Bank charged off \$170,000 in non-performing commercial business loans through a reduction of its allowance for loan loss and \$1,000 was recovered from a prior year charge-off.

There were no non-performing construction loans at September 30, 2018 and 2017. There were no charge-offs of non-performing construction loans while \$3,000 was recovered from a prior year charge off during the year ended September 30, 2018.

The ratio of non-performing loans and troubled debt restructurings to total loans receivable decreased to 0.18% at September 30, 2018 from 0.54% at September 30, 2017. The allowance for loan losses increased \$725,000 to \$4.2 million, or 463.6% of non-performing loans, at September 30, 2018 compared with \$3.5 million, or 147.4% of non-performing loans, at September 30, 2017. Provisions for loan loss during the year ended September 30, 2018 were \$997,000 while net charge-offs were \$272,000, compared with a provision of \$1.3 million and net charge-offs of \$924,000 for the prior year period. The allowance for loan losses was 0.82% and 0.73% of gross loans outstanding at September 30, 2018 and 2017, respectively.

**Investment Securities.** Investment securities decreased \$7.1 million, or 11.2%, to \$56.1 million at September 30, 2018 from \$63.2 million at September 30, 2017. Investment securities at September 30, 2018 consisted of \$47.9 million in mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises, \$4.8

million in U.S. government-sponsored enterprise debt securities, \$3.0 million in corporate notes and \$393,000 in “private-label” mortgage-backed securities. There were no other-than-temporary-impairment charges for the Company’s investment securities for the year ended September 30, 2018

Securities available-for-sale increased \$10.7 million, or 90.2%, to \$22.5 million at September 30, 2018 from \$11.8 million at September 30, 2017. The increase was primarily the result of ten mortgage-backed securities totaling \$12.6 million that were reclassified from the held-to-maturity portfolio. Upon adoption of ASU 2017-12, the Bank reclassified debt securities eligible to be hedged under the ASU from held-to-maturity to available-for-sale. In addition there were \$1.4 million in security purchases, \$2.8 million in principal and premium amortization and \$756,000 in unrealized losses during the year.

Securities held-to-maturity decreased \$17.7 million, or 34.5%, to \$33.6 million at September 30, 2018 from \$51.4 million at September 30, 2017. The decrease was primarily the result of ten mortgage-backed securities totaling \$12.6 million that were reclassified to the available-for-sale portfolio with the adoption of ASU 2017-12. In addition there were \$3.3 million in sales, \$2.0 million in maturities, \$3.2 million in principal and premium amortization and \$1.5 million in unrealized losses during the year, partially offset by \$3.5 million in security purchases.

**Bank-Owned Life Insurance.** The cash surrender value of life insurance held for directors and executive officers of Magyar Bank increased \$293,000, or 2.5%, to \$11.8 million at September 30, 2018 from \$11.6 million at September 30, 2017. The increase in bank-owned life insurance was due to the increase in the cash surrender value of the existing policies.

**Other Real Estate Owned.** Other real estate owned (“OREO”) decreased \$2.5 million, or 22.3%, to \$8.6 million at September 30, 2018 from \$11.1 million at September 30, 2017.

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During the year ended September 30, 2018, the Company sold ten properties totaling \$2.7 million at a net gain of \$184,000, invested \$191,000 to complete or repair properties, and obtained title for one property previously securing a non-performing loan totaling \$323,000. In addition, the carrying values of properties were reduced by \$480,000 in valuation allowances and insurance proceeds. OREO at September 30, 2018 consisted of four residential properties (three of which were leased) totaling \$2.0 million, four real estate lots/land totaling \$3.2 million, and five commercial real estate buildings totaling \$3.4 million. The Bank is determining the proper course of action for its OREO, which may include holding the properties until the real estate market improves, marketing the properties for individual sale, or selling multiple properties to an investor and developer.

**Deposits.** Total deposits increased \$14.9 million, or 2.9%, to \$530.1 million at September 30, 2018 from \$515.2 million at September 30, 2017.

The Company's deposit strategy during the year ended September 30, 2018 was focused on increasing and expanding customer relationships with Magyar Bank, including higher balance commercial deposit accounts. As a result of this strategy, the Bank was able to continue replacing higher-cost, single service time deposit account holders with non-interest bearing checking and money market account balances.

The increase in deposits during the twelve months ended September 30, 2018 occurred in money market account balances, which increased \$29.8 million, or 21.7%, in non-interest checking account balances, which increased \$6.0 million, or 6.1%, in interest-bearing checking account balances, which increased \$2.8 million, or 6.4%, and in certificates of deposit (including individual retirement accounts), which increased \$2.3 million, or 1.8%. Partially offsetting these increases was a decrease in savings account balances, which decreased \$26.0 million, or 24.2%. Deposits accounted for 85.0% of assets and 104.3% of net loans receivable at September 30, 2018.

At September 30, 2018, the Company held \$14.8 million in brokered certificates of deposit, compared with \$10.3 million at September 30, 2017.

**Borrowed Funds.** Borrowings, which include Federal Home Loan Bank of New York advances, increased \$3.6 million, or 11.3%, to \$35.5 million, at September 30, 2018 from \$31.9 million at September 30, 2017.

**Stockholders' Equity.** Stockholders' equity increased \$1.9 million, or 3.9%, to \$51.4 million at September 30, 2018 from \$49.5 million at September 30, 2017. The increase in stockholders' equity was attributable to the Company's results of operations for the year ended September 30, 2018.

The Company did not repurchase any shares during the twelve months ended September 30, 2018. The Company has repurchased 81,000 shares pursuant to the second stock repurchase plan through September 30, 2018, reducing outstanding shares to 5,820,746.

The Company's book value per share increased to \$8.82 at September 30, 2018 from \$8.50 at September 30, 2017. The increase was attributable to the Company's results from operations.

#### Comparison of Operating Results for the Years Ended September 30, 2018 and 2017

**Net Income.** The Company's net income was \$2.0 million for the year ended September 30, 2018, reflecting a \$607,000, or 42.7%, increase from \$1.4 million for the year ended September 30, 2017. The increase in net income between the twelve month periods was attributable to higher net interest and dividend income, which increased \$1.5 million. Partially offsetting this increase were higher non-interest expenses, which increased \$880,000 between the annual periods.

For the year ended September 30, 2018, the net interest margin improved by 13 basis points to 3.49% from 3.36% the prior year period. In addition to growth in its interest earning assets during the year, the Company experienced higher yields on earning assets due to higher market interest rates.

**Net Interest and Dividend Income.** Net interest and dividend income increased \$1.5 million, or 8.2%, to \$19.7 million during the year ended September 30, 2018 from \$18.2 million during the year ended September 30, 2017. Total interest and dividend income increased \$2.4 million, or 10.8%, to \$24.4 million for the year ended September 30, 2018 from \$22.0 million for the year ended September 30, 2017 while interest expense increased \$876,000, or 23.2%, to \$4.6 million for the year ended September 30, 2018 from \$3.8 million for the year ended September 30, 2017.



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**Average Balance Sheet.** The following table presents certain information regarding our financial condition and net interest income for the years ended September 30, 2018, 2017 and 2016. The table presents the annualized average yield on interest-earning assets and the annualized average cost of interest-bearing liabilities. We derived the yields and costs by dividing annualized income or expense by the average balance of interest-earning assets and interest-bearing liabilities, respectively, for the periods shown. We derived average balances from daily balances over the periods indicated. Interest income includes fees that we consider adjustments to yields.

|                                    | For the Year Ended September 30, |                                |                            | 2017               |                                |                            | 2016               |                                |                            |
|------------------------------------|----------------------------------|--------------------------------|----------------------------|--------------------|--------------------------------|----------------------------|--------------------|--------------------------------|----------------------------|
|                                    | 2018                             |                                |                            | 2017               |                                |                            | 2016               |                                |                            |
|                                    | Average<br>Balance               | Interest<br>Income/<br>Expense | Yield/Cost<br>(Annualized) | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/Cost<br>(Annualized) | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/Cost<br>(Annualized) |
|                                    | (Dollars In Thousands)           |                                |                            |                    |                                |                            |                    |                                |                            |
| Interest-earning assets:           |                                  |                                |                            |                    |                                |                            |                    |                                |                            |
| Interest-earning deposits          | \$15,606                         | \$228                          | 1.46%                      | \$15,392           | \$175                          | 1.14%                      | \$22,651           | \$172                          | 0.76%                      |
| Loans receivable, net              | 487,133                          | 22,604                         | 4.64%                      | 462,364            | 20,297                         | 4.39%                      | 429,065            | 18,765                         | 4.36%                      |
| Securities                         |                                  |                                |                            |                    |                                |                            |                    |                                |                            |
| Taxable                            | 59,579                           | 1,384                          | 2.32%                      | 61,801             | 1,387                          | 2.24%                      | 62,847             | 1,417                          | 2.25%                      |
| FHLB of NY stock                   | 2,218                            | 134                            | 6.02%                      | 2,180              | 119                            | 5.48%                      | 2,159              | 97                             | 4.46%                      |
| Total interest-earning assets      | 564,536                          | 24,350                         | 4.31%                      | 541,737            | 21,978                         | 4.06%                      | 516,722            | 20,451                         | 3.95%                      |
| Noninterest-earning assets         | 45,288                           |                                |                            | 47,958             |                                |                            | 51,784             |                                |                            |
| Total assets                       | \$609,824                        |                                |                            | \$589,695          |                                |                            | \$568,506          |                                |                            |
| Interest-bearing liabilities:      |                                  |                                |                            |                    |                                |                            |                    |                                |                            |
| Savings accounts (1)               | \$95,892                         | \$658                          | 0.69%                      | \$109,486          | \$804                          | 0.73%                      | \$95,136           | \$671                          | 0.70%                      |
| NOW accounts (2)                   | 190,618                          | 1,518                          | 0.80%                      | 161,743            | 679                            | 0.42%                      | 153,575            | 489                            | 0.32%                      |
| Time deposits (3)                  | 123,010                          | 1,720                          | 1.40%                      | 131,388            | 1,570                          | 1.20%                      | 138,253            | 1,628                          | 1.17%                      |
| Total interest-bearing deposits    | 409,520                          | 3,896                          | 0.95%                      | 402,617            | 3,053                          | 0.76%                      | 386,964            | 2,788                          | 0.72%                      |
| Borrowings                         | 36,710                           | 753                            | 2.05%                      | 34,538             | 720                            | 2.08%                      | 34,507             | 744                            | 2.15%                      |
| Total interest-bearing liabilities | 446,230                          | 4,649                          | 1.04%                      | 437,155            | 3,773                          | 0.86%                      | 421,471            | 3,532                          | 0.84%                      |
| Noninterest-bearing liabilities    | 112,191                          |                                |                            | 103,458            |                                |                            | 99,260             |                                |                            |
| Total liabilities                  | 558,421                          |                                |                            | 540,613            |                                |                            | 520,731            |                                |                            |
| Retained earnings                  | 51,403                           |                                |                            | 49,082             |                                |                            | 47,775             |                                |                            |
|                                    | \$609,824                        |                                |                            | \$589,695          |                                |                            | \$568,506          |                                |                            |

Total liabilities and retained earnings

|   |           |           |          |          |
|---|-----------|-----------|----------|----------|
| Net interest and dividend income  | \$19,701  |           | \$18,205 | \$16,919 |
| Interest rate spread  | 3.27%     |           | 3.20%    | 3.11%    |
| Net interest-earning assets   | \$118,306 | \$104,582 |          | \$95,251 |
| Net interest margin (4)   | 3.49%     |           | 3.36%    | 3.27%    |
| Average interest-earning assets to average interest-bearing liabilities | 126.51%   | 123.92%   |          | 122.60%  |

(1) Includes passbook savings, money market passbook and club accounts.

(2) Includes interest-bearing checking and money market accounts.

(3) Includes certificates of deposits and individual retirement accounts.

(4) Calculated as annualized net interest income divided by average total interest-earning assets.

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**Rate/Volume Analysis.** The following table presents the effects of changing rates and volumes on our net interest income for the periods indicated. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by average volume). The volume column shows the effects attributable to changes in volume (changes in average volume multiplied by prior rate). The net column represents the sum of the prior columns. For purposes of this table, changes attributable to both rate and volume, which cannot be segregated, have been allocated proportionately, based on the changes due to rate and the changes due to volume.

|                                    | September 30,<br>2018 vs. 2017   |       |         | 2017 vs. 2016                    |       |         |
|------------------------------------|----------------------------------|-------|---------|----------------------------------|-------|---------|
|                                    | Increase<br>(decrease)<br>due to |       |         | Increase<br>(decrease)<br>due to |       |         |
|                                    | Volume                           | Rate  | Net     | Volume                           | Rate  | Net     |
|                                    | (In thousands)                   |       |         |                                  |       |         |
| Interest-earning assets:           |                                  |       |         |                                  |       |         |
| Interest-earning deposits          | \$3                              | \$50  | \$53    | \$(66 )                          | \$69  | \$3     |
| Loans                              | 1,118                            | 1,189 | 2,307   | 1,407                            | 125   | 1,532   |
| Securities                         |                                  |       |         |                                  |       |         |
| Taxable                            | (51 )                            | 48    | (3 )    | (24 )                            | (6 )  | (30 )   |
| FHLB of NY stock                   | 2                                | 13    | 15      | 1                                | 21    | 22      |
| Total interest-earning assets      | 1,072                            | 1,300 | 2,372   | 1,318                            | 209   | 1,527   |
| Interest-bearing liabilities:      |                                  |       |         |                                  |       |         |
| Savings accounts (1)               | (101 )                           | (45 ) | (146 )  | 104                              | 29    | 133     |
| NOW accounts (2)                   | 138                              | 701   | 839     | 28                               | 162   | 190     |
| Time deposits (3)                  | (104 )                           | 254   | 150     | (93 )                            | 35    | (58 )   |
| Total interest-bearing deposits    | (67 )                            | 910   | 843     | 38                               | 227   | 265     |
| Borrowings                         | 44                               | (11 ) | 33      | 1                                | (25 ) | (24 )   |
| Total interest-bearing liabilities | (23 )                            | 899   | 876     | 39                               | 202   | 241     |
| Increase in net interest income    | \$1,095                          | \$401 | \$1,496 | \$1,279                          | \$7   | \$1,286 |

(1) Includes passbook savings, money market passbook and club accounts.

(2) Includes interest-bearing checking and money market accounts.

(3) Includes certificates of deposits and individual retirement accounts.

**Interest and Dividend Income.** Interest and dividend income increased \$2.4 million, or 10.8%, to \$24.4 million for the year ended September 30, 2018 from \$22.0 million for the year ended September 30, 2017. The average balance of interest-earnings assets between the two periods increased \$22.8 million, or 4.2%, to \$564.5 million from \$541.7 million, while the yield on the assets increased 25 basis points to 4.31% for the year ended September 30, 2018 from 4.06% for the same period prior year.

Interest income on loans increased \$2.3 million, or 11.4%, to \$22.6 million for the year ended September 30, 2018, while the average balance of loans increased \$24.8 million, or 5.4%, to \$487.1 million from \$462.4 million. The average yield on such loans was 4.64% at September 30, 2018 compared with 4.39% at September 30, 2017. The increase in yield on loans reflected a \$24.8 million increase in the average balance in loan receivables and the higher interest environment during the year ended September 30, 2018.

Interest earned on investment securities, excluding Federal Home Loan Bank of New York stock, increased \$50,000, or 3.2%, to \$1.6 million for the year ended September 30, 2018 from the prior year. The increase was primarily due to a 12 basis point increase in the average yield on investment securities to 2.14% from 2.02%, offset by a \$2.0 million, or 2.6%, decrease in the average balance of investment securities and interest earning deposits to \$75.2 million from \$77.2 million from the prior year.

**Interest Expense.** Interest expense increased \$876,000, or 23.2%, to \$4.6 million for the year ended September 30, 2018 from \$3.8 million for the year ended September 30, 2017. The average balance of interest-bearing liabilities increased \$9.0 million, or 2.1%, to \$446.2 million from \$437.2 million between the two periods while the cost of such liabilities increased 18 basis points to 1.04% for the year ended September 30, 2018 from 0.86% for the same period prior year due to the higher market interest environment.

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The average balance of interest-bearing deposits increased \$6.9 million, or 1.7%, to \$409.5 million for the year ended September 30, 2018 from \$402.6 million for the prior year while the average cost of such deposits increased 19 basis points to 0.95% from 0.76%. Interest expense on average deposits increased \$843,000, or 27.6%, to \$3.9 million for the year ended September 30, 2018 from \$3.1 million for the year ended September 30, 2017.

Interest expense on advances increased \$33,000, or 4.6%, to \$753,000 for the year ended September 30, 2018 from \$720,000 for the year ended September 30, 2017. The average cost of borrowings decreased 3 basis points to 2.05% for the year ended September 30, 2018 from 2.08% for the year ended September 30, 2017. The average balance of advances and securities sold under agreements to repurchase increased \$2.2 million to \$36.7 million for the year ended September 30, 2018 from \$34.5 million the prior year.

**Provision for Loan Losses.** We establish provisions for loan losses, which are charged to earnings, at a level necessary to absorb known and inherent losses that are both probable and reasonably estimable at the date of the financial statements. In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, peer group information and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events occur.

After an evaluation of these factors, management made a provision of \$997,000 for the year ended September 30, 2018 compared with a \$1.3 million provision for the prior year. There were net charge-offs of \$272,000 for the year ended September 30, 2018 compared with \$924,000 for the year ended September 30, 2017. The charge-offs resulted from updated valuations of collateral securing impaired loans.

Total non-performing loans decreased \$1.5 million, or 61.6%, to \$906,000 at September 30, 2018 from \$2.4 million at September 30, 2017. The allowance for loan losses increased \$725,000 to \$4.2 million, or 20.9% of gross loans outstanding at September 30, 2018, from \$3.5 million, or 0.73% of gross loans outstanding at September 30, 2017. The increase in the allowance for loan losses during the year ended September 30, 2018 was attributable to growth in total loan receivable.

**Other Income.** Other income increased \$122,000 during the year ended September 30, 2018 due to higher gains on the sales of assets, partially offset by lower service charges.

Gains from the sales of assets increased \$276,000 to \$600,000 for the twelve months ended September 30, 2018 compared with \$324,000 for the twelve months ended September 30, 2017. Gains from the sales of loans increased \$169,000, or 52.2%, to \$493,000 from \$324,000 for the year ended September 30, 2017 while gains from the sales of investment securities increased \$107,000 in the current year period.

Service charges decreased \$159,000, or 12.7%, to \$1.1 million for the year ended September 30, 2018 from \$1.3 million for the prior year due to lower loan prepayment penalties and loan late charges received during the current year period.

**Other Expenses.** Other expenses increased \$880,000, or 5.4%, to \$17.3 million for the year ended September 30, 2018 compared to \$16.4 million for the year ended September 30, 2017 due to higher compensation and occupancy expenses.

Compensation and employee benefit expenses increased \$603,000, or 6.6%, to \$9.7 million and occupancy expense increased \$138,000, or 4.9%, to \$2.9 million due in large part to the opening of the Bank's seventh branch location in June of 2017. Compensation expense also increased from annual merit increases for employees, higher incentive plan accruals, and higher medical benefit expenses than the prior year period.

**Income Tax Expense.** The Company recorded tax expense of \$1.5 million for the year ended September 30, 2018 compared with tax expense of \$994,000 for the year ended September 30, 2017. The income tax expense increase was the result of higher income from operations and a \$410,000 charge resulting from the write-down of deferred tax assets due to the enactment of the Tax Cuts and Jobs Act on December 22, 2017, which lowered the Company's federal income tax rate from 34% to 21%.

The Company recognized additional tax expense in our tax provision for the year ended September 30, 2018 related to adjustment of our net deferred tax asset to reflect the new corporate tax rate. As a result, income tax expense was adjusted to reflect the effects of the change in the tax law and resulted in an increase in income tax expense of \$410,000 for the year ended September 30, 2018.

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The federal income tax rate change is administratively effective at the beginning of our fiscal year resulting in the use of a blended rate for the annual period. As a result, the blended statutory federal tax rate for the Company for the year ending September 30, 2018 is 24.0%. The Company utilized an effective combined federal and state tax rate of 30.3% and 41.1% for the years ended September 30, 2018 and September 30, 2017, respectively.

**Management of Market Risk**

**General.** The majority of our assets and liabilities are monetary in nature. Consequently, our most significant form of market risk is interest rate risk. Our assets, consisting primarily of mortgage loans, have longer maturities than our liabilities, consisting primarily of deposits. As a result, a principal part of our business strategy is to manage interest rate risk and reduce the exposure of our net interest income to changes in market interest rates. Accordingly, our Board of Directors has established an Asset and Liability Management Committee which is responsible for evaluating the interest rate risk inherent in our assets and liabilities, for determining the level of risk that is appropriate, given our business strategy, operating environment, capital, liquidity and performance objectives, and for managing this risk consistent with the guidelines approved by the Board of Directors. Senior management monitors the level of interest rate risk on a regular basis and the Asset and Liability Committee meets at least on a quarterly basis to review our asset/liability policies and interest rate risk position.

We have sought to manage our interest rate risk in order to minimize the exposure of our earnings and capital to changes in interest rates. As part of our ongoing asset-liability management, we seek to manage our exposure to interest rate risk by retaining in our loan portfolio fewer fixed rate residential loans, by originating and retaining adjustable-rate loans in the residential, construction and commercial real estate loan portfolios, by using alternative funding sources, such as advances from the Federal Home Loan Bank of New York (“FHLBNY”), to “match fund” longer-term residential and commercial mortgage loans, and by originating and retaining variable rate home equity and short-term and medium-term fixed-rate commercial business loans. We have also increased money market account deposits as a percentage of our total deposits. Money market accounts offer a variable rate based on market indications. By following these strategies, we believe that we are well-positioned to react to changes in market interest rates.

**Net Interest Income Analysis.** The table below sets forth, as of September 30, 2018, the estimated changes in our Net Interest Income (“NII”) for each of the next two years that would result from the designated instantaneous changes in interest rates. These estimates require making certain assumptions including loan and mortgage-related investment prepayment speeds, reinvestment rates, and deposit maturities and decay rates. These assumptions are inherently uncertain and, as a result, we cannot precisely predict the impact of changes in interest rates on net interest income. Actual results may differ significantly due to timing, magnitude and frequency of interest rate changes and changes in market conditions. Further, certain shortcomings are inherent in the methodology used in the interest rate risk measurement. Modeling changes in net interest income require making certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates.

| Change in | Estimated<br>Decrease | Estimated Increase |
|-----------|-----------------------|--------------------|
|-----------|-----------------------|--------------------|

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| Interest rates<br>(Basis Points) <sup>(1)</sup><br>(Dollars in thousands) | Estimated in NII Year 1 |                | Estimated NII Year 2 |            | (Decrease) in NII Year 2 |            |
|---|-------------------------|----------------|----------------------|------------|--------------------------|------------|
|   | NII Year 1<br>Amount    | Percentage     | NII Year 2<br>Amount | Percentage | Amount                   | Percentage |
| +200  | \$ 19,349               | \$(747) -3.72% | \$ 20,295            |            | \$(442)                  | -2.13%     |
| Unchanged   | 20,096                  | — —            | 20,737               |            | —                        | —          |
| -100  | 19,552                  | (544) -2.71%   | 19,851               |            | (886)                    | -4.27%     |

(1) Assumes an instantaneous uniform change in interest rates at all maturities.

### Liquidity and Capital Resources

Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan repayments and maturities and sales of securities. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. Our Asset/Liability Management Committee is responsible for establishing and monitoring our liquidity targets and strategies in order to ensure that sufficient liquidity exists for meeting the borrowing needs of our customers as well as unanticipated contingencies. We seek to maintain a liquidity ratio of 5.0% of assets or greater. The liquidity ratio is calculated by determining the sum of the difference between liquid assets (cash and unpledged investment securities) and short-term liabilities (estimated 30-day deposit outflows), borrowing capacity from the FHLB/BNY, and brokered deposit capacity and dividing the sum by total assets. At September 30, 2018, our liquidity ratio was 14.6% of assets.



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We regularly adjust our investments in liquid assets based upon our assessment of expected loan demand, expected deposit flows, yields available on interest-earning deposits and securities, and the objectives of our asset/liability management program. Excess liquid assets are invested generally in interest-earning deposits and short-and intermediate-term securities.

Our most liquid assets are cash and cash equivalents. The levels of these assets are dependent on our operating, financing, lending and investing activities during any given period. At September 30, 2018, cash and cash equivalents totaled \$15.4 million. Securities classified as available-for-sale, which provide additional sources of liquidity from sales, totaled \$22.5 million at September 30, 2018. At September 30, 2018, we also had the ability to borrow \$134.3 million from the FHLBNY. On that date, we had an aggregate of \$35.5 million in advances outstanding.

Our cash flows are derived from operating activities, investing activities and financing activities as reported in our consolidated Statements of Cash Flows included in our consolidated Financial Statements.

At September 30, 2018, we had \$16.9 million in loan origination commitments outstanding. In addition to commitments to originate loans, we had \$54.1 million in unused lines of credit to borrowers. Certificates of deposit due within one year of September 30, 2018 totaled \$66.0 million, or 12.5% of total deposits. If these deposits do not remain with us, we will be required to seek other sources of funds, including other deposits and FHLBNY advances. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit (including individual retirement accounts and brokered certificate deposit accounts) due on or before September 30, 2019. We believe, however, that based on past experience a significant portion of our certificates of deposit (including individual retirement accounts and brokered certificate deposit accounts) will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

Our primary investing activities are the origination of loans and the purchase of securities. The balance of loans we originated in the current year was \$80.0 million and \$84.2 million, and purchased \$4.9 million and \$13.4 million of investment securities for the years ended September 30, 2018 and 2017, respectively.

Financing activities consist primarily of activity in deposit accounts and FHLBNY advances. We experienced a net increase in total deposits of \$14.9 million for the year ended September 30, 2018 and a net increase in total deposits of \$22.6 million for the year ended September 30, 2017. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors and other factors.

Liquidity management is both a daily and long-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the FHLBNY, which provide an additional source of funds. FHLBNY advances totaled \$35.5 million and \$31.9 million at September 30, 2018 and September 30, 2017, respectively. FHLBNY advances have primarily been used to fund loan demand.

Magyar Bank is subject to various regulatory capital requirements, (see "Supervision and Regulation-Federal Banking Regulation-Capital Requirements"). As of September 30, 2018, Magyar Bank's Tier 1 capital as a percentage of the Bank's average assets was 8.61% and the total qualifying capital as a percentage of risk-weighted assets was 12.44%.

Bank-owned life insurance is a tax-advantaged financing transaction that is used to offset employee benefit plan costs. Policies are purchased insuring directors and officers of Magyar Bank using a single premium method of payment. Magyar Bank is the owner and beneficiary of the policies and records tax-free income through cash surrender value accumulation. We have minimized our credit exposure by choosing carriers that are highly rated and limiting the concentration of any one carrier. The investment in bank-owned life insurance has no significant impact on our capital and liquidity.

## **Off-Balance Sheet Arrangements and Aggregate Contractual Obligations**

**Commitments.** As a financial services provider, we routinely are a party to various financial instruments with off-balance-sheet risks, such as commitments to extend credit, standby letters of credit and unused lines of credit. While these contractual obligations represent our future cash requirements, a significant portion of commitments to extend credit may expire without being drawn upon. Such commitments are subject to the same credit policies and approval process accorded to loans made by us. For additional information, see Note P, “Commitments,” and Note Q “Financial Instruments with Off-Balance-Sheet Risk” to our consolidated financial statements.

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**Contractual Obligations.** In the ordinary course of our operations, we enter into certain contractual obligations. Such obligations include operating leases for premises and equipment.

The following table summarizes our significant fixed and determinable contractual obligations and other funding needs by payment date at September 30, 2018. The payment amounts represent those amounts due to the recipient and do not include any unamortized premiums or discounts or other similar carrying amount adjustments.

| September 30, 2018              | Payments Due by Period |                    |                     |                      | Total    |
|---------------------------------|------------------------|--------------------|---------------------|----------------------|----------|
|                                 | Less Than One Year     | One to Three Years | Three to Five Years | More Than Five Years |          |
|                                 | (In thousands)         |                    |                     |                      |          |
| Federal Home Loan Bank advances | \$8,940                | \$12,794           | \$11,381            | \$2,409              | \$35,524 |
| Operating leases                | 696                    | 1,405              | 1,197               | 2,130                | 5,428    |
| Total                           | \$9,636                | \$14,199           | \$12,578            | \$4,539              | \$40,952 |

ITEM 7A.Quantitative and Qualitative Disclosures About Market Risk

Not required for smaller reporting companies.



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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders

Magyar Bancorp, Inc.

**Opinion on the Financial Statements**

We have audited the accompanying consolidated balance sheet of Magyar Bancorp, Inc. and Subsidiary (the Company) as of September 30, 2018, the related consolidated statements of operations, comprehensive income, changes in stockholders' equity and cash flows for the year then ended, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of September 30, 2018 and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

**Basis for Opinion**

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audit, we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audit included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ RSM US LLP

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

Blue Bell, Pennsylvania

December 20, 2018

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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders

Magyar Bancorp, Inc.

We audited the accompanying consolidated balance sheets of Magyar Bancorp, Inc. and subsidiary (the “Company”) as of September 30, 2017, and the related consolidated statements of operations, comprehensive income, changes in stockholders’ equity and cash flows for the year then ended. The Company’s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements 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 the financial statements are free of material misstatement. An audit also 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 audit provides 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 the Company as of September 30, 2017, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Baker Tilly Virchow Krause, LLP

Iselin, New Jersey

December 21, 2017

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## MAGYAR BANCORP, INC. AND SUBSIDIARY

## Consolidated Balance Sheets

(In Thousands, Except Share and Per Share Data)

|  | September 30, |           |
|--|---------------|-----------|
|  | 2018          | 2017      |
| Assets   |               |           |
| Cash   | \$674         | \$871     |
| Interest earning deposits with banks   | 14,694        | 21,463    |
| Total cash and cash equivalents  | 15,368        | 22,334    |
| Investment securities - available for sale, at fair value  | 22,469        | 11,815    |
| Investment securities - held to maturity, at amortized cost (fair value of \$32,151 and \$51,241 at September 30, 2018 and 2017, respectively) | 33,645        | 51,368    |
| Federal Home Loan Bank of New York stock, at cost  | 2,164         | 2,002     |
| Loans receivable, net of allowance for loan losses of \$4,200 and \$3,475 at September 30, 2018 and 2017, respectively                         | 508,430       | 470,693   |
| Bank owned life insurance  | 11,843        | 11,550    |
| Accrued interest receivable  | 2,181         | 1,929     |
| Premises and equipment, net  | 16,990        | 17,567    |
| Other real estate owned ("OREO")   | 8,586         | 11,056    |
| Other assets   | 2,292         | 2,730     |
| Total assets   | \$623,968     | \$603,044 |
| Liabilities and Stockholders' Equity   |               |           |
| Liabilities  |               |           |
| Deposits   | \$530,137     | \$515,201 |
| Escrowed funds   | 2,285         | 1,937     |
| Federal Home Loan Bank of New York advances  | 35,524        | 31,905    |
| Accrued interest payable   | 193           | 105       |
| Accounts payable and other liabilities   | 4,467         | 4,439     |
| Total liabilities  | 572,606       | 553,587   |
| Stockholders' equity   |               |           |
| Preferred stock: \$.01 Par Value, 1,000,000 shares authorized; none issued   | —             | —         |
| Common stock: \$.01 Par Value, 8,000,000 shares authorized; 5,923,742 issued; 5,820,746 shares outstanding at September 30, 2018 and 2017      | 59            | 59        |
| Additional paid-in capital   | 26,310        | 26,289    |
| Treasury stock: 102,996 shares   |               |           |

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|   |           |           |
|---|-----------|-----------|
| at September 30, 2018 and 2017, at cost       | (1,152 )  | (1,152 )  |
| Unearned Employee Stock Ownership Plan shares | (356 )    | (492 )    |
| Retained earnings                             | 27,975    | 25,757    |
| Accumulated other comprehensive loss          | (1,474 )  | (1,004 )  |
| Total stockholders' equity                    | 51,362    | 49,457    |
| Total liabilities and stockholders' equity    | \$623,968 | \$603,044 |

The accompanying notes are an integral part of these consolidated financial statements.

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## MAGYAR BANCORP, INC. AND SUBSIDIARY

## Consolidated Statements of Operations

(In Thousands, Except Share and Per Share Data)

|   | For the Year<br>Ended September 30, |          |
|---|-------------------------------------|----------|
|   | 2018                                | 2017     |
| Interest and dividend income  |                                     |          |
| Loans, including fees   | \$22,604                            | \$20,297 |
| Investment securities   |                                     |          |
| Taxable   | 1,612                               | 1,562    |
| Federal Home Loan Bank of New York stock                            | 134                                 | 119      |
| Total interest and dividend income                                  | 24,350                              | 21,978   |
| Interest expense  |                                     |          |
| Deposits  | 3,896                               | 3,053    |
| Borrowings  | 753                                 | 720      |
| Total interest expense  | 4,649                               | 3,773    |
| Net interest and dividend income                                    | 19,701                              | 18,205   |
| Provision for loan losses   | 997                                 | 1,343    |
| Net interest and dividend income after<br>provision for loan losses | 18,704                              | 16,862   |
| Other income  |                                     |          |
| Service charges   | 1,097                               | 1,256    |
| Income on bank owned life insurance                                 | 293                                 | 293      |
| Other operating income  | 131                                 | 126      |
| Gains on sales of loans   | 493                                 | 324      |
| Gains on sales of investment securities                             | 107                                 | —        |
| Total other income  | 2,121                               | 1,999    |
| Other expenses  |                                     |          |
| Compensation and employee benefits                                  | 9,687                               | 9,084    |
| Occupancy expenses  | 2,941                               | 2,803    |
| Professional fees   | 1,026                               | 1,018    |
| Data processing expenses  | 581                                 | 513      |
| OREO expenses   | 540                                 | 592      |
| FDIC deposit insurance premiums                                     | 426                                 | 498      |

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|   |           |           |
|---|-----------|-----------|
| Loan servicing expenses                               | 322       | 269       |
| Insurance expense                                     | 206       | 233       |
| Other expenses  | 1,595     | 1,434     |
| Total other expenses                                  | 17,324    | 16,444    |
| Income before income tax expense                      | 3,501     | 2,417     |
| Income tax expense                                    | 1,471     | 994       |
| Net income  | \$2,030   | \$1,423   |
| Net income per share-basic and diluted                | \$0.35    | \$0.24    |
| Weighted average basic and diluted shares outstanding | 5,820,746 | 5,820,746 |

The accompanying notes are an integral part of these consolidated financial statements.

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MAGYAR BANCORP, INC. AND SUBSIDIARY

Consolidated Statements of Comprehensive Income

(In Thousands)

|   | For the Year<br>Ended<br>September 30,<br>2018    2017 |         |
|---|--|---------|
| Net income  | \$2,030  | \$1,423 |
| Other comprehensive (loss) income                                     |  |         |
| Unrealized (loss) income on<br>securities available for sale          | (586 )   | (218 )  |
| Less reclassification adjustments for:                                |  |         |
| Net unrealized gains on securities<br>reclassified available for sale | 104  | —       |
| Net gains realized on securities<br>available for sale                | (107 )   | —       |
| Defined benefit pension plan  | 202  | 490     |
| Other comprehensive (loss) income, before tax                         | (387 )   | 272     |
| Deferred income tax effect  | 105  | (117 )  |
| Total other comprehensive (loss) income                               | (282 )   | 155     |
| Total comprehensive income  | \$1,748  | \$1,578 |

The accompanying notes are an integral part of these consolidated financial statements.

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## MAGYAR BANCORP, INC. AND SUBSIDIARY

## Consolidated Statements of Changes in Stockholders' Equity

For the Year Ended September 30, 2018 and 2017

(In Thousands, Except for Share Amounts)

|   | Common Stock<br>Shares<br>Outstanding | Par<br>Value | Additional<br>Paid-In<br>Capital | Treasury<br>Stock | Unearned<br>ESOP<br>Shares | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Total     |
|---|---------------------------------------|--------------|----------------------------------|-------------------|----------------------------|----------------------|---|-----------|
| Balance, September 30, 2016   | 5,820,746                             | \$ 59        | \$ 26,270                        | \$(1,152 )        | \$( 627 )                  | \$ 24,334            | \$( 1,159 )                                   | \$ 47,725 |
| Net income  | —                                     | —            | —                                | —                 | —                          | 1,423                | —   | 1,423     |
| Other comprehensive income  | —                                     | —            | —                                | —                 | —                          | —                    | 155   | 155       |
| ESOP shares allocated   | —                                     | —            | 19                               | —                 | 135                        | —                    | —   | 154       |
| Balance, September 30, 2017   | 5,820,746                             | \$ 59        | \$ 26,289                        | \$(1,152 )        | \$( 492 )                  | \$ 25,757            | \$( 1,004 )                                   | \$ 49,457 |
| Net income  | —                                     | —            | —                                | —                 | —                          | 2,030                | —   | 2,030     |
| Other comprehensive loss  | —                                     | —            | —                                | —                 | —                          | —                    | (282 )  | (282 )    |
| Reclassification of the<br>stranded tax<br>effect related to deferred<br>taxes for: |                                       |              |                                  |                   |                            |                      |   |           |
| Defined benefit pension<br>plan <sup>(1)</sup>                                      | —                                     | —            | —                                | —                 | —                          | 177                  | (177 )  | —         |
| Securities available-for-sale <sup>(1)</sup>  | —                                     | —            | —                                | —                 | —                          | 11                   | (11 )   | —         |
| ESOP shares allocated   | —                                     | —            | 21                               | —                 | 136                        | —                    | —   | 157       |
| Balance, September 30, 2018   | 5,820,746                             | \$ 59        | \$ 26,310                        | \$(1,152 )        | \$( 356 )                  | \$ 27,975            | \$( 1,474 )                                   | \$ 51,362 |

(1) In January 2018, the Company adopted ASU 2018-02, as a result, the Company made a policy election to release income tax effects, as a result of the Tax Act, from AOCI to retained earnings.

The accompanying notes are an integral part of these consolidated financial statements.

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## MAGYAR BANCORP, INC. AND SUBSIDIARY

## Consolidated Statements of Cash Flows

(In Thousands)

|  | For the Year Ended<br>September 30, |           |
|--|-------------------------------------|-----------|
|  | 2018                                | 2017      |
| Operating activities   |                                     |           |
| Net income   | \$2,030                             | \$1,423   |
| Adjustment to reconcile net income to net cash provided<br>by operating activities |                                     |           |
| Depreciation expense   | 861                                 | 816       |
| Premium amortization on investment securities, net                                 | 134                                 | 187       |
| Provision for loan losses  | 997                                 | 1,343     |
| Provision for loss on other real estate owned                                      | 418                                 | 218       |
| Originations of loans held for sale  | (8,167 )                            | (4,382 )  |
| Proceeds from the sales of loans receivable  | 8,660                               | 4,706     |
| Gains on sale of loans receivable  | (493 )                              | (324 )    |
| Gains on sales of investment securities  | (107 )                              | —         |
| (Gains) losses on the sales of other real estate owned                             | (184 )                              | 80        |
| ESOP compensation expense  | 157                                 | 154       |
| Deferred income tax expense  | 710                                 | 997       |
| Increase in accrued interest receivable  | (252 )                              | (219 )    |
| Increase in surrender value bank owned life insurance                              | (293 )                              | (293 )    |
| (Increase) decrease in other assets  | (167 )                              | 155       |
| Increase (decrease) in accrued interest payable                                    | 88                                  | (10 )     |
| Increase (decrease) in accounts payable and other liabilities                      | 230                                 | (1,250 )  |
| Net cash provided by operating activities  | 4,622                               | 3,601     |
| Investing activities   |                                     |           |
| Net increase in loans receivable   | (37,233 )                           | (5,540 )  |
| Purchases of loans receivable  | (5,562 )                            | (12,626 ) |
| Proceeds from the sale of loans receivable   | 3,738                               | —         |
| Purchases of investment securities held to maturity                                | (3,492 )                            | (5,484 )  |
| Purchases of investment securities available for sale                              | (1,443 )                            | (7,931 )  |
| Sales of investment securities held to maturity                                    | 3,408                               | —         |
| Principal repayments on investment securities held to maturity                     | 5,223                               | 6,896     |
| Principal repayments on investment securities available for sale                   | 2,757                               | 1,099     |
| Purchases of premises and equipment  | (284 )                              | (299 )    |
| Investment in other real estate owned  | (191 )                              | (58 )     |
| Proceeds from other real estate owned  | 2,750                               | 1,948     |
| (Purchases) redemptions of Federal Home Loan Bank stock                            | (162 )                              | 237       |
| Net cash used by investing activities  | (30,491 )                           | (21,758 ) |

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|   |          |          |
|---|----------|----------|
| Financing activities  |          |          |
| Net increase in deposits  | 14,936   | 22,551   |
| Net increase in escrowed funds  | 348      | 269      |
| Proceeds from long-term advances  | 8,719    | 865      |
| Repayments of long-term advances  | (5,100 ) | (5,000 ) |
| Net cash provided by financing activities                                     | 18,903   | 18,685   |
| Net (decrease) increase in cash and cash equivalents                          | (6,966 ) | 528      |
|   |          |          |
| Cash and cash equivalents, beginning of period                                | 22,334   | 21,806   |
|   |          |          |
| Cash and cash equivalents, end of period                                      | \$15,368 | \$22,334 |
|   |          |          |
| Supplemental disclosures of cash flow information                             |          |          |
| Cash paid for   |          |          |
| Interest  | \$4,561  | \$3,782  |
| Income taxes  | \$1,066  | \$36     |
| Non-cash investing activities   |          |          |
| Real estate acquired in full satisfaction of loans in foreclosure             | \$—      | \$1,161  |
| Investment securities transferred from held to maturity to available for sale | \$12,619 | \$—      |

The accompanying notes are an integral part of these consolidated financial statements.



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**MAGYAR BANCORP, INC. AND SUBSIDIARY**

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

**NOTE A - ORGANIZATION**

On January 23, 2006, Magyar Bank (the “Bank”) completed a reorganization involving a series of transactions by which Bank’s corporate structure was changed from a mutual savings bank to the mutual holding company form of ownership. Magyar Bank became a New Jersey-chartered stock savings bank subsidiary of Magyar Bancorp, Inc., a Delaware-chartered mid-tier stock holding company. Magyar Bancorp, Inc. (the “Company”) owns 100% of the outstanding shares of common stock of Magyar Bank. Magyar Bancorp, Inc. is a majority-owned subsidiary of Magyar Bancorp, MHC, a New Jersey-chartered mutual holding company.

Magyar Bancorp, MHC, owns 54.0%, or 3,200,450, of the issued shares of common stock of Magyar Bancorp, Inc. Of the remaining shares, 2,620,296, or 44.2%, are held by public stockholders and 102,996, or 1.8%, are held by Magyar Bancorp, Inc. in treasury stock. So long as Magyar Bancorp, MHC exists, it will be required to own a majority of the voting stock of Magyar Bancorp, Inc. Magyar Bancorp, Inc. and Magyar Bancorp, MHC are subject to comprehensive regulation and examination by the Board of Governors of the Federal Reserve System and the New Jersey Department of Banking and Insurance.

The Bank is subject to regulations issued by the New Jersey Department of Banking and Insurance and the Federal Deposit Insurance Corporation (the “FDIC”). The Bank’s administrative office is located in New Brunswick, New Jersey. The Bank has seven branch offices which are located in New Brunswick, North Brunswick, South Brunswick, Branchburg, Bridgewater, and Edison, New Jersey, and a loan product office located in Keyport, New Jersey. The Bank’s savings deposits are insured by the FDIC through the Deposit Insurance Fund (DIF); also, the Bank is a member of the Federal Home Loan Bank of New York.

MagBank Investment Company, a New Jersey investment corporation subsidiary of the Bank, was formed on August 15, 2006 for the purpose of buying, selling and holding investment securities.

Hungaria Urban Renewal, LLC is a Delaware limited-liability corporation established in 2002 as a qualified intermediary operating for the purpose of acquiring and developing the Bank’s new main office. The Bank owns a 100% interest in Hungaria Urban Renewal, LLC, which has no other business other than owning the Bank’s main office site.

Magyar Service Corporation, a New Jersey corporation, is a wholly owned, non-bank subsidiary of the Bank. Magyar Service Corporation, which also operates under the name Magyar Financial Services, receives commissions from annuity and life insurance sales referred to a licensed, non-bank financial planner.

The Bank competes with other banking and financial institutions in its primary market areas. Commercial banks, savings banks, savings and loan associations, credit unions and money market funds actively compete for savings and time certificates of deposit and all types of loans. Such institutions, as well as consumer financial and insurance companies, may be considered competitors of the Bank with respect to one or more of the services it renders.

The Bank is subject to regulations of certain state and federal agencies and, accordingly, the Bank is periodically examined by such regulatory authorities. As a consequence of the regulation of commercial banking activities, the Bank's business is particularly susceptible to future state and federal legislation and regulations.

#### NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### 1. Basis of Financial Statement Presentation

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (US GAAP) and predominant practices within the banking industry. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, the Bank, and its wholly-owned subsidiaries MagBank Investment Company, Magyar Service Corporation, and Hungaria Urban Renewal, LLC. All intercompany balances and transactions have been eliminated in the consolidated financial statements.

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**MAGYAR BANCORP, INC. AND SUBSIDIARY**

Notes to Consolidated Financial Statements

September 30, 2018 and 2017

The Company has evaluated subsequent events and transactions occurring subsequent to the consolidated balance sheet date of September 30, 2018, for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were available to be issued.

In preparing financial statements in conformity with US GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The principal estimates that are particularly susceptible to significant change in the near term relate to the allowance for loan losses and the deferred tax asset. The evaluation of the adequacy of the allowance for loan losses includes an analysis of the individual loans and overall risk characteristics and size of the different loan portfolios, and takes into consideration current economic and market conditions, the capability of specific borrowers to pay specific loan obligations, as well as current loan collateral values. However, actual losses on specific loans, which also are encompassed in the analysis, may vary from estimated losses.

The Company records income taxes using the asset and liability method. Accordingly, deferred tax assets and liabilities: (i) are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns; (ii) are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases; and (iii) are measured using enacted tax rates expected to apply in the years when those temporary differences are expected to be recovered or settled.

Where applicable, deferred tax assets are reduced by a valuation allowance for any portions determined not likely to be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period of enactment. The valuation allowance is adjusted, by a charge or credit to income tax expense, as changes in facts and circumstances warrant.

2. Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, time deposits with original maturities less than three months and overnight deposits.

### 3. Investment Securities

The Company classifies its investment securities into one of three portfolios: held to maturity, available for sale or trading. Investments in debt securities that the Company has the positive intent and ability to hold to maturity are classified as held to maturity securities and reported at amortized cost. Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized holding gains and losses included in earnings. Debt securities not classified as either trading securities or as held to maturity securities are classified as available for sale securities and reported at fair value, with unrealized holding gains or losses, net of deferred income taxes, reported in the accumulated other comprehensive income (“AOCI”) component of stockholders’ equity. Equity securities, with certain exceptions, are measured at fair value with changes in fair value recognized in net income.

If the fair value of a security is less than its amortized cost, the security is deemed to be impaired. Management evaluates all securities with unrealized losses quarterly to determine if such impairments are “temporary” or “other-than-temporary” in accordance with applicable accounting guidance. The Company accounts for temporary impairments based upon security classification as either available for sale, held to maturity or trading. Temporary impairments on “available for sale” securities are recognized, on a tax-effected basis, through AOCI with offsetting entries adjusting the carrying value of the security and the balance of deferred taxes. Conversely, the Company does not adjust the carrying value of “held to maturity” securities for temporary impairments, although information concerning the amount and duration of impairments on held to maturity securities is generally disclosed in periodic consolidated financial statements. The carrying value of securities held in a trading portfolio is adjusted to their fair value through earnings on a daily basis. However, the Company maintained no securities in trading portfolios at or during the periods presented in these consolidated financial statements.

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The Company accounts for other-than-temporary impairments based upon several considerations. First, other-than-temporary impairments on securities that the Company has decided to sell as of the close of a fiscal period, or will, more likely than not, be required to sell prior to the full recovery of their fair value to a level equal to or exceeding their amortized cost, are recognized in operations. If neither of these criteria apply, then the other-than-temporary impairment is separated into credit-related and noncredit-related components. The credit-related impairment generally represents the amount by which the present value of the cash flows that are expected to be collected on an other-than-temporarily impaired security fall below its amortized cost while the noncredit-related component represents the remaining portion of the impairment not otherwise designated as credit-related. The Company recognizes credit-related, other-than-temporary impairments in earnings, while noncredit-related, other-than-temporary impairments on debt securities are recognized, net of deferred taxes, in AOCI.

Federal law requires a member institution of the Federal Home Loan Bank (“FHLB”) system to purchase and hold restricted stock of its district FHLB according to a predetermined formula. This stock is restricted in that it may only be sold to the FHLB and all sales must be at par. Accordingly, the FHLB restricted stock is carried at cost, less any applicable impairment charges.

Premiums and discounts on all securities are amortized or accreted to maturity by use of the level-yield method considering the impact of principal amortization and prepayments on mortgage-backed securities. Gain or loss on sales of securities is recognized on the specific identification method.

4. Loans and Allowance for Loan Losses

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the amount of unpaid principal, adjusted for net deferred loan fees and costs, and reduced by an allowance for loan losses. Interest on loans is accrued and credited to operations based upon the principal amounts outstanding. The allowance for loan losses is established through a provision for possible loan losses charged to operations. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely.

Income recognition of interest is discontinued when, in the opinion of management, the collectability of such interest becomes doubtful. A loan is generally classified as non-accrual when the scheduled payment(s) due on the loan is delinquent for more than three months. Loan origination fees and certain direct origination costs are deferred and amortized over the life of the related loans as an adjustment to the yield on loans receivable using the effective interest method.

Management uses a ten point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized, and are aggregated as “Pass” rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than three months past due are considered Substandard. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as severe delinquency, bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. The Bank’s Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis. The Asset Review Committee performs monthly reviews of all commercial relationships internally rated 6 (“Watch”) or worse. Confirmation of the appropriate risk grade is performed by an external loan review company that semi-annually reviews and assesses loans within the portfolio. Generally, the external consultant reviews commercial relationships greater than \$500,000 and/or criticized relationships greater than \$250,000. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a monthly basis.

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The allowance for loan losses is maintained at an amount management deems adequate to cover estimated losses. In determining the level to be maintained, management evaluates many factors, including current economic trends, industry experience, historical loss experience, industry loan concentrations, the borrowers' ability to repay and repayment performance, and estimated collateral values. In the opinion of management, the present allowance is adequate to absorb reasonable, foreseeable loan losses. While management uses the best information available to make such evaluations, future adjustments to the allowance may be necessary based on changes in economic conditions or any of the other factors used in management's determination. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for losses on loans. Such agencies 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. Charge-offs to the allowance are made when the loan is transferred to other real estate owned or other determination of a confirmed loss. Recoveries on loans previously charged off are also recorded through the allowance.

A loan is considered impaired when, based upon current information and events, it is probable that a creditor will be unable to collect all amounts due including principal and interest, according to the contractual terms of the loan agreement. The Company measures impaired loans based on the present value of expected future cash flows discounted at the loan's effective interest rate or as a practical expedient, at the loan's current observable market price, or the fair value of the collateral if the loan is collateral dependent. The amount by which the recorded investment of an impaired loan exceeds the measurement value is recognized by creating a valuation allowance through a charge to the provision for loan losses. Impairment criteria generally do not apply to those smaller-balance homogeneous loans that are collectively evaluated for impairment which, for the Company, includes one- to four-family first mortgage loans and consumer loans, other than those modified in a troubled debt restructuring.

The Company records cash receipts on impaired loans that are non-performing as a reduction to principal before applying amounts to interest or late charges unless specifically directed by the Bankruptcy Court to apply payments otherwise. The Company may continue to recognize interest income on impaired loans where there is no confirmed loss.

5. Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation, and include capitalized expenditures for new facilities, major betterments and renewals. Expenditures for maintenance and repairs are charged to expense as incurred. Depreciation is computed using the straight-line method based upon the estimated useful lives of the related assets for financial reporting purposes and using the mandated methods by asset type for income tax purposes. Leasehold improvements are depreciated using the straight-line method based upon the initial term of the lease.

The Company accounts for the impairment of long-lived assets in accordance with US GAAP, which requires recognition and measurement for the impairment of long-lived assets to be held and used or to be disposed of by sale. The Company had no impaired long-lived assets at September 30, 2018 and 2017.

#### 6. Revenue recognition

The Company recognizes revenue in the consolidated statements of income as it is earned and when collectability is reasonably assured. The primary source of revenue is interest income from interest earning assets, which is recognized on the accrual basis of accounting using the effective interest method. The recognition of revenues from interest earning assets is based upon formulas from underlying loan agreements, securities contracts, or other similar contracts. Non-interest income is recognized on the accrual basis of accounting as services are provided or as transactions occur. Non-interest income includes earnings on bank-owned life insurance, deposit accounts, merchant services, ATM and debit card fees, mortgage banking activities, and other miscellaneous services and transactions.

#### 7. Other Real Estate Owned

Real estate acquired through foreclosure, or a deed-in-lieu of foreclosure, is recorded at fair value less estimated selling costs at the date of acquisition or transfer, and subsequently at the lower of its net cost or fair value less estimated selling costs. Adjustments to the carrying value at the date of acquisition or transfer are charged to the allowance for loan losses. The carrying value of the individual properties is subsequently adjusted to the extent it exceeds estimated fair value less estimated selling costs, at which time a provision for losses on such real estate is charged to operations.



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Operating expenses of holding real estate, net of related income, are charged against income as incurred. Gains on sales of real estate are recognized, normally at closing, when down payment and certain other requirements are met; otherwise such gains are deferred and recognized on the installment method of accounting. Losses on the disposition of real estate, including expenses incurred in connection with the disposition, are charged to operations.

8. Pension and Postretirement Plans

The Company sponsors qualified defined benefit pension plan and supplemental executive retirement plan (SERP). The qualified defined benefit pension plan is funded with trust assets invested in a diversified portfolio of debt and equity securities. Accounting for pensions and other postretirement benefits involves estimating the cost of benefits to be provided well into the future and attributing that cost over the time period each employee works. This involves extensive use of assumptions about inflation, investment returns, mortality, turnover, and discount rates. Among other factors, changes in interest rates, investment returns and the market value of plan assets can (i) affect the level of plan funding; (ii) cause volatility in the net periodic pension cost; and (iii) increase our future contribution requirements. A significant decrease in investment returns or the market value of plan assets or a significant decrease in interest rates could increase our net periodic pension costs and adversely affect our results of operations. A significant increase in our contribution requirements with respect to our qualified defined benefit pension plan could have an adverse impact on our cash flow. Changes in the key actuarial assumptions would impact net periodic benefit expense and the projected benefit obligation for our defined benefit and other postretirement benefit plan. See Note M, "Pension Plan," and Note N, "Non-Qualified Compensation Plan" for information on these plans and the assumptions used.

9. Income Taxes

The Company and its subsidiaries file consolidated federal and individual state income tax returns. Income taxes are allocated based on the contribution of their respective income or loss to the consolidated income tax return.

The Company records income taxes on the basis of reported income using the asset and liability method. Accordingly, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. To the extent that current available evidence about the future raises doubt about the realization of a deferred tax asset, a valuation allowance is established. 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.

The Company follows the provisions of Financial Accounting Standards Board Accounting Standards Codification Topic 740, which provides clarification on accounting for uncertainty in income taxes recognized in an enterprise's

financial statements. The guidance prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company recorded additional tax expense for the year ended September 30, 2018 due to higher income from operations and the write-down of its net deferred tax asset due to the enactment of the Tax Cuts and Jobs Act on December 22, 2017, which lowered the Company's federal income tax rate from 34% to 21%. The Company recognized additional tax expense in its tax provision for the year ended September 30, 2018 related to adjustment of our net deferred tax asset to reflect the new corporate tax rate. See Note L, "Income Taxes" for information on the Company's income tax expense and deferred tax asset for the years ended September 30, 2018 and 2017.

At September 30, 2018 and 2017, no significant income tax uncertainties have been included in the Company's Consolidated Balance Sheets. The Company's policy is to recognize interest and penalties on unrecognized tax benefits in income tax expense in the Consolidated Statements of Operations. No interest and penalties were recorded during the years ended September 30, 2018 and 2017. The tax years subject to examination by the taxing authorities are the years ended September 30, 2013 and forward.

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10. Advertising Costs

The Company expenses advertising costs as incurred.

11. Earnings Per Share

Basic income per share is calculated by dividing income available to common stockholders by the weighted average number of shares of common stock outstanding for the period. The weighted average common shares outstanding include shares held by the Magyar Bancorp, MHC and shares allocated to the Employee Stock Ownership Plan.

Diluted income per share is calculated by adjusting the weighted average common shares outstanding to reflect the potential dilution that could occur using the treasury stock method if securities or other contracts to issue common stock, such as stock options and unvested restricted stock, were exercised and converted into common stock. The resulting shares issued would share in the earnings of the Company. Shares issued and shares reacquired during the period are weighted for the portion of the period that they were outstanding. In periods of loss, dilution is not calculated and diluted loss per share is equal to basic loss per share.

The following table illustrates the reconciliation of the numerators and denominators of the basic and diluted earnings per share (EPS) calculations. All stock options were anti-dilutive at September 30, 2018 and 2017.

|   | For the Years Ended September 30,               |                        |                  |                               |                        |         |
|---|---|------------------------|------------------|-------------------------------|------------------------|---------|
|   | 2018  |                        | 2017             |                               |                        |         |
|   | Weighted<br>average<br>Income<br>shares         | Per<br>share<br>Amount | Income<br>shares | Weighted<br>average<br>shares | Per<br>share<br>Amount |         |
|   | (In thousands, except share and per share data) |                        |                  |                               |                        |         |
| Basic EPS                                   |   |                        |                  |                               |                        |         |
| Net income available to common shareholders | \$2,030   | 5,820,746              | \$ 0.35          | \$1,423                       | 5,820,746              | \$ 0.24 |
| Effect of dilutive securities               |   |                        |                  |                               |                        |         |
| Options and grants                          | —   | —                      | —                | —                             | —                      | —       |
| Diluted EPS                                 |   |                        |                  |                               |                        |         |

|   |         |           |         |         |           |         |
|---|---------|-----------|---------|---------|-----------|---------|
| Net income available to common shareholders plus assumed conversion | \$2,030 | 5,820,746 | \$ 0.35 | \$1,423 | 5,820,746 | \$ 0.24 |
|---|---------|-----------|---------|---------|-----------|---------|

12. Comprehensive Income (Loss) and Accumulated Other Comprehensive Income (Loss)

Comprehensive income (loss) includes net income as well as certain other items which result in a change to equity during the period. The other items allocated to comprehensive income (loss), as well as the related income tax effects, for the years ended September 30, 2018 and 2017 were as follows:

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## Notes to Consolidated Financial Statements

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|  | September 30,<br>2018                     |                             | 2017                    |                         |                             |                         |
|--|---|-----------------------------|-------------------------|-------------------------|-----------------------------|-------------------------|
|  | Before<br>Tax<br>Amount<br>(In thousands) | Tax<br>(Benefit)<br>Expense | Net of<br>Tax<br>Amount | Before<br>Tax<br>Amount | Tax<br>(Benefit)<br>Expense | Net of<br>Tax<br>Amount |
| Unrealized holding (losses) gains arising during period on:            |   |                             |                         |                         |                             |                         |
| Available-for-sale investments   | \$ (586)                                  | \$ 161                      | \$ (425 )               | \$ (218)                | \$ 79                       | \$ (139 )               |
| Less reclassification adjustment for:                                  |   |                             |                         |                         |                             |                         |
| Net unrealized gains on securities reclassified available-for-sale     | 104                                       | (32 )                       | 72                      | —                       | —                           | —                       |
| Net gains realized on securities available-for-sale <sup>(a) (b)</sup> | (107)                                     | 33                          | (74 )                   | —                       | —                           | —                       |
| Defined benefit pension plan   | 202                                       | (57 )                       | 145                     | 490                     | (196 )                      | 294                     |
| Other comprehensive income (loss), net                                 | \$ (387)                                  | \$ 105                      | \$ (282 )               | \$ 272                  | \$ (117 )                   | \$ 155                  |

(a) Realized gains on securities transactions included in gains on sales of investment securities in the accompanying Consolidated Statements of Operations

(b) Tax effect included in income tax expense in the accompanying Consolidated Statements of Operations

The components of accumulated other comprehensive loss at September 30, 2018 and 2017 were as follows:

|  | September 30,<br>2018 |            | 2017           |  |
|--|-----------------------|------------|----------------|--|
|  | (In thousands)        |            | (In thousands) |  |
| Available-for-sale investments             | \$ (544 )             | \$ (106 )  |                |  |
| Defined benefit pension plan               | (930 )                | (898 )     |                |  |
| Total accumulated other comprehensive loss | \$ (1,474)            | \$ (1,004) |                |  |

13. Bank-Owned Life Insurance

The Company has purchased Bank-Owned Life Insurance policies (“BOLI”). BOLI involves the purchasing of life insurance by the Company on directors and executive officers. The proceeds are used to help defray the costs of non-qualified compensation plans. The Company is the owner and beneficiary of the policies. BOLI is recorded on the Consolidated Balance Sheets at its cash surrender value and changes in the cash surrender value are recorded in other income in the Consolidated Statement of Operations.

#### 14. Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under commercial lines of credit. Such financial instruments are recorded when they are funded. The Company does not engage in the use of derivative financial instruments. See Note Q, “Financial Instruments With Off-Balance Risk”.

#### 15. Segment Reporting

The Company acts as an independent, community, financial services provider, and offers traditional banking and related financial services to individual, business and government customers. The Company offers a full array of commercial and retail financial services, including the taking of time, savings and demand deposits; the making of commercial, consumer and home equity loans; and the provision of other financial services.

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Management does not separately allocate expenses, including the cost of funding loan demand, between the commercial and retail operations of the Company. As such, discrete financial information is not available and segment reporting would not be meaningful.

16. New Accounting Pronouncements

In connection with the preparation of quarterly and annual reports in accordance with the Securities and Exchange Commission's ("SEC") Securities Exchange Act of 1934, SEC Staff Accounting Bulletin Topic 11.M requires the disclosure of the impact that recently issued accounting standards will have on financial statements when they are adopted in the future.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which will supersede the current revenue recognition requirements in Topic 605, *Revenue Recognition*. The ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In August 2015, the FASB issued ASU 2015-14 which deferred the effective date of ASU 2014-09 by one year. The new guidance is effective for public companies for periods beginning after December 15, 2017. The ASU permits application of the new revenue recognition guidance to be applied using one of two retrospective application methods.

Based on our evaluation under the current guidance, we estimated that substantially all of our interest income and non-interest income will not be impacted by the adoption of ASU 2014-09 because either the revenue from those contracts with customers is covered by other guidance in US GAAP or the revenue recognition outcomes anticipated with the adoption of ASU 2014-09 will likely be similar to our current revenue recognition practices. The Company evaluated certain noninterest revenue streams, including, deposit related fees, service and interchange fees, and merchant income to determine the potential impact of the guidance on the Company's consolidated financial statements. The Company expects additional financial statement disclosures of non-interest income revenue streams with the adoption of this ASU. In addition, we are reviewing our business processes, systems and controls to support recognition and disclosures under the new standard. The Company is expected to use the modified retrospective method for transition in which the cumulative effect will be recognized at the date of adoption with no restatement of comparative periods presented. The adoption of the ASU is not expected to have a material effect on the Company's consolidated financial statements.

In January 2016, FASB issued ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income; (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; and (vii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. In addition, the amendments in this ASU require an entity to disclose the fair value of its financial instruments using the exit price notion. Exit price is 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. For public entities, the guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The Company has updated the fair value disclosure on Note R “Fair Value Disclosures” in this report to reflect adoption of this standard, to include using the exit price notion in the fair value disclosure of financial instruments. The Company’s adoption of the ASU did not have a significant impact on the Company’s consolidated financial statements.



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In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which will supersede the current lease requirements in Topic 840. The ASU requires lessees to recognize a right of use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of income. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new guidance will be effective for years beginning after December 15, 2018 for public companies. Once effective, the standard will be applied using a modified retrospective transition method to the beginning of the earliest period presented. The Company is currently assessing the impacts this new standard will have on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses*. ASU 2016-13 requires entities to report “expected” credit losses on financial instruments and other commitments to extend credit rather than the current “incurred loss” model. These expected credit losses for financial assets held at the reporting date are to be based on historical experience, current conditions, and reasonable and supportable forecasts. This ASU will also require enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an entity’s portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. For public business entities that are U.S. Securities and Exchange Commission filers, the amendments are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently evaluating the impact the adoption of ASU 2016-13 will have on its consolidated financial statements.

In August 2017, the FASB issued the ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. The purpose of this guidance is to better align a company’s financial reporting for hedging relationships with the company’s risk management activities by expanding strategies that qualify for hedge accounting, modifying the presentation of certain hedging relationships in the financial statements and simplifying the application of hedge accounting in certain situations. ASU 2017-12 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted in any interim or annual period before the effective date. ASU 2017-12 will be applied using a modified retrospective approach through a cumulative-effect adjustment related to the elimination of the separate measurement of ineffectiveness to the balance of accumulated other comprehensive income with a corresponding adjustment to retained earnings as of the beginning of the fiscal year in which the amendments in this update are adopted. The amended presentation and disclosure guidance is required only prospectively. Upon adoption, the ASU allows for the reclassification of debt securities eligible to be hedged under the ASU from held-to-maturity to available-for-sale. The Company adopted ASU 2017-12 during the quarter ended December 31, 2017 and reclassified ten mortgage-backed securities totaling \$12.6 million from the held-to-maturity portfolio to the available-for-sale portfolio.

In February 2018, the FASB issued ASU 2018-02, *Income Statement- Reporting Comprehensive Income (Topic 220) – Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The amendments in this update affect any entity that is required to apply the provisions of Topic 220, Income Statement- Reporting Comprehensive Income. Deferred tax assets (“DTAs”) related to defined pension benefit plans and securities available for sale that were revalued as of December 31, 2017 created “stranded tax effects” in Accumulated Other Comprehensive Income (“AOCI”) due to the enactment of the Tax Cuts and Jobs Act (the “Tax Act”). Existing GAAP required recognition of the tax rate change effects on the DTA revaluation as an adjustment to income tax expense. As a result the AOCI contained the stranded amounts from prior periods at the previous tax rate. ASU 2018-12 permits the reclassification of the stranded amounts from AOCI to retained earnings resulting from the Tax Act. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Act, the underlying GAAP guidance that requires the effect of a change in tax laws or rates to be included in income from continuing operations is not affected. The amendments in this update are optional and are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption of the amendments is permitted, including adoption in any interim period.

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The Company adopted the provisions of ASU 2018-02 effective September 30, 2018 and elected to record a reclassification adjustment of \$188,000 from AOCI to retained earnings in the consolidated statements of stockholders' equity for stranded tax effects resulting from enactment of the Tax Act.

**NOTE C – STOCK-BASED COMPENSATION**

The Company follows FASB Accounting Standards Codification (“ASC”) Section 718, Compensation-Stock Compensation, which covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. ASC 718 requires that compensation cost relating to share-based payment transactions be recognized in financial statements. The cost is measured based on the fair value of the equity or liability instruments issued.

Stock options generally vest over a five-year service period and expire ten years from issuance. The fair values of all option grants were estimated using the Black-Scholes option-pricing model. Management recognizes compensation expense for the fair values of these awards, which have graded vesting, on a straight-line basis over the vesting period of the awards. Once vested, these awards are irrevocable.

There was no activity for the Company’s stock option plan for the year ended September 30, 2018.

The following is a summary of the status of the Company’s stock option activity and related information for its option plan for the year ended September 30, 2017 and 2018.

|                               | Number<br>of<br>Stock<br>Options | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Aggregate<br>Intrinsic<br>Value |
|-------------------------------|----------------------------------|--|---|---------------------------------|
| Balance at September 30, 2016 | 188,276                          | \$ 14.61                                 | 0.4<br>years  | \$ —                            |
| Granted                       | —                                | —  |   |                                 |
| Exercised                     | —                                | —  |   |                                 |

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|                                   |           |       |      |      |
|-----------------------------------|-----------|-------|------|------|
| Forfeited                         | —         | —     |      |      |
| Expired                           | (188,276) | 14.61 |      |      |
| Balance at September 30, 2017     | —         | \$ —  | \$ — | \$ — |
| Granted                           | —         | —     |      |      |
| Exercised                         | —         | —     |      |      |
| Forfeited                         | —         | —     |      |      |
| Expired                           | —         | —     |      |      |
| Balance at September 30, 2018     | —         | \$ —  | \$ — | \$ — |
| Exercisable at September 30, 2018 | —         | \$ —  | \$ — | \$ — |

There were no grants, vested shares or forfeitures of non-vested restricted stock awards as of or during the twelve months ended September 30, 2018 and 2017.

There were no stock option and stock award expenses included with compensation expense for the years ended September 30, 2018 and 2017.

The Company has an Employee Stock Ownership Plan ("ESOP") for the benefit of employees who meet the eligibility requirements as defined in the plan. The ESOP trust purchased 217,863 shares of common stock in the open market using proceeds of a loan from the Company. The total cost of shares purchased by the ESOP trust was \$2.3 million, reflecting an average cost per share of \$10.58. The Bank will make cash contributions to the ESOP on an annual basis sufficient to enable the ESOP to make the required loan payments to the Company. The loan bears a variable interest rate that adjusts annually to Prime Rate (4.50% at January 1, 2018) with principal and interest payable annually in equal installments over thirty years. The loan is secured by shares of the Company's stock.

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As the debt is repaid, shares are released as collateral and allocated to qualified employees. Accordingly, the shares pledged as collateral are reported as unearned ESOP shares in the Consolidated Balance Sheets. The Company accounts for its ESOP in accordance with FASB ASC Topic 718, "Employer's Accounting for Employee Stock Ownership Plans". As shares are released from collateral, the Company reports compensation expense equal to the current market price of the shares, and the shares become outstanding for earnings per share computations. The Company's contribution expense for the ESOP was \$157,000 and \$154,000 for years ended September 30, 2018 and 2017, respectively.

The following table presents the components of the ESOP shares as of September 30, 2018:

|   |             |
|---|-------------|
| Unreleased shares at September 30, 2017                                 | 52,092      |
| Shares released for allocation during the year ended September 30, 2018 | (12,445 )   |
| Unreleased shares at September 30, 2018                                 | 39,647      |
| Total released shares   | 178,216     |
| <br>Total ESOP shares   | <br>217,863 |

The aggregate fair value of the unreleased shares at September 30, 2018 was approximately \$482,000.

**NOTE D - INVESTMENT SECURITIES**

The amortized cost, gross unrealized gains or losses and fair value of the Company's investment securities available-for-sale and held-to-maturity are as follows:

| September 30, 2018 |                        |                         |            |
|--------------------|------------------------|-------------------------|------------|
| Amortized Cost     | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|                    |                        |                         |            |
| (In thousands)     |                        |                         |            |

Securities available-for-sale:

Obligations of U.S. government agencies:

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|   |          |       |         |            |
|---|----------|-------|---------|------------|
| Mortgage backed securities - residential              | \$1,463  | \$ 40 | \$ (8   | ) \$1,495  |
| Obligations of U.S. government-sponsored enterprises: |          |       |         |            |
| Mortgage-backed securities-residential                | 19,262   | 13    | (662    | ) 18,613   |
| Debt securities                                       | 2,500    | —     | (139    | ) 2,361    |
| Total securities available for sale                   | \$23,225 | \$ 53 | \$ (809 | ) \$22,469 |

September 30, 2018

|  | Gross<br>Amortized<br>Cost | Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--|----------------------------|---------------------|-------------------------------|---------------|
| (In thousands)   |                            |                     |                               |               |
| Securities held-to-maturity:                           |                            |                     |                               |               |
| Obligations of U.S. government agencies:               |                            |                     |                               |               |
| Mortgage-backed securities - residential               | \$568                      | \$ —                | \$ (93                        | ) \$475       |
| Mortgage-backed securities - commercial                | 904                        | —                   | (9                            | ) 895         |
| Obligations of U.S. government-sponsored enterprises:  |                            |                     |                               |               |
| Mortgage backed securities - residential               | 26,316                     | 4                   | (867                          | ) 25,453      |
| Debt securities  | 2,464                      | —                   | (142                          | ) 2,322       |
| Private label mortgage-backed securities - residential | 393                        | 1                   | —                             | 394           |
| Corporate securities                                   | 3,000                      | —                   | (388                          | ) 2,612       |
| Total securities held to maturity                      | \$33,645                   | \$ 5                | \$ (1,499                     | ) \$32,151    |

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September 30, 2018 and 2017

|   | At September 30, 2017 |            |            |          |
|---|-----------------------|------------|------------|----------|
|   | Gross                 | Gross      |            | Fair     |
|   | Amortized             | Unrealized | Unrealized | Value    |
|   | Cost                  | Gains      | Losses     |          |
|   | (In thousands)        |            |            |          |
| Securities available-for-sale:                        |                       |            |            |          |
| Obligations of U.S. government-sponsored enterprises: |                       |            |            |          |
| Mortgage-backed securities-residential                | \$9,442               | \$ 9       | \$ (125 )  | \$9,326  |
| Debt securities                                       | 2,500                 | —          | (51 )      | 2,449    |
| Private label mortgage-backed securities-residential  | 40                    | —          | —          | 40       |
| Total securities available-for-sale                   | \$11,982              | \$ 9       | \$ (176 )  | \$11,815 |

|  | At September 30, 2017 |            |            |          |
|--|-----------------------|------------|------------|----------|
|  | Gross                 | Gross      |            | Fair     |
|  | Amortized             | Unrealized | Unrealized | Value    |
|  | Cost                  | Gains      | Losses     |          |
|  | (In thousands)        |            |            |          |
| Securities held-to-maturity:                           |                       |            |            |          |
| Obligations of U.S. government agencies:               |                       |            |            |          |
| Mortgage-backed securities - residential               | \$3,466               | \$ 123     | \$ (96 )   | \$3,493  |
| Mortgage-backed securities - commercial                | 968                   | —          | (10 )      | 958      |
| Obligations of U.S. government-sponsored enterprises:  |                       |            |            |          |
| Mortgage backed securities - residential               | 39,016                | 349        | (251 )     | 39,114   |
| Debt securities  | 4,461                 | —          | (24 )      | 4,437    |
| Private label mortgage-backed securities - residential | 457                   | —          | (2 )       | 455      |
| Corporate securities                                   | 3,000                 | —          | (216 )     | 2,784    |
| Total securities held-to-maturity                      | \$51,368              | \$ 472     | \$ (599 )  | \$51,241 |

The contractual maturities of mortgage-backed securities generally exceed 10 years; however, the effective lives are expected to be shorter due to anticipated prepayments. The amortized cost and fair value of the Company's securities available-for-sale at September 30, 2018 are summarized in the following table:

September 30,  
2018  
(In thousands)  
Amortized Fair  
Cost Value

|                                 |          |          |
|---------------------------------|----------|----------|
| Due within 1 year               | \$—      | \$—      |
| Due after 1 but within 5 years  | 1,500    | 1,411    |
| Due after 5 but within 10 years | 1,000    | 950      |
| Due after 10 years              | —        | —        |
| Total debt securities           | 2,500    | 2,361    |
| Mortgage-backed securities:     |          |          |
| Residential <sup>(1)</sup>      | 20,725   | 20,108   |
| Commercial                      | —        | —        |
| Total                           | \$23,225 | \$22,469 |

Available-for-sale mortgage-backed securities – residential include an amortized cost of \$1.5 million and a fair value of \$1.5 million for obligations of U.S. government agencies issued by the Government National Mortgage Association and obligations of U.S. government-sponsored enterprises issued by Federal National Mortgage Association and Federal Home Loan Mortgage Corporation which had an amortized cost of \$19.3 million and a fair value of \$18.6 million. There were no residential mortgage backed securities issued by non-U.S. government agencies and government-sponsored enterprises.



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The maturities of the debt securities and the mortgage-backed securities held to maturity at September 30, 2018 are summarized in the following table:

|                                 | September 30,<br>2018 |               |
|---------------------------------|-----------------------|---------------|
|                                 | Amortized<br>Cost     | Fair<br>Value |
|                                 | (In thousands)        |               |
| Due within 1 year               | \$—                   | \$—           |
| Due after 1 but within 5 years  | 1,499                 | 1,446         |
| Due after 5 but within 10 years | 3,000                 | 2,612         |
| Due after 10 years              | 965                   | 876           |
| Total debt securities           | 5,464                 | 4,934         |
| Mortgage backed securities:     |                       |               |
| Residential <sup>(1)</sup>      | 27,277                | 26,322        |
| Commercial <sup>(2)</sup>       | 904                   | 895           |
| Total                           | \$33,645              | \$32,151      |

Held-to-maturity mortgage-backed securities – residential include an amortized cost of \$568,000 and a fair value of \$475,000 for obligations of U.S. government agencies issued by the Government National Mortgage Association and obligations of U.S. government-sponsored enterprises issued by Federal National Mortgage Association and <sup>(1)</sup> Federal Home Loan Mortgage Corporation which had an amortized cost of \$26.3 million and a fair value of \$25.5 million. Also included are mortgage backed securities issued by non-U.S. government agencies and government-sponsored enterprises with an amortized cost of \$393,000 and a fair value of \$394,000.

<sup>(2)</sup> Held-to-maturity mortgage-backed securities – commercial include an amortized cost of \$904,000 and a fair value of \$895,000 for obligations of U.S. government agencies issued by the Small Business Administration.

There were no sales of securities from the available-for-sale portfolios during the year ended September 30, 2018 and 2017.

There were \$3.4 million sales of securities from the held-to-maturity portfolios during the year ended September 30, 2018 and there were no sales from the held-to-maturity portfolios during the year ended September 30, 2017. In

accordance with ASC 320 “Investments- Debt and Equity Securities”, sales from the held to maturity portfolio occurred after the Company had already collected a substantial portion (at least 85 percent) of the principal outstanding at acquisition due to prepayments on the debt security. The net gain on sales of held-to-maturity securities totaled \$107,000 for the year ended September 30, 2018.

As of September 30, 2018 and 2017, securities having an estimated fair value of approximately \$25.0 million and \$21.8 million, respectively, were pledged to secure public deposits.

Details of securities with unrealized losses at September 30, 2018 and 2017 are as follows:

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|  | Number<br>of<br>Securities | September 30, 2018     |                      |                         |                      |               |                      |
|--|----------------------------|------------------------|----------------------|-------------------------|----------------------|---------------|----------------------|
|  |                            | Less Than 12<br>Months |                      | 12 Months Or<br>Greater |                      | Total         |                      |
|  |                            | Fair<br>Value          | Unrealized<br>Losses | Fair<br>Value           | Unrealized<br>Losses | Fair<br>Value | Unrealized<br>Losses |
| (Dollars in thousands)                               |                            |                        |                      |                         |                      |               |                      |
| Obligations of U.S. government agencies:             |                            |                        |                      |                         |                      |               |                      |
| Mortgage-backed securities - residential             | 3                          | \$532                  | \$ (8 )              | \$475                   | \$ (93 )             | \$1,007       | \$ (101 )            |
| Mortgage-backed securities - commercial              | 1                          | —                      | —                    | 895                     | (9 )                 | 895           | (9 )                 |
| Obligations of U.S. government-sponsored enterprises |                            |                        |                      |                         |                      |               |                      |
| Mortgage-backed securities - residential             | 34                         | 11,336                 | (312 )               | 30,605                  | (1,217 )             | 41,941        | (1,529 )             |
| Debt securities                                      | 4                          | —                      | —                    | 4,683                   | (281 )               | 4,683         | (281 )               |
| Private label mortgage-backed securities residential | 1                          | —                      | —                    | 104                     | —                    | 104           | —                    |
| Corporate securities                                 | 1                          | —                      | —                    | 2,612                   | (388 )               | 2,612         | (388 )               |
| Total  | 44                         | \$11,868               | \$ (320 )            | \$39,374                | \$ (1,988 )          | \$51,242      | \$ (2,308 )          |

|  | Number<br>of<br>Securities | September 30, 2017     |                      |                         |                      |               |                      |
|--|----------------------------|------------------------|----------------------|-------------------------|----------------------|---------------|----------------------|
|  |                            | Less Than 12<br>Months |                      | 12 Months Or<br>Greater |                      | Total         |                      |
|  |                            | Fair<br>Value          | Unrealized<br>Losses | Fair<br>Value           | Unrealized<br>Losses | Fair<br>Value | Unrealized<br>Losses |
| (Dollars in thousands)                               |                            |                        |                      |                         |                      |               |                      |
| Obligations of U.S. government agencies:             |                            |                        |                      |                         |                      |               |                      |
| Mortgage-backed securities- residential              | 2                          | \$—                    | \$ —                 | \$605                   | \$ (96 )             | \$605         | \$ (96 )             |
| Mortgage-backed securities - commercial              | 1                          | 958                    | (10 )                | —                       | —                    | 958           | (10 )                |
| Obligations of U.S. government-sponsored enterprises |                            |                        |                      |                         |                      |               |                      |
| Mortgage backed securities- residential              | 20                         | 6,582                  | (92 )                | 21,713                  | (284 )               | 28,295        | (376 )               |
| Debt securities                                      | 5                          | 4,890                  | (71 )                | 1,996                   | (4 )                 | 6,886         | (75 )                |
| Private label mortgage-backed securities-residential | 2                          | —                      | —                    | 193                     | (2 )                 | 193           | (2 )                 |
| Corporate securities                                 | 1                          | —                      | —                    | 2,784                   | (216 )               | 2,784         | (216 )               |
| Total  | 31                         | \$12,430               | \$ (173 )            | \$27,291                | \$ (602 )            | \$39,721      | \$ (775 )            |

The investment securities listed above currently have fair values less than amortized cost and therefore contain unrealized losses. The Company evaluated these securities and determined that the decline in value was primarily related to fluctuations in the interest rate environment and were not related to any company or industry specific event.

The Company anticipates full recovery of amortized costs with respect to these securities. The Company does not intend to sell these securities and has determined that it is not more likely than not that the Company would be required to sell these securities prior to maturity or market price recovery. Management has considered factors regarding other than temporarily impaired securities and determined that there are no securities with impairment that is other than temporary as of September 30, 2018 and 2017.

#### NOTE E - LOANS RECEIVABLE, NET

Loans receivable are comprised of the following:

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|                                 | September<br>30,<br>2018 | September<br>30,<br>2017 |
|---------------------------------|--------------------------|--------------------------|
|                                 | (In thousands)           |                          |
| One-to four-family residential  | \$ 185,287               | \$ 178,336               |
| Commercial real estate          | 219,347                  | 207,118                  |
| Construction                    | 30,412                   | 22,622                   |
| Home equity lines of credit     | 17,982                   | 18,536                   |
| Commercial business             | 53,320                   | 41,113                   |
| Other                           | 6,150                    | 6,266                    |
| Total loans receivable          | 512,498                  | 473,991                  |
| Net deferred loan costs         | 132                      | 177                      |
| Allowance for loan losses       | (4,200 )                 | (3,475 )                 |
| <br>Total loans receivable, net | <br>\$ 508,430           | <br>\$ 470,693           |

Certain directors and executive officers of the Company have loans with the Bank. Such loans were made in the ordinary course of business at the Bank's normal credit terms, including interest rate and collateralization, and do not represent more than a normal risk of collection. Total loans receivable from directors and executive officers, and affiliates thereof, were approximately \$2.8 million and \$2.9 million at September 30, 2018 and 2017, respectively. There were \$137,000 in new advances on existing lines of credit during the year ended September 30, 2018 and there were no principal additions during the year ended September 30, 2017. Total principal repayments were approximately \$231,000 and \$305,000 for the year ended September 30, 2018 and 2017, respectively.

At September 30, 2018 and 2017, the Company was servicing loans for others amounting to approximately \$41.4 million and \$38.7 million, respectively. The Company held mortgage servicing rights in the amount of \$45,000 and \$69,000 at September 30, 2018 and 2017, respectively. Servicing loans for others generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors, and foreclosure processing. Loan servicing income is recorded on the cash basis and includes servicing fees from investors and certain charges collected from borrowers, such as late payment fees. In connection with loans serviced for others, the Company held borrowers' escrow balances of approximately \$78,000 and \$97,000 at September 30, 2018 and 2017, respectively.

The segments of the Bank's loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The residential mortgage loan segment is further disaggregated into two classes: amortizing term loans, which are primarily first liens, and home equity lines of credit, which are generally second liens. The commercial loan segment is further disaggregated into three classes: loans secured by multifamily structures, owner-occupied

commercial structures, and non-owner occupied nonresidential properties. The construction loan segment consists primarily of developers or investors for the purpose of acquiring, developing and constructing residential or commercial structures and to a lesser extent one-to-four family residential construction loans made to individuals for the acquisition of and/or construction on a lot or lots on which a residential dwelling is to be built. Construction loans to developers and investors have a higher risk profile because the ultimate buyer, once development is completed, is generally not known at the time of the loan. The commercial business loan segment consists of loans made for the purpose of financing the activities of commercial customers and consists primarily of revolving lines of credit. The consumer loan segment consists primarily of stock-secured installment loans, but also includes unsecured personal loans and overdraft lines of credit connected with customer deposit accounts.

Management evaluates individual loans in all segments for possible impairment if the loan either is in nonaccrual status, or is risk rated Substandard and is greater than 90 days past due. Loans are considered to be 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 evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. 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.

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Once the determination has been made that a loan is impaired, the recorded investment in the loan is compared to the fair value of the loan using one of three methods: (a) the present value of expected future cash flows discounted at the loan's effective interest rate; (b) the loan's current observable market price; or (c) the fair value of the collateral securing the loan, less anticipated selling and disposition costs. The method is selected on a loan-by loan basis, with management primarily utilizing the fair value of collateral method. If there is a shortfall between the fair value of the loan and the recorded investment in the loan, the Company charges the difference to the allowance for loan loss as a charge-off and carries the impaired loan on its books at fair value. It is the Company's policy to evaluate impaired loans on an annual basis to ensure the recorded investment in a loan does not exceed its fair value.

The following tables present impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary for the periods presented:

|   | Impaired<br>Loans with<br>Specific<br>Allowance | Impaired<br>Loans<br>with No<br>Specific<br>Allowance | Total Impaired<br>Loans | Unpaid<br>Principal<br>Balance |
|---|---|---|-------------------------|--------------------------------|
| At and for the year ended<br>September 30, 2018 | Recorded<br>Investment<br>(In thousands)        | Recorded<br>Investment                                | Recorded<br>Investment  | Balance                        |
| One-to four-family residential                  | \$—   | \$ 1,132  | \$1,132                 | \$ 1,132                       |
| Commercial real estate                          | —   | 3,961   | 3,961                   | 3,961                          |
| Home equity lines of credit                     | —   | 58  | 58                      | 58                             |
| Commercial business                             | —   | 710   | 710                     | 801                            |
| Total impaired loans                            | \$—   | \$ 5,861  | \$5,861                 | \$ 5,952                       |

|  | Impaired<br>Loans with<br>Specific<br>Allowance | Impaired<br>Loans<br>with No<br>Specific<br>Allowance | Total Impaired<br>Loans | Unpaid |
|--|---|---|-------------------------|--------|
|--|---|---|-------------------------|--------|

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| At and for the year ended<br>September 30, 2017 | Recorded<br>Investment<br>(In thousands) | Recorded<br>Investment | Recorded<br>Investment | Principal<br>Balance |
|---|--|------------------------|------------------------|----------------------|
| One-to four-family residential                  | \$—                                      | \$ 3,124               | \$3,124                | \$ 3,436             |
| Commercial real estate                          | —  | 4,088                  | 4,088                  | 4,110                |
| Commercial business                             | —  | 243                    | 243                    | 243                  |
| Total impaired loans                            | \$—                                      | \$ 7,455               | \$7,455                | \$ 7,789             |

The average recorded investment in impaired loans was \$6.1 million and \$8.6 million for the years ended September 30, 2018 and 2017, respectively. The Company's impaired loans include \$1.2 million in delinquent loans and \$4.7 million in performing Troubled Debt Restructurings ("TDRs"), as TDRs remain impaired loans until fully repaid. During the years ended September 30, 2018 and 2017, interest income of \$238,000 and \$253,000, respectively, was recognized for TDR loans while no interest income was recognized for delinquent non-accrual loans.

The following tables present the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the Bank's internal risk rating system for the periods presented:



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|                                | Pass           | Special<br>Mention | Substandard | Doubtful | Total      |
|--------------------------------|----------------|--------------------|-------------|----------|------------|
|                                | (In thousands) |                    |             |          |            |
| September 30, 2018             |                |                    |             |          |            |
| One-to four-family residential | \$ 185,118     | \$ —               | \$ 169      | \$ —     | \$ 185,287 |
| Commercial real estate         | 217,935        | 753                | 659         | —        | 219,347    |
| Construction                   | 30,412         | —                  | —           | —        | 30,412     |
| Home equity lines of credit    | 17,924         | —                  | 58          | —        | 17,982     |
| Commercial business            | 52,845         | —                  | 475         | —        | 53,320     |
| Other                          | 6,150          | —                  | —           | —        | 6,150      |
| Total                          | \$510,384      | \$ 753             | \$ 1,361    | \$ —     | \$512,498  |

|                                | Pass           | Special<br>Mention | Substandard | Doubtful | Total      |
|--------------------------------|----------------|--------------------|-------------|----------|------------|
|                                | (In thousands) |                    |             |          |            |
| September 30, 2017             |                |                    |             |          |            |
| One-to four-family residential | \$ 176,285     | \$ 127             | \$ 1,924    | \$ —     | \$ 178,336 |
| Commercial real estate         | 204,435        | —                  | 2,683       | —        | 207,118    |
| Construction                   | 20,194         | —                  | 2,428       | —        | 22,622     |
| Home equity lines of credit    | 18,536         | —                  | —           | —        | 18,536     |
| Commercial business            | 40,820         | 293                | —           | —        | 41,113     |
| Other                          | 6,266          | —                  | —           | —        | 6,266      |
| Total                          | \$466,536      | \$ 420             | \$ 7,035    | \$ —     | \$473,991  |

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans for the periods presented:

|         | 30-59<br>Days | 60-89<br>Days | 90<br>Days<br>+ | Total<br>Past<br>Due | Non-<br>Accrual | Total<br>Loans |
|---------|---------------|---------------|-----------------|----------------------|-----------------|----------------|
| Current | Past<br>Due   | Past<br>Due   | Past<br>Due     | Past<br>Due          |                 |                |

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(In thousands)

September 30, 2018

|                                |            |        |      |        |          |        |            |
|--------------------------------|------------|--------|------|--------|----------|--------|------------|
| One-to four-family residential | \$ 185,132 | \$ 17  | \$ — | \$ 138 | \$ 155   | \$ 138 | \$ 185,287 |
| Commercial real estate         | 218,892    | —      | —    | 455    | 455      | 455    | 219,347    |
| Construction                   | 30,412     | —      | —    | —      | —        | —      | 30,412     |
| Home equity lines of credit    | 17,892     | —      | —    | 90     | 90       | 90     | 17,982     |
| Commercial business            | 52,845     | 252    | —    | 223    | 475      | 223    | 53,320     |
| Other                          | 6,150      | —      | —    | —      | —        | —      | 6,150      |
| Total                          | \$511,323  | \$ 269 | \$ — | \$ 906 | \$ 1,175 | \$ 906 | \$ 512,498 |

|         | 30-59 | 60-89 | 90     | Total | Non-    | Total |
|---------|-------|-------|--------|-------|---------|-------|
|         | Days  | Days  | Days + | Past  | Accrual | Loans |
| Current | Past  | Past  | Past   | Past  |         |       |
|         | Due   | Due   | Due    | Due   |         |       |

(In thousands)

September 30, 2017

|                                |            |        |        |          |          |          |            |
|--------------------------------|------------|--------|--------|----------|----------|----------|------------|
| One-to four-family residential | \$ 176,546 | \$ —   | \$ 127 | \$ 1,663 | \$ 1,790 | \$ 1,663 | \$ 178,336 |
| Commercial real estate         | 206,218    | 418    | —      | 482      | 900      | 482      | 207,118    |
| Construction                   | 22,622     | —      | —      | —        | —        | —        | 22,622     |
| Home equity lines of credit    | 18,344     | —      | 192    | —        | 192      | —        | 18,536     |
| Commercial business            | 40,420     | 400    | 80     | 213      | 693      | 213      | 41,113     |
| Other                          | 6,266      | —      | —      | —        | —        | —        | 6,266      |
| Total                          | \$470,416  | \$ 818 | \$ 399 | \$ 2,358 | \$ 3,575 | \$ 2,358 | \$ 473,991 |

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The amount of interest income not recognized on non-accrual loans was approximately \$40,000 and \$106,000 for the years ended September 30, 2018 and 2017, respectively. At September 30, 2018 and September 30, 2017, there were no commitments to lend additional funds to borrowers whose loans are classified as non-accrual.

An allowance for loan losses (“ALL”) is maintained to absorb losses from the loan portfolio. The ALL is based on management’s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of NPLs.

The Bank’s methodology for determining the ALL is based on the requirements of ASC Section 310-10-35 for loans individually evaluated for impairment (discussed above) and ASC Subtopic 450-20 for loans collectively evaluated for impairment, as well as the Interagency Policy Statements on the Allowance for Loan and Lease Losses and other bank regulatory guidance.

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative and economic factors.

The loans are segmented into classes based on their inherent varying degrees of risk, as described above. Management tracks the historical net charge-off activity by segment and utilizes this figure, as a percentage of the segment, as the general reserve percentage for pooled, homogenous loans that have not been deemed impaired. Typically, an average of losses incurred over 5 historical years is used.

Non-impaired credits are segregated for the application of qualitative factors. Management has identified a number of additional qualitative factors which it uses to supplement the historical charge-off factor because these factors are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors that are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources are: national and local economic trends and conditions; levels of and trends in delinquency rates and non-accrual loans; trends in volumes and terms of loans; effects of changes in lending policies; experience, ability, and depth of lending staff; value of underlying collateral; and concentrations of credit from a loan type, industry and/or geographic standpoint.

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Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL. Since loans individually evaluated for impairment are promptly written down to their fair value, typically there is no portion of the ALL for loans individually evaluated for impairment.

The following tables summarize the activity in the allowance for loan losses by loan category for the years ended September 30, 2018 and 2017:

|                            | One-to<br>Four-<br>Family Residential | Commercial<br>Real Estate | Construction | Home<br>Equity<br>Lines<br>of<br>Credit | Commercial<br>Business | Other | Unallocated | Total   |
|----------------------------|---------------------------------------|---------------------------|--------------|---|------------------------|-------|-------------|---------|
|                            | (In thousands)                        |                           |              |   |                        |       |             |         |
| Balance-September 30, 2017 | \$587                                 | \$ 1,277                  | \$ 490       | \$ 57                                   | \$ 956                 | \$ 6  | \$ 102      | \$3,475 |
| Charge-offs                | (213)                                 | —                         | —            | —                                       | (170 )                 | (3 )  | —           | (386 )  |
| Recoveries                 | 87                                    | 23                        | 3            | —                                       | 1                      | —     | —           | 114     |
| Provision                  | 226                                   | 240                       | —            | 52                                      | 364                    | 22    | 93          | 997     |
| Balance-September 30, 2018 | \$687                                 | \$ 1,540                  | \$ 493       | \$ 109                                  | \$ 1,151               | \$ 25 | \$ 195      | \$4,200 |

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|                            | One-to<br>Four-<br>Family Residential | Commercial<br>Real Estate | Construction | Home<br>Equity<br>Lines<br>of<br>Credit | Commercial<br>Business | Other | Unallocated | Total   |
|----------------------------|---------------------------------------|---------------------------|--------------|---|------------------------|-------|-------------|---------|
|                            | (In thousands)                        |                           |              |   |                        |       |             |         |
| Balance-September 30, 2016 | \$542                                 | \$ 1,075                  | \$ 361       | \$ 71                                   | \$ 976                 | \$ 9  | \$ 22       | \$3,056 |
| Charge-offs                | (295)                                 | (23 )                     | —            | —                                       | (672 )                 | —     | —           | (990 )  |
| Recoveries                 | 36                                    | —                         | 12           | 14                                      | 4                      | —     | —           | 66      |
| Provision                  | 304                                   | 225                       | 117          | (28 )                                   | 648                    | (3 )  | 80          | 1,343   |
| Balance-September 30, 2017 | \$587                                 | \$ 1,277                  | \$ 490       | \$ 57                                   | \$ 956                 | \$ 6  | \$ 102      | \$3,475 |

The following tables summarize the ALL by loan category, segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of September 30, 2018 and September 30, 2017:

|                                       | One-to-Four<br>Family Residential | Commercial<br>Real Estate | Construction | Home<br>Equity<br>Lines of<br>Credit | Commercial<br>Business | Other   | Unallocated | Total     |
|---------------------------------------|-----------------------------------|---------------------------|--------------|--------------------------------------|------------------------|---------|-------------|-----------|
|                                       | (In thousands)                    |                           |              |                                      |                        |         |             |           |
| Allowance for Loan Losses:            |                                   |                           |              |                                      |                        |         |             |           |
| Balance - September 30, 2018          | \$687                             | \$ 1,540                  | \$ 493       | \$109                                | \$ 1,151               | \$25    | \$ 195      | \$4,200   |
| Individually evaluated for impairment | —                                 | —                         | —            | —                                    | —                      | —       | —           | —         |
| Collectively evaluated for impairment | 687                               | 1,540                     | 493          | 109                                  | 1,151                  | 25      | 195         | 4,200     |
| Loans receivable:                     |                                   |                           |              |                                      |                        |         |             |           |
| Balance - September 30, 2018          | \$185,287                         | \$ 219,347                | \$ 30,412    | \$17,982                             | \$ 53,320              | \$6,150 | \$ —        | \$512,498 |
| Individually evaluated for impairment | 1,132                             | 3,961                     | —            | 58                                   | 710                    | —       | —           | 5,861     |
| Collectively evaluated for impairment | 184,155                           | 215,386                   | 30,412       | 17,924                               | 52,610                 | 6,150   | —           | 506,637   |

|                                       | One-to-Four<br>Family Residential<br>(In thousands) | Commercial<br>Real Estate | Construction | Home<br>Equity<br>Lines of<br>Credit | Commercial<br>Business | Other    | Unallocated | Total      |
|---------------------------------------|---|---------------------------|--------------|--------------------------------------|------------------------|----------|-------------|------------|
| Allowance for Loan Losses:            |   |                           |              |                                      |                        |          |             |            |
| Balance - September 30, 2017          | \$ 587  | \$ 1,277                  | \$ 490       | \$ 57                                | \$ 956                 | \$ 6     | \$ 102      | \$ 3,475   |
| Individually evaluated for impairment | —   | —                         | —            | —                                    | —                      | —        | —           | —          |
| Collectively evaluated for impairment | 587   | 1,277                     | 490          | 57                                   | 956                    | 6        | 102         | 3,475      |
| Loans receivable:                     |   |                           |              |                                      |                        |          |             |            |
| Balance - September 30, 2017          | \$ 178,336  | \$ 207,118                | \$ 22,622    | \$ 18,536                            | \$ 41,113              | \$ 6,266 | \$ —        | \$ 473,991 |
| Individually evaluated for impairment | 3,124   | 4,088                     | —            | —                                    | 243                    | —        | —           | 7,455      |
| Collectively evaluated for impairment | 175,212   | 203,030                   | 22,622       | 18,536                               | 40,870                 | 6,266    | —           | 466,536    |

The allowance for loan losses is based on estimates, and actual losses will vary from current estimates. Management believes that the segmentation of the loan portfolio into homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

A TDR is a loan that has been modified whereby the Bank has agreed to make certain concessions to a borrower to meet the needs of both the borrower and the Bank to maximize the ultimate recovery of a loan. TDR occurs when a borrower is experiencing, or is expected to experience, financial difficulties and the loan is modified using a modification that would otherwise not be granted to the borrower. The types of concessions granted generally included, but are not limited to interest rate reductions, limitations on the accrued interest charged, term extensions, and deferment of principal.

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A default on a troubled debt restructured loan for purposes of this disclosure occurs when a borrower is 90 days past due or a foreclosure or repossession of the applicable collateral has occurred. There was one TDR during the year ended September 30, 2017, and there were no TDRs during the year ended September 30, 2018. The following table summarizes the TDRs during the year ended September 30, 2017:

|                                | Year Ended September 30, 2017 |                                    |                                   |
|--------------------------------|-------------------------------|------------------------------------|-----------------------------------|
|                                | Number of Loans               | Investment Before TDR Modification | Investment After TDR Modification |
| One-to four-family residential | 1                             | \$ 182                             | \$ 182                            |
| Total                          | 1                             | \$ 182                             | \$ 182                            |

(Dollars in thousands)

The Company held no interest-only mortgage loans at September 30, 2018 and held interest-only loans with principal balances of \$6.1 million at September 30, 2017. The average interest-only term on these loans was 10 years at which time the loans reset to fully amortize over 20 years, on average.

Total loans pledged as collateral against Federal Home Loan Bank of New York borrowings was \$172.4 million and \$177.6 million as of September 30, 2018 and 2017, respectively.

**NOTE F - ACCRUED INTEREST RECEIVABLE**

The following is a summary of accrued interest receivable:

|                       | September 30, 2018 | September 30, 2017 |
|-----------------------|--------------------|--------------------|
| Loans                 | \$2,026            | \$1,767            |
| Investment securities | 59                 | 57                 |

(In thousands)

|                                   |         |         |
|-----------------------------------|---------|---------|
| Mortgage-backed securities        | 96      | 105     |
| Total accrued interest receivable | \$2,181 | \$1,929 |

## NOTE G - PREMISES AND EQUIPMENT

Premises and equipment consist of the following:

|                                   | Estimated<br>Useful Lives | September 30,<br>2018      2017<br>(Dollars in<br>thousands) |          |
|-----------------------------------|---------------------------|--|----------|
| Land                              | Indefinite                | \$3,811  | \$3,811  |
| Buildings and improvements        | 10-40 years               | 22,514   | 22,453   |
| Furniture, fixtures and equipment | 5-10 years                | 3,288  | 3,065    |
|                                   |                           | 29,613   | 29,329   |
| Less accumulated depreciation     |                           | (12,623)   | (11,762) |
| Premises and equipment, net       |                           | \$16,990   | \$17,567 |



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For the years ended September 30, 2018 and 2017, depreciation expense included in occupancy expense amounted to approximately \$861,000 and \$816,000, respectively.

Hungaria Urban Renewal, LLC was formed in 2002 and its sole purpose was to purchase the land and construct the office building for which the Company is the primary tenant. The Bank owns a 100% interest in Hungaria Urban Renewal, LLC, which has no other business other than owning the Bank's main office site. At September 30, 2018, Hungaria Urban Renewal, LLC accounted for approximately \$3.1 million, \$9.3 million and \$0 of land, building, furniture, fixtures and equipment, net of depreciation, respectively. At September 30, 2017, Hungaria Urban Renewal, LLC accounted for approximately \$3.1 million, \$9.7 million, and \$0 of land, building, and furniture, fixtures and equipment, net of depreciation, respectively.

**NOTE H - OTHER REAL ESTATE OWNED**

The Company held \$8.6 million of real estate owned properties at September 30, 2018 and \$11.1 million at September 30, 2017. The Company incurred write-downs totaling \$418,000 and \$218,000 on these properties for the years ended September 30, 2018 and 2017; these amounts were carried as valuation allowances at September 30, 2018 and 2017, respectively. Further declines in real estate values may result in increased foreclosed real estate expense in the future. Routine holding costs are charged to expense as incurred and improvements to real estate owned that enhance the value of the real estate are capitalized.

**NOTE I - DEPOSITS**

A summary of deposits by type of account follows:

|                  | September 30,  |          |
|------------------|----------------|----------|
|                  | 2018           | 2017     |
|                  | (In thousands) |          |
| Demand accounts  | \$104,745      | \$98,728 |
| Savings accounts | 81,373         | 107,362  |
| NOW accounts     | 46,336         | 43,556   |

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|                        |           |           |
|------------------------|-----------|-----------|
| Money market accounts  | 167,340   | 137,527   |
| Certificate of deposit | 112,014   | 108,740   |
| Retirement accounts    | 18,329    | 19,288    |
| Total deposits         | \$530,137 | \$515,201 |

The current FDIC insurance limit on bank deposit accounts is \$250,000. The aggregate amount of deposit accounts with a minimum denomination of \$250,000 was approximately \$266.6 million at September 30, 2018 compared with \$227.2 million at September 30, 2017. The aggregate amount of certificate deposits, including individual retirement accounts with balance of \$250,000 or more was \$35.6 million at September 30, 2018 compared with \$31.5 million at September 30, 2017.

At September 30, 2018, certificates of deposit (including retirement accounts and brokered certificate deposit accounts) have contractual maturities as follows (in thousands):

|  |                           |           |
|--|---------------------------|-----------|
|  | Year Ending September 30, |           |
|  | 2019                      | \$65,984  |
|  | 2020                      | 39,334    |
|  | 2021                      | 13,979    |
|  | 2022                      | 3,381     |
|  | 2023 and after            | 7,665     |
|  | Total                     | \$130,343 |

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## NOTE J - BORROWINGS

1. Federal Home Loan Bank of New York Advances

Long term Federal Home Loan Bank of New York (“FHLBNY”) advances at September 30, 2018 and September 30, 2017 totaled approximately \$35.5 million and \$31.9 million, respectively. The weighted average interest rate on advances outstanding at September 30, 2018 and 2017 were 2.09% and 2.00%, respectively. The advances were collateralized by unencumbered qualified assets consisting of one-to-four family residential and commercial real estate mortgage loans. Advances are made pursuant to several different credit programs offered from time to time by the FHLBNY.

Long term FHLBNY advances as of September 30, 2018 mature as follows (in thousands):

| Year Ending September 30, |          |
|---------------------------|----------|
| 2019                      | \$8,940  |
| 2020                      | 10,294   |
| 2021                      | 2,500    |
| 2022                      | 7,731    |
| 2023                      | 3,650    |
| Thereafter                | 2,409    |
| Total                     | \$35,524 |

Additionally, the Company has established an Overnight Line of Credit arrangement with the FHLBNY. The total amount available under the line of credit is based on the amount of eligible collateral pledged to the FHLBNY. At September 30, 2018 and 2017, the Company had available credit from the FHLBNY totaling \$78.7 million and \$92.6 million, respectively. Information concerning short-term borrowings with the FHLBNY is summarized as follows:

| September 30, |      |
|---------------|------|
| 2018          | 2017 |

(Dollars in  
thousands)

|   |          |          |
|---|----------|----------|
| Balance at end of year                    | \$—      | \$—      |
| Weighted average balance during the year  | \$3,418  | \$966    |
| Maximum month-end balance during the year | \$25,175 | \$11,150 |
| Average interest rate during the year     | 2.16 %   | 1.00 %   |

## 2. Securities Sold Under Reverse Repurchase Agreements

Qualifying repurchase agreements are treated as financings and are reflected as a liability in the Consolidated Balance Sheets. The Company did not have repurchase agreements outstanding at September 30, 2018 and September 30, 2017.

## NOTE K – SERVICING POLICY

The Company originates and sells loans receivable secured by one-to four-family residential properties and commercial business loans guaranteed by the Small Business Administration (the “SBA”). The Company has sold loans on a servicing retained basis and on a servicing released basis. Loans sold with servicing retained and servicing released during the year ended September 30, 2018 were \$8.7 million and \$0, respectively. Loans sold with servicing retained and servicing released during the year ended September 30, 2017 were \$4.7 million and \$0, respectively. The Company accounts for sales in accordance with ASC 860, Transfers and Servicing. Upon sale, the receivables are removed from the balance sheet, mortgage servicing rights are recorded as an asset for servicing rights retained, and a gain on sale, if applicable, is recognized for the difference between the carrying value of the receivables and the sales proceeds, net of origination costs.

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Gains on sales of loans, representing the difference between the total sales price received for the loans and the allocated cost of the loans, are recognized when mortgage loans are sold and delivered to the purchasers. Loans are accounted for as sold when control of the mortgage is surrendered. Control over the mortgage loans is deemed surrendered when (1) the mortgage loans have been isolated from the Company, (2) the buyer has the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the mortgage loans and (3) the Company does not maintain effective control over the mortgage loans through either (a) an agreement that entitles and obligates the Company to repurchase or redeem the mortgage loans before maturity, or (b) the ability to unilaterally cause the buyer to return specific mortgage loans.

The Company services one-to-four family residential mortgage loans for investors in the secondary mortgage market, which are not included in the Consolidated Balance Sheets. The Company's fee is a percentage of the principal balance and is recognized as income when received. At September 30, 2018 and 2017, the Company was servicing such sold loans in the amount of \$8.5 million and \$10.1 million, respectively. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent mortgagors, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans. Mortgage servicing rights are amortized in proportion to, and over the period of, estimated net servicing revenues and are included in other assets on the Consolidated Balance Sheets. Activity in mortgage servicing rights during the years ended September 30, 2018 and 2017 are summarized as follows:

|  | September<br>30,<br>2018 2017<br>(In<br>thousands) |      |
|--|--|------|
| Beginning balance                        | \$69   | \$97 |
| Origination of mortgage servicing rights | —  | —    |
| Amortization                             | (24)   | (28) |
| Ending balance                           | \$45   | \$69 |

Mortgage servicing rights are carried at the lower of amortized cost or fair value. Fair values are estimated using discounted cash flows based on a current market interest rate.

The Company also services the SBA guaranteed portion of commercial business loans sold to investors in the secondary market, which are not included in the Consolidated Balance Sheets. The Company's fee is a percentage of

the principal balance and is recognized as income when received. At September 30, 2018 and 2017, the Company was servicing SBA loans sold in the amount of \$26.5 million and \$22.4 million, respectively. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent mortgagors, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans.

#### NOTE L - INCOME TAXES

The income tax expense is comprised of the following components for the years ended September 30, 2018 and 2017:

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|   | September 30,<br>2018 | September 30,<br>2017 |
|---|-----------------------|-----------------------|
|   | (In thousands)        |                       |
| Income tax expense at the statutory federal tax rate of 24% for the year ended September 30, 2018 and 34% for the year ended September 30, 2017 | \$839                 | \$822                 |
| State tax expense   | 240                   | 141                   |
| Reduction of deferred tax asset from tax legislation  | 410                   | —                     |
| Other   | (18 )                 | 31                    |
| Income tax expense  | \$1,471               | \$994                 |

A reconciliation of income tax at the statutory tax rate to the effective income tax expense for the years ended September 30, 2018 and 2017 is as follows:

|   | September 30,<br>2018 | September 30,<br>2017 |
|---|-----------------------|-----------------------|
|   | (In thousands)        |                       |
| Income tax expense at statutory rate                  | \$839                 | \$822                 |
| Increase (decrease) resulting from:                   |                       |                       |
| State income taxes, net of federal income tax benefit | 244                   | 141                   |
| Tax-exempt income, net                                | (70 )                 | (95 )                 |
| Nondeductible expenses                                | 32                    | 4                     |
| Employee stock ownership plan                         | 5                     | 7                     |
| Increase (decrease) in valuation allowance            | —                     | 115                   |
| Increase due to change in tax law                     | 410                   | —                     |
| Other, net  | 11                    | —                     |
| Total income tax expense                              | \$1,471               | \$994                 |

The major sources of temporary differences and their deferred tax effect at September 30, 2018 and 2017 are as follows:

September 30,  
2018      2017

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(In thousands)

|   |         |         |
|---|---------|---------|
| Allowance for loan losses                                     | \$1,181 | \$1,388 |
| Deferred loan fees  | —       | 1       |
| Net operating losses  | —       | 431     |
| Alternative minimum tax credit                                | —       | 311     |
| Unrealized loss, minimum pension liability                    | 363     | 597     |
| Net unrealized loss, investment securities available-for-sale | 213     | 61      |
| OREO  | 410     | 382     |
| Straight line rent  | 125     | 177     |
| Gross deferred tax asset                                      | 2,292   | 3,348   |
| Depreciation  | (964 )  | (1,370) |
| Discount accretion on investments                             | (87 )   | (119 )  |
| Employee benefits   | (66 )   | (39 )   |
| Deferred loan fees  | (19 )   | —       |
| Mortgage servicing rights                                     | (13 )   | (28 )   |
| Gross deferred tax liability                                  | (1,149) | (1,556) |
| Net deferred tax asset, included in other assets              | \$1,143 | \$1,792 |



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In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences are deductible and carry forwards are available.

There were no valuation allowances for the year ended September 30, 2018 and 2017. The Company has considered future market growth, forecasted earnings, future taxable income, feasible and permissible tax planning strategies in determining the realizability of deferred tax assets. If the Company was to determine that it would not be able to realize a portion of its net deferred tax asset in the future for which there is currently no valuation allowance, an adjustment to the net deferred tax asset would be charged to earnings in the period such determination was made.

On December 22, 2017, the Tax Cuts and Jobs Act was signed into law. ASC 740 (Income Taxes) requires the recognition of the effect of changes in tax laws or rates in the period in which the legislation is enacted. The changes in the deferred tax assets and liabilities remeasured at the new 21% federal tax rate are reflected in income tax expense for the year ended September 30, 2018. The Company expensed \$410,000 due to the impact of the lower corporate tax rates on the deferred tax assets and liabilities.

**NOTE M - PENSION PLAN**

The Company had a noncontributory defined benefit pension plan (the “Plan”) covering all eligible employees. On January 26, 2006, the Plan was frozen and amended to eliminate future benefit accruals after February 15, 2006.

Plan assets are invested in six diversified investment funds of the Pentegra Retirement Trust (the “Trust”), a no load series open-ended mutual fund. The Trust has been given discretion by the Plan Sponsor to determine the appropriate strategic asset allocation versus plan liabilities, as governed by the Trust’s Statement of Investment Objectives and Guidelines. The long-term investment objective is to be invested 65% in equity securities (equity mutual funds) and 35% in debt securities (bond mutual funds). Asset rebalancing is performed at least annually, with interim adjustments made when the investment mix varies more than 5% from the target (i.e., a 10% target range). Risk/volatility is further managed by the distinct investment objectives of each of the Trust funds and the diversification within each fund.

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The following table sets forth the Plan's funded status and amounts recognized in the Company's Consolidated Balance Sheets at September 30, 2018 and September 30, 2017.

|  | September 30,  |           |
|--|----------------|-----------|
|  | 2018           | 2017      |
|  | (In thousands) |           |
| Actuarial present value of benefit obligations | \$4,390        | \$4,550   |
| Change in benefit obligations                  |                |           |
| Projected benefit obligation, beginning        | \$4,550        | \$4,779   |
| Interest cost                                  | 178            | 175       |
| Actuarial (gain) loss                          | (149 )         | (214 )    |
| Annuity payments and lump sum distributions    | (189 )         | (190 )    |
| Projected benefit obligation, end              | \$4,390        | \$4,550   |
| Change in plan assets                          |                |           |
| Fair value of assets, beginning                | \$3,237        | \$2,951   |
| Actual return on plan assets                   | 155            | 312       |
| Employer contributions                         | 200            | 164       |
| Annuity payments and lump sum distributions    | (189 )         | (190 )    |
| Fair value of assets, end                      | \$3,403        | \$3,237   |
| Funded status included with other liabilities  | \$(987 )       | \$(1,313) |

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Net pension cost for the years ended September 30, 2018 and 2017 included the following components:

|   | September 30,  |       |
|---|----------------|-------|
|   | 2018           | 2017  |
|   | (In thousands) |       |
| Service cost benefits earned during the year  | \$—            | \$—   |
| Interest cost on projected benefit obligation | 178            | 175   |
| Expected return on plan assets                | (222)          | (202) |
| Amortization of unrecognized net loss         | 119            | 166   |
| Net pension cost                              | \$75           | \$139 |

For the year ended September 30, 2018 and 2017, the weighted average discount rate used in determining the actuarial net periodic pension cost was 4.00% and 3.75%, respectively. For the year ended September 30, 2018 and 2017, the weighted average discount rate used in determining the actuarial present value of the projected benefit obligation was 4.25% and 4.00%, respectively.

The long-term rate-of-return-on-assets assumption was set based on historical returns earned by equities and fixed income securities, adjusted to reflect expectations of future returns as applied to the plan's target allocation of asset classes. Equities and fixed income securities were assumed to earn rates of return in the ranges of 6-8% and 3-5%, respectively, with an assumed long-term inflation rate of 2.5% reflected within these ranges for the year ended September 30, 2018. When these overall return expectations are applied to the plan's target allocation, the result is an expected rate of return of 5.0% to 7.0%. Accordingly, the expected long-term rate of return on assets was 7.00% for both 2018 and 2017.

Current Asset Allocation

The Plan's weighted-average asset allocations at September 30, 2018 and 2017, by asset category are as follows:

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September  
30,  
2018 2017

|                                     |      |       |
|-------------------------------------|------|-------|
| Equity securities                   | 64 % | 68 %  |
| Debt securities (bond mutual funds) | 36 % | 32 %  |
| Other (money market fund)           | 0 %  | 0 %   |
| Total                               | 100% | 100 % |

The target asset allocation set for the assets of the Plan are in equity securities ranging from 40 percent to 70 percent and in debt securities ranging from 30 percent to 60 percent. In general, the Plan assets are investment securities that are well-diversified in terms of industry, capitalization and asset class. The Plan assets are mostly a mix of U.S. Treasury security indexed funds, mutual funds indexed to the performance of Fortune 500 U.S. companies, debt securities held in bond funds, domestic and foreign common equity funds, and a money market fund. The Plan's exposure to a concentration of credit risk is limited by the diversification of the investments into various investment options with multiple asset managers.

Expected Contributions

For the fiscal year ending September 30, 2019, the Company expects to contribute \$67,299 to the Plan.

Estimated Future Benefit Payments

The following benefit payments are expected to be paid as follows (in thousands):

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September 30, 2018 and 2017

|  |         |
|--|---------|
| October 1, 2018 through September 30, 2019 | \$207   |
| October 1, 2019 through September 30, 2020 | 210     |
| October 1, 2020 through September 30, 2021 | 211     |
| October 1, 2021 through September 30, 2022 | 211     |
| October 1, 2022 through September 30, 2023 | 215     |
| October 1, 2023 through September 30, 2028 | 1,247   |
| Total                                      | \$2,301 |

Included in the funded status of the Plan at September 30, 2018 and 2017, are actuarial losses of \$1,292,000 and \$1,494,000, respectively. These amounts are included, net of related income tax effects of \$363,000 and \$597,000, respectively, in the accumulated other comprehensive loss component of stockholders' equity. During the year ending September 30, 2019, approximately \$105,000 of the actuarial losses is expected to be amortized into net periodic pension expense.

The following table presents the Plan assets that are measured at fair value on a recurring basis by level within the fair value hierarchy under ASC Topic 820. Financial assets are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. See Note R for further detail regarding fair value hierarchy.

|                       | Fair Value Measurements at Reporting Date Using:               |                                    |   |   |
|-----------------------|--|------------------------------------|---|---|
|                       | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Inputs (Level 2) | Significant Observable Inputs (Level 3) | Significant Unobservable Inputs (Level 3) |
| At September 30, 2018 |  |                                    |   |   |
| Investment Type       |  |                                    |   |   |
| Mutual Funds- Equity  |  |                                    |   |   |
| Large-Cap Value       | \$468  | \$468                              | \$ —                                    | \$ —                                      |
| Large-Cap Core        | 480  | 480                                | —                                       | —   |

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|                            |         |         |    |    |
|----------------------------|---------|---------|----|----|
| Mid-Cap Core               | 198     | 198     | —  | —  |
| Small-Cap Core             | 201     | 201     | —  | —  |
| Non-U.S. Core              | 815     | 815     | —  | —  |
| Mutual Funds- Fixed Income |         |         |    |    |
| Intermediate-Term Core     | 1,241   | 1,241   | —  | —  |
| Cash Equivalents           |         |         |    |    |
| Money Market               | —       | —       | —  | —  |
| Total Investment           | \$3,403 | \$3,403 | \$ | \$ |

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## Notes to Consolidated Financial Statements

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|                            | Fair Value Measurements at Reporting Date Using:               |   |   |      |
|----------------------------|--|---|---|------|
|                            | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |      |
|                            | Total  |   |   |      |
|                            | (In thousands)   |   |   |      |
| At September 30, 2017      |  |   |   |      |
| Investment Type            |  |   |   |      |
| Mutual Funds- Equity       |  |   |   |      |
| Large-Cap Value            | \$462  | \$462   | \$ —                                      | \$ — |
| Large-Cap Core             | 482  | 482   | —   | —    |
| Mid-Cap Core               | 224  | 224   | —   | —    |
| Small-Cap Core             | 222  | 222   | —   | —    |
| Non-U.S. Core              | 803  | 803   | —   | —    |
| Mutual Funds- Fixed Income |  |   |   |      |
| Intermediate-Term Core     | 1,033  | 1,033   | —   | —    |
| Cash Equivalents           |  |   |   |      |
| Money Market               | 11   | 11  | —   | —    |
| Total Investment           | \$3,237  | \$3,237                                       | \$ —                                      | \$ — |

Equity and debt securities are reported at fair value in the table above utilizing exchange quoted prices in active markets for identical instruments (Level 1 inputs).

**NOTE N - NONQUALIFIED COMPENSATION PLAN**

The Company maintains a Supplemental Executive Retirement Plan (“SERP”) for the benefit of its senior officers. In addition, the Company also adopted voluntary Deferred Income and Emeritus Plans on behalf of its directors and those directors elected by the Board as “Director Emeritus.” The SERP provides the Company with the opportunity to supplement the retirement income of selected officers to achieve equitable wage replacement at retirement while the Deferred Income Plan provides participating directors with an opportunity to defer all or a portion of their fees into a tax deferred accumulation account for future retirement. The Director Emeritus Plan enables the Company to reward its directors for longevity of service in consideration of their availability and consultation. The SERP is based upon achieving retirement benefits equal to two percent multiplied by the number of service years multiplied by the final

salary.

In 2001, the Company adopted a New Director Emeritus Plan (the “New Plan”), which supplemented the prior Director Emeritus Plans. Under the New Plan, the directors will be entitled to a benefit upon attainment of his/her benefit age. The directors will receive an annual amount in monthly installments based on his/her total Board and Committee fees in the twelve months prior to attainment of his/her benefit age. The amount will be ten percent (10%) plus two and one-half percent (2 1/2%) for each year of service as a Director, with a minimum of fifty percent (50%), provided the Director has served for at least five (5) years, and a maximum of sixty percent (60%). The maximum benefit increases for any Director serving as Chairman of the Board to seventy-five percent (75%).

The Company funds the plans through a modified endowment contract. Income recorded for the plans represents life insurance income as recorded based on the projected increases in cash surrender values of life insurance policies. As of September 30, 2018 and 2017, the Life Insurance Contracts had cash surrender values of approximately \$11,843,000 and \$11,550,000, respectively.

The Company is recording benefit costs so that the cost of each participant’s retirement benefits is being expensed and accrued over the participant’s active employment so as to result in a liability at retirement date equal to the present value of the benefits expected to be provided.

#### NOTE O - 401(K) EMPLOYEE CONTRIBUTION PLAN

The Company has a defined contribution 401(k) plan covering all employees, as defined under the plan document. Employees may contribute to the plan, as defined under the plan document, and the Company can make discretionary contributions. The Company contributed \$163,000 and \$145,000 to the plan for the years ended September 30, 2018 and 2017, respectively, and is included in compensation and employee benefits in the accompanying Consolidated Statements of Operations.



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**NOTE P - COMMITMENTS**

1. Lease Commitments

Approximate future minimum payments under non-cancelable operating leases are due as follows for the years indicated (in thousands):

|                    |         |
|--------------------|---------|
| September 30, 2019 | \$696   |
| September 30, 2020 | 700     |
| September 30, 2021 | 705     |
| September 30, 2022 | 595     |
| September 30, 2023 | 602     |
| Thereafter         | 2,130   |
| Total              | \$5,428 |

Total rental expense, included in occupancy expense, was approximately \$803,000 and \$732,000 for the years ended September 30, 2018 and 2017, respectively.

2. Contingencies

The Company and its subsidiaries, from time to time, are a party to routine litigation that arises in the normal course of business. In the opinion of management, the resolution of this litigation, if any, would not have a material adverse effect on the Company's consolidated financial position or results of operations.

**NOTE Q - FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK**

The Company may use derivative financial instruments, such as interest rate floors and collars, as part of its interest rate risk management. Interest rate caps and floors are agreements whereby one party agrees to pay or receive a floating rate of interest on a notional principal amount for a predetermined period of time if certain market interest rate thresholds are met. The Company considers the credit risk inherent in these contracts to be negligible. As of September 30, 2018 and 2017, the Company did not hold any interest rate floors or collars.

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 are commitments to extend credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the Consolidated Balance Sheets.

The Company's exposure to credit loss in the event of nonperformance by the other parties to the financial instrument for commitments to extend credits is represented by the contractual notional 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.

At September 30, 2018 and 2017, the Company had outstanding commitments (substantially all of which expire within one year) to originate one-to four-family residential loans, construction loans, commercial real estate loans, commercial business loans and consumer loans. These commitments were comprised of fixed and variable rate loans.

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## Notes to Consolidated Financial Statements

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|  | September 30,<br>2018      2017<br>(In thousands) |          |
|--|---|----------|
| Financial instruments whose contract amounts represent credit risk |   |          |
| Letters of credit  | \$1,939   | \$633    |
| Unused lines of credit   | 54,127  | 64,220   |
| Fixed rate loan commitments  | 4,397   | 2,429    |
| Variable rate loan commitments                                     | 12,523  | 3,952    |
| Total  | \$72,986  | \$71,234 |

**NOTE R - FAIR VALUE DISCLOSURES**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Company's 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 or liabilities on a non-recurring basis, such as held-to-maturity securities, mortgage servicing rights, loans receivable and other real estate owned, or OREO. These non-recurring fair value adjustments involve the application of lower-of-cost-or-market accounting or write-downs of individual assets.

In accordance with ASC 820, Fair Value Measurements and Disclosures ("ASC 820"), the Company groups its assets and liabilities 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 our own estimates of assumptions that market participants

would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques. The results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability.

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. ASC 820 requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The following is a description of valuation methodologies used for assets measured at fair value on a recurring basis.

#### Securities available-for-sale

The Company's available-for-sale portfolio is carried at estimated fair value on a recurring basis, with any unrealized gains and losses, net of taxes, reported as accumulated other comprehensive income/loss in stockholders' equity. The securities available-for-sale portfolio consists of U.S. government and government-sponsored enterprise obligations, municipal bonds, and mortgage-backed securities. The fair values of these securities are obtained from an independent nationally recognized pricing service. An independent pricing service provides prices which are categorized as Level 2, as quoted prices in active markets for identical assets are generally not available for the securities.

The following table provides the level of valuation assumptions used to determine the carrying value of the Company's assets measured at fair value on a recurring basis at September 30, 2018 and 2017:

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## Notes to Consolidated Financial Statements

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|   | Fair Value at September 30,<br>2018 |            |          |            |
|---|-------------------------------------|------------|----------|------------|
|   | Total                               | Level<br>1 | Level 2  | Level<br>3 |
|   | (In thousands)                      |            |          |            |
| Securities available for sale:                        |                                     |            |          |            |
| Obligations of U.S. government agencies:              |                                     |            |          |            |
| Mortgage-backed securities - residential              | \$1,495                             | \$ —       | \$1,495  | \$ —       |
| Obligations of U.S. government-sponsored enterprises: |                                     |            |          |            |
| Mortgage-backed securities-residential                | 18,613                              | —          | 18,613   | —          |
| Debt securities                                       | 2,361                               | —          | 2,361    | —          |
| Total securities available for sale                   | \$22,469                            | \$ —       | \$22,469 | \$ —       |

|   | Fair Value at September 30,<br>2017 |            |          |            |
|---|-------------------------------------|------------|----------|------------|
|   | Total                               | Level<br>1 | Level 2  | Level<br>3 |
|   | (In thousands)                      |            |          |            |
| Securities available for sale:                        |                                     |            |          |            |
| Obligations of U.S. government-sponsored enterprises: |                                     |            |          |            |
| Mortgage-backed securities-residential                | \$9,326                             | \$ —       | \$9,326  | \$ —       |
| Debt securities                                       | 2,449                               | —          | 2,449    | —          |
| Private label mortgage-backed securities-residential  | 40                                  | —          | 40       | —          |
| Total securities available for sale                   | \$11,815                            | \$ —       | \$11,815 | \$ —       |

The following is a description of valuation methodologies used for assets measured at fair value on a non-recurring basis.

Mortgage Servicing Rights

Mortgage Servicing Rights (MSR's) are carried at the lower of amortized cost or estimated fair value. The estimated fair value of MSRs is determined through a calculation of future cash flows, incorporating estimates of assumptions market participants would use in determining fair value including market discount rates, prepayment speeds, servicing income, servicing costs, default rates and other market driven data, including the market's perception of future interest rate movements and, as such, are classified as Level 3. No valuation write-downs were made to MSR's during the

years ended September 30, 2018 and 2017.

### Impaired Loans

Loans which meet certain criteria are evaluated individually for impairment. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. All amounts due according to the contractual terms means that both the contractual interest and principal payments of a loan will be collected as scheduled in the loan agreement. Three impairment measurement methods are used, depending upon the collateral securing the asset: 1) the present value of expected future cash flows discounted at the loan's effective interest rate; 2) the asset's observable market price; or 3) the fair value of the collateral if the asset is collateral dependent. The regulatory agencies require this method for loans from which repayment is expected to be provided solely by the underlying collateral. The Company's impaired loans are generally collateral dependent and, as such, are carried at the estimated fair value of the collateral less estimated selling and disposition costs. Fair value is estimated through current appraisals, and adjusted as necessary, by management, to reflect current market conditions and, as such, are generally classified as Level 3.

Appraisals of collateral securing impaired loans are conducted by approved, qualified, and independent third-party appraisers. Such appraisals are ordered via the Bank's credit administration department, independent from the lender who originated the loan, once the loan is deemed impaired, as described in the previous paragraph. Impaired loans are generally re-evaluated with an updated appraisal within one year of the last appraisal. However, the Company also obtains updated appraisals on performing construction loans that are approaching their maturity date to determine whether or not the fair value of the collateral securing the loan remains sufficient to cover the loan amount prior to considering an extension. The Company discounts the appraised "as is" value of the collateral for estimated selling and disposition costs and compares the resulting fair value of collateral to the outstanding loan amount. If the outstanding loan amount is greater than the discounted fair value, the Company requires a reduction in the outstanding loan balance or additional collateral before considering an extension to the loan. If the borrower is unwilling or unable to reduce the loan balance or increase the collateral securing the loan, it is deemed impaired and the difference between the loan amount and the fair value of collateral, net of estimated selling and disposition costs, is charged off through a reduction of the allowance for loan loss.

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Other Real Estate Owned

Other real estate owned is carried at lower of cost or estimated fair value less disposal costs. The estimated fair value of the real estate is determined through current appraisals, and adjusted as necessary, by management, to reflect current market conditions. As such, other real estate owned is generally classified as Level 3. Valuation write-downs totaling \$418,000 were made to seven properties held as other real estate owned during the year ended September 30, 2018. The properties were written down based on an updated appraisal of the real estate.

The following tables provide the level of valuation assumptions used to determine the carrying value of our assets measured at fair value on a non-recurring basis at September 30, 2018 and 2017:

|                         | Fair Value at September 30,<br>2018 |            |            |
|-------------------------|-------------------------------------|------------|------------|
| Total                   | Level<br>1                          | Level<br>2 | Level<br>3 |
|                         | (In thousands)                      |            |            |
| Impaired loans          | \$464                               | \$ —       | —\$464     |
| Other real estate owned | 8,586                               | —          | — 8,586    |
| Total                   | \$9,050                             | \$ —       | —\$9,050   |

|                         | Fair Value at September 30,<br>2017 |            |           |
|-------------------------|-------------------------------------|------------|-----------|
| Total                   | Level<br>1                          | Level<br>2 | Level 3   |
|                         | (In thousands)                      |            |           |
| Impaired loans          | \$909                               | \$ —       | —\$909    |
| Other real estate owned | 11,056                              | —          | — 11,056  |
| Total                   | \$11,965                            | \$ —       | —\$11,965 |

Impaired loans reported for the period ended September 30, 2018 consisted of two loans with aggregate loan balances of \$351,000 reduced by \$90,000 in cumulative charge-offs. There were no specific loss reserves at September 30,

2018.

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which Company has utilized Level 3 inputs to determine fair value:

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## Notes to Consolidated Financial Statements

September 30, 2018 and 2017

## Quantitative Information about Level 3 Fair Value Measurements

(Dollars in thousands)

| September 30, 2018      | Fair Value Valuation |  | Unobservable Input                   | Range (Weighted Average)  |
|-------------------------|----------------------|--|--------------------------------------|---------------------------|
|                         | Estimate             | Techniques                             |                                      |                           |
| Impaired loans          | \$ 464               | Appraisal of collateral <sup>(1)</sup> | Appraisal adjustments <sup>(2)</sup> | -10.2% to -32.0% (-21.3%) |
| Other real estate owned | \$ 8,586             | Appraisal of collateral <sup>(1)</sup> | Liquidation expenses <sup>(2)</sup>  | -5.6% to -48.5% (-15.4%)  |

## Quantitative Information about Level 3 Fair Value Measurements

(Dollars in thousands)

| September 30, 2017      | Fair Value Valuation |  | Unobservable Input                   | Range (Weighted Average) |
|-------------------------|----------------------|--|--------------------------------------|--------------------------|
|                         | Estimate             | Techniques                             |                                      |                          |
| Impaired loans          | \$ 909               | Appraisal of collateral <sup>(1)</sup> | Appraisal adjustments <sup>(2)</sup> | -7.9% to -35.2% (-22.3%) |
| Other real estate owned | \$ 11,056            | Appraisal of collateral <sup>(1)</sup> | Liquidation expenses <sup>(2)</sup>  | -8.0% to -55.4% (-25.0%) |

<sup>(1)</sup> Fair value is generally determined through independent appraisals for the underlying collateral, which generally include various level 3 inputs which are not identifiable.

Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated <sup>(2)</sup>liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate fair value:

Cash and interest earning deposits with banks: The carrying amounts are a reasonable estimate of fair value.

Held to maturity securities: The fair values of Company's held to maturity securities are obtained from an independent nationally recognized pricing service. The Company's independent pricing service provides prices which are categorized as Level 2, as quoted prices in active markets for identical assets are generally not available for the securities.

Federal Home Loan Bank Stock: FHLB stock is carried at cost. The carrying value approximates fair value based upon the redemption price provision of FHLB stock.

Loans receivable: Fair value for the loan portfolio, excluding impaired loans, is estimated based on discounted cash flow analysis using interest rates currently offered for loans with similar terms to borrowers of similar credit quality.

Bank owned life insurance: The carrying amounts are based on the cash surrender values of the individual policies, which is a reasonable estimate of fair value.

Deposits: The fair value of savings deposits with no stated maturity, such as money market deposit accounts, interest-bearing checking accounts and savings accounts, is equal to the amount payable on demand. The fair value of certificates of deposit including retirement accounts is based on the discounted value of contractual cash flows. The discount rate is equivalent to the rate currently offered by the Bank for deposits of similar size, type and maturity.

Accrued interest receivable and payable: For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Federal Home Loan Bank of New York advances: The fair value of borrowings is based on the discounted value of contractual cash flows. The discount rate is equivalent to the rate currently offered by the Federal Home Loan Bank of New York for borrowings of similar maturity and terms.

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The fair value of commitments to extend credit is estimated based on the amount of unamortized deferred loan commitment fees. The fair value of letters of credit is based on the amount of unearned fees plus the estimated cost to terminate the letters of credit. Fair values of unrecognized financial instruments including commitments to extend credit and the fair value of letters of credit are considered immaterial.

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments carried at cost or amortized cost as of September 30, 2018 and September 30, 2017. This table excludes financial instruments for which the carrying amount approximates fair value, which includes cash and cash equivalents, FHLB stock, bank owned life insurance, accrued interest receivable, interest and non-interest bearing demand, savings deposits, and accrued interest payable. For short-term financial assets such as cash and cash equivalents, the carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization. For financial liabilities such as interest-bearing demand, NOW, and money market savings deposits, the carrying amount is a reasonable estimate of fair value due to these products having no stated maturity.

|  | Carrying<br>Amount | Fair<br>Value | Fair Value Measurement<br>Placement |           |           |
|--|--------------------|---------------|-------------------------------------|-----------|-----------|
|  |                    |               | (Level<br>1)                        | (Level 2) | (Level 3) |
| (In thousands)                         |                    |               |                                     |           |           |
| September 30, 2018                     |                    |               |                                     |           |           |
| Financial instruments - assets         |                    |               |                                     |           |           |
| Investment securities held-to-maturity | \$33,645           | \$32,151      | \$—                                 | \$32,151  | \$—       |
| Loans                                  | 508,430            | 505,479       | —                                   | —         | 505,479   |
| Financial instruments - liabilities    |                    |               |                                     |           |           |
| Certificates of deposit                | 130,343            | 130,813       | —                                   | 130,813   | —         |
| Borrowings                             | 35,524             | 34,863        | —                                   | 34,863    | —         |
| September 30, 2017                     |                    |               |                                     |           |           |
| Financial instruments - assets         |                    |               |                                     |           |           |
| Investment securities held-to-maturity | \$51,368           | \$51,241      | \$—                                 | \$51,241  | \$—       |
| Loans                                  | 470,693            | 473,538       | —                                   | —         | 473,538   |
| Financial instruments - liabilities    |                    |               |                                     |           |           |
| Certificates of deposit                | 128,028            | 128,750       | —                                   | 128,750   | —         |
| Borrowings                             | 31,905             | 31,865        | —                                   | 31,865    | —         |

## NOTE S - REGULATORY CAPITAL

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

The federal banking agencies have substantially amended the regulatory risk-based capital rules applicable to the Bank. The amendments implemented the “Basel III” regulatory capital reforms and changes required by the Dodd-Frank Act. The amended rules included new minimum risk-based capital and leverage ratios, which became effective in January 2017, with certain requirements to be phased in beginning in 2018. The rule includes a new common equity Tier 1 capital (“CET1”) to risk-weighted assets ratio of 4.5% of risk-weighted assets, which is in addition to the Tier 1 and Total risk-based capital requirements. The interim final rule also raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% and requires a minimum leverage ratio of 4.0%. The required minimum ratio of total capital to risk-weighted assets will remain 8.0%. The new risk-based capital requirements (except for the capital conservation buffer) became effective for the Company and the Bank on January 1, 2015.

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The amended rules also established a “capital conservation buffer” of 2.5% beginning in January 2016 (phased in over four years at 0.625% per year) above the new regulatory minimum capital ratios, and would result in the following phased-in minimum ratios when fully implemented: (i) a common equity Tier 1 capital ratio of 7.0%; (ii) a Tier 1 capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%. The new capital conservation buffer requirement phased in at 0.625% of risk-weighted assets and will increase each year until fully implemented in January 2019. An institution will be 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 will establish a maximum percentage of eligible retained income that could be utilized for such actions.

As of September 30, 2018, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank’s category.

The following table sets forth the Company’s and the Bank’s actual and required capital levels under those measures:

|                                 | At September 30,<br>2018 |        | Required for capital<br>adequacy purposes effective |                 | To be well-<br>capitalized under<br>prompt corrective<br>action provisions |
|---------------------------------|--------------------------|--------|---|-----------------|--|
|                                 |                          |        | September 30, 2018                                  | January 1, 2019 | Bank   |
| Tier 1 leverage ratio           | 8.55%                    | 8.61%  | ≥ 4.00%   | ≥ 4.00%         | ≥ 5.00%  |
| CET1                            | 11.44%                   | 11.53% | ≥ 6.375%  | (1) ≥ 7.00%     | (2) ≥ 6.50%  |
| Tier 1 risk-based capital ratio | 11.44%                   | 11.53% | ≥ 7.875%  | (1) ≥ 8.50%     | (2) ≥ 8.00%  |
| Total risk-based capital ratio  | 12.35%                   | 12.44% | ≥ 9.875%  | (1) ≥ 10.50%    | (2) ≥ 10.00%   |

(1) Includes 1.875% capital conservation buffer

(2) Includes 2.50% capital conservation buffer

To be well-  
capitalized under

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|                                 | At September 30,<br>2017 |        | Required for capital<br>adequacy purposes effective |                         | prompt corrective<br>action provisions |
|---------------------------------|--------------------------|--------|---|-------------------------|--|
|                                 | Company                  | Bank   | September 30, 2017                                  | January 1, 2019         | Bank                                   |
| Tier 1 leverage ratio           | 8.45%                    | 8.41%  | ≥ 4.00%   | ≥ 4.00%                 | ≥ 5.00%                                |
| CET1                            | 11.80%                   | 11.75% | ≥ 5.75%   | <sup>(3)</sup> ≥ 7.00%  | <sup>(4)</sup> ≥ 6.50%                 |
| Tier 1 risk-based capital ratio | 11.80%                   | 11.75% | ≥ 7.25%   | <sup>(3)</sup> ≥ 8.50%  | <sup>(4)</sup> ≥ 8.00%                 |
| Total risk-based capital ratio  | 12.62%                   | 12.57% | ≥ 9.25%   | <sup>(3)</sup> ≥ 10.50% | <sup>(4)</sup> ≥ 10.00%                |

<sup>(3)</sup> Includes 1.25% capital conservation buffer

<sup>(4)</sup> Includes 2.50% capital conservation buffer

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ITEM 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure

On May 8, 2018, the Audit Committee of the Company's Board of Directors (the "Audit Committee") decided to dismiss Baker Tilly Virchow Krause LLP ("Baker Tilly") as the Company's independent registered public accounting firm effective May 11, 2018.

The audit reports of Baker Tilly on the Company's consolidated financial statements as of and for the years ended September 30, 2017 and 2016 did not contain an adverse opinion or a disclaimer of opinion, and were not qualified or modified as to uncertainty, audit scope or accounting principles.

During the years ended September 30, 2017 and 2016 and through May 11, 2018, there were (1) no disagreements with Baker Tilly on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, that, if not resolved to the satisfaction of Baker Tilly, would have caused them to make reference to such disagreements in its report on the Company's financial statements for such periods, and (2) no reportable events (as defined in Item 304(a)(1)(v) of Regulation S-K).

The Audit Committee appointed RSM US LLP ("RSM") to serve as the Company's independent registered public accounting firm effective May 11, 2018. During the two most recent fiscal years and through May 11, 2018, the Company did not consult with RSM regarding any matters or events set forth in Item 304(a)(2)(i) or (ii) of SEC Regulation S-K.

ITEM 9A.

Controls and Procedures

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There has been no change in Magyar Bancorp, Inc.'s internal control over financial reporting during Magyar Bancorp, Inc.'s fourth quarter of fiscal year 2018 that has materially affected, or is reasonably likely to materially affect, Magyar Bancorp, Inc.'s internal control over financial reporting.

Report by Management on Internal Control over Financial Reporting

The management of Magyar Bancorp, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting. Magyar Bancorp Inc.'s internal control system was designed to provide reasonable assurance to the Magyar Bancorp, Inc.'s management and board of directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Magyar Bancorp, Inc.'s management assessed the effectiveness of the Company's internal control over financial reporting as of September 30, 2018. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) 2013 in Internal Control-Integrated Framework. Based on our assessment, we believe that, as of September 30, 2018, the Company's internal control over financial reporting was effective based on those criteria.

The Annual Report on Form 10-K does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to exemption rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.



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|       |                 |                          |
|-------|-----------------|--------------------------|
| None. | <u>ITEM 9B.</u> | <u>Other Information</u> |
|-------|-----------------|--------------------------|

PART III

ITEM 10.                      Directors, Executive Officers, and Corporate Governance

Magyar Bancorp, Inc. has adopted a Code of Ethics that applies to Magyar Bancorp, Inc.'s principal executive officer, principal financial officer, principal accounting officer or controller or persons performing similar functions. The Code of Ethics, and any amendments to and waivers from the Code of Ethics, will be posted on the Company's website located at [www.magbank.com](http://www.magbank.com). A copy of the Code will be furnished without charge upon written request to the Secretary, Magyar Bancorp, Inc., 400 Somerset Street, New Brunswick, New Jersey.

Information concerning directors and executive officers of Magyar Bancorp, Inc. is incorporated herein by reference from our definitive Proxy Statement related to our 2018 Annual Meeting of Stockholders (the "Proxy Statement"), specifically the section captioned "Proposal I - Election of Directors."

ITEM 11.                      Executive Compensation

Information concerning executive compensation is incorporated herein by reference from our Proxy Statement, specifically the section captioned "Proposal I - Election of Directors."

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information concerning security ownership of certain owners and management is incorporated herein by reference from our Proxy Statement, specifically the sections captioned "Voting Securities and Principal Holders Thereof" and "Proposal I - Election of Directors."

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

Information concerning relationships and transactions is incorporated herein by reference from our Proxy Statement, specifically the section captioned “Transactions with Certain Related Persons.”

ITEM 14.                    Principal Accountant Fees and Services

Information concerning principal accountant fees and services is incorporated herein by reference from our Proxy Statement, specifically the section captioned “Proposal IV - Ratification of Appointment of Independent Registered Public Accounting Firm.”

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## PART IV

| <u>ITEM 15.</u> |       | <u>Exhibits and Financial Statement Schedules</u>   |
|-----------------|-------|---|
| 3.1             |       | <u>Certificate of Incorporation of Magyar Bancorp, Inc.*</u>  |
|                 | 3.2   | <u>Bylaws of Magyar Bancorp, Inc.*</u>  |
| 4               |       | <u>Form of Common Stock Certificate of Magyar Bancorp, Inc.*</u>  |
|                 | 10.1  | <u>Form of Employee Stock Ownership Plan*</u>   |
| 10.2            |       | <u>Restated Executive Supplemental Retirement Income Agreement for Elizabeth E. Hance**</u>   |
| 10.3            |       | <u>Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Elizabeth E. Hance**</u>  |
| 10.4            |       | <u>Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Joseph J. Lukacs, Jr.**</u>   |
| 10.5            |       | <u>Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Salvatore J. Romano**</u>   |
| 10.6            |       | <u>Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Joseph A. Yelencsics**</u>  |
| 10.7            |       | <u>Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Edward C. Stokes, III**</u>   |
| 10.8            |       | <u>Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Martin A. Lukacs**</u>  |
| 10.9            |       | <u>Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Thomas Lankey**</u>   |
| 10.10           |       | <u>Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Andrew G. Hodulik**</u>   |
|                 | 10.11 | <u>Form of Employment Agreement for Elizabeth E. Hance*</u>   |
|                 | 10.12 | <u>Form of Change in Control Agreement for Executive Officers*</u>  |
|                 | 10.13 | <u>Executive Supplemental Retirement Income Agreement for Jon Ansari**</u>  |
|                 | 10.14 | <u>Executive Supplemental Retirement Income Agreement for John Fitzgerald**</u>   |
|                 | 10.15 | <u>Separation Agreement, between Magyar Bancorp and Elizabeth E. Hance***</u>   |
|                 | 10.16 | <u>2006 Equity Incentive Plan****</u>   |
|                 | 21    | <u>Subsidiaries of Registrant*</u>  |
|                 | 23    | <u>Consent of Experts and Counsel</u>   |
| 31.1            |       | <u>Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>   |
| 31.2            |       | <u>Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>   |
| 32              |       | <u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>  |
| 101             |       | The following materials from the Company's Annual Report on Form 10-K for the year ended September 30, 2018, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statement of Comprehensive Income, (iv) the Consolidated Statements of Changes in Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Consolidated Financial Statements. |

\* Incorporated by reference to the Registration Statement on Form SB-2 of Magyar Bancorp, Inc. (file no. 333-128392), originally filed with the Securities and Exchange Commission on September 16, 2005, as amended.

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- \*\* Incorporated by reference to the Annual Report on Form 10-KSB of Magyar Bancorp, Inc. (file no. 000-51726), originally filed with the Securities and Exchange Commission on December 29, 2006.
- \*\*\* Incorporated by reference to the Quarterly Report on Form 10-Q of Magyar Bancorp, Inc. (file no. 000-51726), originally filed with the Securities and Exchange Commission on February 16, 2010.
- \*\*\*\* Incorporated by reference to the Plan filed as an attachment to the Company's proxy statement dated January 8, 2007, filed with the Securities and Exchange Commission on January 8, 2007.

ITEM 16.

Form 10-K Summary

None

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SIGNATURES

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

**MAGYAR BANCORP, INC.**

December 20, 2018 By: /s/ John S. Fitzgerald  
Date John S. Fitzgerald  
President and Chief Executive Officer  
(Duly Authorized Representative)

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Pursuant to the requirements of the Securities Exchange of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signatures                                       | Title  | Date              |
|--|--|-------------------|
| /s/ John S. Fitzgerald<br>John S. Fitzgerald     | President and Chief Executive Officer<br>(Principal Executive Officer)                               | December 20, 2018 |
| /s/ Jon R. Ansari<br>Jon R. Ansari               | Executive Vice President and Chief Financial Officer<br>(Principal Financial and Accounting Officer) | December 20, 2018 |
| /s/ Thomas Lankey<br>Thomas Lankey               | Chairman of the Board  | December 20, 2018 |
| /s/ Andrew Hodulik<br>Andrew Hodulik             | Vice Chairman of the Board   | December 20, 2018 |
| /s/ Martin A. Lukacs<br>Martin A. Lukacs, D.M.D. | Director   | December 20, 2018 |
| /s/ Joseph A. Yelencsics<br>Joseph A. Yelencsics | Director   | December 20, 2018 |
| /s/ Edward C. Stokes<br>Edward C. Stokes, III    | Director   | December 20, 2018 |