# HARLEYSVILLE SAVINGS FINANCIAL CORPORATION

2013

Annual Report

# HARLEYSVILLE SAVINGS FINANCIAL CORPORATION
## 2013 ANNUAL REPORT

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CORPORATE PROFILE

Harleysville Savings Financial Corporation is a Pennsylvania corporation headquartered in Harleysville, Pennsylvania. The Company became the bank holding company for Harleysville Savings Bank in connection with the holding company reorganization of the Bank in February 2000 (the "Reorganization"). In August 1987, the Bank's predecessor, Harleysville Savings Association, converted to the stock form of organization. The Bank, whose predecessor was originally, incorporated in 1915, converted from a Pennsylvania chartered, permanent reserve fund savings association to a Pennsylvania chartered stock savings bank in June 1991. The Bank operates from six full-service offices located in Montgomery County and one office located in Bucks County, Pennsylvania. The Bank's primary market area includes Montgomery County, which has the third largest population and the second highest per capita income in the Commonwealth of Pennsylvania, and, to a lesser extent, Bucks County. As of September 30, 2013, the Company had \$810.4 million of total assets, \$534.7 million of deposits and \$61.6 million of stockholders' equity. The Company's stockholders' equity constituted 7.6% of total assets as of September 30, 2013.

The Bank's primary business consists of attracting deposits from the general public and business customers through a variety of deposit programs and investing such deposits principally in first mortgage loans secured by residential properties in the Bank's primary market area. The Bank also originates a variety of consumer loans, predominately home equity loans and lines of credit also secured by residential properties in the Bank's primary lending area. The Bank is also engaged in the general commercial banking business, and provides a full range of commercial loans and commercial real estate loans to customers in the Bank's primary market area. The Bank serves its customers through its full-service branch network as well as through remote ATM locations, the internet and telephone banking.

Deposits with the Bank are insured to the maximum extent provided by law through the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is subject to examination and comprehensive regulation by the FDIC and the Pennsylvania Department of Banking ("Department"). It is also a member of the Federal Home Loan Bank of Pittsburgh ("FHLB of Pittsburgh" or "FHLB"), which is one of the 12 regional banks comprising the Federal Home Loan Bank System ("FHLB System"). The Bank is also subject to regulations of the Board of Governors of the Federal Reserve System ("Federal Reserve Board") governing reserves required to be maintained against deposits and certain other matters.

The Company's principal executive offices are located at 271 Main Street, Harleysville, Pennsylvania 19438 and its telephone number is (215) 256-8828.

**Competition**

The Company faces significant competition in attracting deposits. Its most direct competition for deposits has historically come from commercial banks and other savings institutions located in its market area. The Company faces additional significant competition for investors' funds from other financial intermediaries. The Company competes for deposits principally by offering depositors a variety of deposit programs, convenient branch locations, hours and other services. The Company does not rely upon any individual group or entity for a material portion of its deposits.

The Company's competition for real estate loans comes principally from mortgage banking companies, other savings institutions, commercial banks and credit unions. The Bank competes for loan originations primarily through the interest rates and loan fees it charges, the efficiency and quality of services it provides borrowers, referrals from real estate brokers and builders, and the variety of its products. Factors which affect competition include the general and local economic conditions, current interest rate levels and volatility in the mortgage markets.

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") eliminated many of the distinctions between commercial banks and savings institutions and holding companies and allowed bank holding companies to acquire savings institutions. FIRREA has generally resulted in an increase in the competition encountered by savings institutions and has resulted in a decrease in both the number of savings institutions and the aggregate size of the savings industry.

## STOCK MARKET INFORMATION

Harleysville Savings Financial Corporation's common stock has traded on the OTC Bulletin Board since December 27, 2012, under the symbol "HARL". Prices shown below reflect the prices reported on the OTC Bulletin Board since December 27, 2012, and on the NASDAQ Stock Market prior thereto during the indicated periods. The closing price of the common stock on September 30, 2013, was $18.50 per share. There were 3,786,627 shares of common stock outstanding as of September 30, 2013, held by approximately 1,000 stockholders of record, not including the number of persons or entities whose stock is held in nominee or "street" name through various brokerage firms and banks.

| For The Quarter Ended | High | Low | Close | Cash Dividends Declared |
|---|---|---|---|---|
| September 30, 2013 | **$19.50** | **$17.20** | **$18.50** | **$0.21** |
| June 30, 2013 | **20.50** | **17.60** | **19.00** | **0.21** |
| March 31, 2013 | **18.50** | **14.93** | **18.13** | **0.21** |
| December 31, 2012 | **19.50** | **14.55** | **15.74** | **0.20** |
| | | | | |
| September 30, 2012 | $18.03 | $16.40 | $16.40 | $0.20 |
| June 30, 2012 | 19.48 | 16.00 | 17.72 | 0.20 |
| March 31, 2012 | 18.08 | 13.87 | 16.50 | 0.19 |
| December 31, 2011 | 15.14 | 13.28 | 14.34 | 0.19 |

## **Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The following discussion is intended to assist in understanding our financial condition, and the results of operations for Harleysville Savings Financial Corporation, and its subsidiary Harleysville Savings Bank, for the fiscal years ended September 30, 2013 and 2012. The information in this section should be read in conjunction with the Company's financial statements and the accompanying notes included elsewhere herein.

### Overview

Harleysville Savings Financial Corporation, a bank holding company, of which Harleysville Savings Bank (the "Bank"), is a wholly owned subsidiary, was formed in February 2000. For purposes of this discussion, the Company, including its wholly owned subsidiary, will be referred to as the "Company." The Company's earnings are primarily dependent upon its net interest income, which is determined by (i) the difference between yields earned on interest-earning assets and rates paid on interest-bearing liabilities ("interest rate spread") and (ii) the relative amounts of interest-earning assets and interest-bearing liabilities outstanding. The Company's interest rate spread is affected by regulatory, economic, and competitive factors that influence interest rates, loan demand and deposit flows. The Company, like other thrift institutions, is vulnerable to an increase in interest rates to the extent that interest-bearing liabilities mature or reprice more rapidly than interest-earning assets. To reduce the effect of adverse changes in interest rates on its operations, the Company has adopted certain asset and liability management strategies, described below. The Company's earnings are also affected by, among other factors, other non-interest income, other expenses, and income taxes.

The Company's total assets at September 30, 2013 amounted to $810.4 million compared to $802.6 million as of September 30, 2012. The increase in assets was primarily due to an increase in total investments of $41.2 million. The increase in investments was partially offset by a decrease in loans receivable of $18.0 million, and a decrease of $14.2 million in cash, loans held for sale, prepaid expenses and other assets. Total liabilities at September 30, 2013 were $748.7 million compared to $742.9 million at September 30, 2012. The increase in liabilities was due to an increase in borrowings of $13.2 million which was offset by a decrease in total deposits of $5.9 million. Stockholder's equity totaled $61.6 million at September 30, 2013 compared to $59.7 million at September 30, 2012.

During fiscal 2013, net interest income decreased $1.4 million or 7.1% from the prior fiscal year. This decrease was the result of a 2.7% decrease in the average interest-earning assets which was offset by a 4.3% decrease in average interest-bearing liabilities, and a decrease in the interest rate spread to 2.1% in fiscal year 2013 from 2.3% in fiscal year 2012. Net income for fiscal 2013 was $4.8 million compared to $5.1 million for the fiscal year ended 2012. The Company's return on average assets (net income divided by average total assets) was 0.6% during fiscal 2013 compared to 0.6% during fiscal 2012. Return on average equity (net income divided by average equity) was 8.0% during fiscal 2013 compared to 8.7% during fiscal 2012.

## Results of Operations

The following table sets forth as of the periods indicated, information regarding: (i) the total dollar amounts of interest income from interest-earning assets and the resulting average yields; (ii) the total dollar amount of interest expense on interest-bearing liabilities and the resulting average costs; (iii) net interest income; (iv) interest rate spread; (v) net interest-earning assets; (vi) the net yield earned on interest-earning assets; and (vii) the ratio of total interest-earning assets to total interest-bearing liabilities. Average balances are calculated on a monthly basis. Yields on tax-exempt assets have not been calculated on a fully tax-exempt basis.

| | As of September 30, 2013 | For The Year Ended September 30, 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|---|
| | Rate | Average Balance | Interest | Yield/Rate | Average Balance | Interest | Yield/Rate |
| | | | | (Dollars in Thousands) | | | |
| Interest-earning assets: | | | | | | | |
| Mortgage loans (2)(3) | **5.13%** | **$289,651** | **$ 15,519** | **5.36%** | $322,429 | $ 17,843 | 5.53% |
| Mortgage-backed securities | **2.43%** | **188,518** | **4,156** | **2.20%** | 155,510 | 5,199 | 3.34% |
| Commercial loans | **5.05%** | **110,987** | **5,789** | **5.22%** | 101,445 | 5,634 | 5.55% |
| Consumer and other loans(3) | **4.19%** | **96,429** | **3,470** | **3.60%** | 97,147 | 3,686 | 3.79% |
| Investments | **1.90%** | **93,828** | **1,653** | **1.76%** | 124,258 | 2,171 | 1.75% |
| Total interest-earning assets | **3.90%** | **779,413** | **30,587** | **3.92%** | 800,789 | 34,533 | 4.31% |
| Interest-bearing liabilities: | | | | | | | |
| Savings and money market | **0.19%** | **169,314** | **388** | **0.23%** | 150,762 | 565 | 0.37% |
| Checking | **0.10%** | **78,994** | **51** | **0.06%** | 72,089 | 56 | 0.08% |
| Certificates of deposit | **1.49%** | **267,028** | **4,290** | **1.61%** | 289,788 | 5,185 | 1.79% |
| Total deposits | **0.81%** | **515,336** | **4,729** | **0.92%** | 512,639 | 5,806 | 1.13% |
| Borrowings | **3.64%** | **187,261** | **7,798** | **4.16%** | 221,483 | 9,289 | 4.19% |
| Total interest-bearing liabilities | **1.62%** | **702,597** | **12,527** | **1.78%** | 734,122 | 15,095 | 2.06% |
| Net interest income/interest rate spread | **2.28%** | | **$ 18,060** | **2.14%** | | $ 19,438 | 2.25% |
| Net interest-earning assets/net yield on interest-earning assets(1) | | **$ 76,816** | | **2.32%** | $ 66,667 | | 2.43% |
| Ratio of interest-earning assets to interest-bearing liabilities | | | | **110.9%** | | | 109.1% |

(1) Net interest income divided by average interest-earning assets.
(2) Loan fee income is immaterial to this analysis.
(3) There were 54 non-accruing loans totaling $9.1 million at September 30, 2013, 43 non-accruing loans totaling $10.8 million at September 30, 2012.

**Net Interest Income**

Net interest income decreased by $1.4 million or 7.1% in fiscal 2013, over the prior year. The decrease in the net interest income in fiscal 2013 was due to a decrease in the interest rate spread between interest bearing assets and interest earning liabilities in spite of an increase in the balance sheet. The driving factors are further explained below under "- Interest Income" and "- Interest Expense."

**Interest Income**

Interest income on mortgage loans decreased by $2.3 million or 13.0% in fiscal 2013 from the prior year. During fiscal 2013, the average balance of mortgage loans decreased $32.8 million or 10.2% and the yield decreased by 17 basis points. The majority of loans during the year were fixed rate mortgages. The increase in interest on mortgage-backed securities reflects an increase in the average balance of $33.0 million, despite a decrease in the yield of 114 basis points in fiscal 2013. During fiscal 2013, the average consumer and other loan average balance decreased $718,000 or 0.7% and the yield decreased by 19 basis points. The increase on interest income on commercial loans during fiscal 2013 reflected an increase in average balance of $9.5 million, which was partially offset by a decrease in yield of 33 basis points.

Interest and dividends on investments decreased by $518,000 or 23.9% in fiscal 2013 from fiscal 2012. During fiscal 2013, the decrease in income resulted from an increase in yield of 1 basis point and a decrease in average balance of $30.4 million or 24.5%. The decrease in the average balance in fiscal 2013, is a result of investments maturing and being called due to a low interest rate environment.

**Interest Expense**

Interest expense on deposits decreased $1.1 million or 18.6% in fiscal 2013 as compared to the prior year. In fiscal 2013, the average balance of deposits increased by $2.7 million. The average rate paid on deposits was 0.9% for the year ended September 30, 2013, compared to 1.1% for the year ended September 30, 2012. The average rate paid on deposits is a direct reflection of the falling interest rate environment.

Interest expense on borrowings decreased by $1.5 million or 16.1% in fiscal 2013 compared to the prior year. The decrease in 2013 was primarily the result of a decrease in the average balance in borrowings of $34.2 million or 15.5%. Borrowings were primarily paid down by the maturity of investments during fiscal 2013.

**Provision for Loan Losses**

Management establishes reserves for losses on loans when it determines that losses are probable. The adequacy of loan loss reserves is based upon a regular monthly review of loan delinquencies and "classified assets", as well as local and national economic trends. The allowance for loan losses totaled $3.3 million and $4.0 million at September 30, 2013 and 2012 or 0.7% and 0.8% of total loans at September 30, 2013 and 2012, respectively. The Company recorded a provision for loan losses of $890,000 in fiscal 2013 compared to $930,000 in fiscal 2012, although the unemployment trends and property values remained constant from 2012 to 2013, our average loan value decreased from fiscal year end 2012 to fiscal year end 2013.

**Other Income**

The Company's total other operating income increased to $3.0 million in fiscal 2013 compared to $2.2 million in fiscal 2012. The increase in fiscal 2013 was primarily due to re-instatement of Federal Home Loan Bank (Mortgage Participation Finance) program. Income from sales of loans was $624,000 in fiscal 2013, compared to $34,000 in fiscal 2012.

Customer service fees were $564,000 and $578,000 in fiscal 2013 and 2012, respectively. The decrease was due to less NSF fees during 2013.

Other income, which consists primarily of loan servicing fees, the sale of non-deposit products and insurance commissions, increased by $253,000 or 24.4% during fiscal 2013. The fees, which comprise other income, are set by the Company at a level, which is intended to cover the cost of providing the related services and expenses to customers and employees.

**Other Expenses**

Salaries and employee benefits decreased by $223,000 or 2.9% in fiscal 2013 as compared to fiscal 2012. The decreased expenses of salaries and employee benefits during the periods are attributable to an increase in the amount of deferred salary loan expense, as a result of the FHLB MPF program, in fiscal 2013.

Occupancy and equipment expense decreased by $42,000 or 3.0% in fiscal 2013 compared to fiscal 2012. Data processing costs increased by $69,000 in fiscal 2013. The decrease in occupancy and equipment was attributable to normal fluctuation in building maintenance and furniture and fixture expenses. The increase in data processing expenses in fiscal 2013 was attributable to an implementation of a new online banking system and normal technology needs.

Other expenses, which consist primarily of advertising expenses, directors' fees, ATM network fees, professional fees, checking account costs, REO expenses, and stockholders expense decreased by $332,000 or 10.9% in fiscal 2013 compared to fiscal 2012. The decrease in other expenses in 2013 was attributable to the Bank de-registering from the SEC and not experiencing the related expenses as in the prior year. Included in fiscal 2012 other expenses is a reserve on unfunded loan commitments of $85,000.

FDIC insurance expense for the fiscal year 2013 increased $22,000 or 4.0% from fiscal 2012 due to a change in the assessment rate.

**Income Taxes**

The Company recorded income tax provisions of $2.4 million and $2.1 million for fiscal year 2013 and 2012, respectively. The effective tax rate was 32.9% in fiscal 2013 compared to 29.7% in fiscal 2012. See Note 8 of the "Notes to Consolidated Financial Statements" which provides an analysis of the provision for income taxes.

**Report of Management's Assessment of Internal Control over Financial Reporting**

Management is responsible for designing, implementing, documenting, and maintaining an adequate system of internal control over financial reporting. An adequate system of internal control over financial reporting encompasses the processes and procedures that have been established by management to:

- maintain records that accurately reflect the company's transactions;
- prepare financial statement and footnote disclosures in accordance with GAAP that can be relied upon by external users;
- prevent and detect unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Management conducted an evaluation of the effectiveness of the Company's internal control over financial reporting based on the criteria in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation under the criteria in Internal Control-Integrated Framework, management concluded that internal control over financial reporting was effective as of September 30, 2013. Furthermore, during the conduct of its assessment, management identified no material weakness in its financial reporting control system.

The Board of Directors of Harleysville Savings Financial Corporation, through its Audit Committee, provides oversight to managements' conduct of the financial reporting process. The Audit Committee, which is composed entirely of independent directors, is also responsible to recommend the appointment of independent public accountants. The Audit Committee also meets with management, the internal audit staff, and the independent public accountants throughout the year to provide assurance as to the adequacy of the financial reporting process and to monitor the overall scope of the work performed by the internal audit staff and the independent public accountants.

Because of its inherent limitations, our disclosure controls and procedures may not prevent or detect misstatements. A control system, no matter how well conceived and operated, can only provide reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

This annual report 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 under rules of the Securities and Exchange Commission that permits the Company to provide only management's report in this annual report.

/s/ Ronald B. Geib
President and Chief Executive Officer

/s/ Brendan J. McGill
Executive Vice President,
Chief Operating and Financial Officer

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AND CONSULTANTS

INDEPENDENT AUDITOR'S REPORT

Audit Committee
Harleysville Savings Financial Corporation
Harleysville, Pennsylvania

**Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of Harleysville Savings Financial Corporation, which comprise the balance sheet as of September 30, 2013; the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the year then ended; and the related notes to the consolidated financial statements.

**Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

S.R. Snodgrass, A.C. * 2100 Corporate Drive, Suite 400 * Wexford, Pennsylvania 15090-8399 * Phone: (724) 934-0344 * Facsimile: (724) 934-0345

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Harleysville Savings Financial Corporation as of September 30, 2013, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

**Other Matter**

The consolidated financial statements of Harleysville Savings Financial Corporation, as of and for the year ended September 30, 2012, were audited by other auditors whose report dated December 17, 2012, expressed an unmodified opinion on those statements.

S. R. Snodgrass, A.C.

Wexford, Pennsylvania
December 6, 2013

## Consolidated Statements of Financial Condition

| (In thousands, except share data) | September 30, 2013 | 2012 |
|---|---|---|
| **Assets** | | |
| Cash and amounts due from depository institutions | **$ 6,239** | $ 5,154 |
| Interest-bearing demand deposits | **8,889** | 18,432 |
| Total cash and cash equivalents | **15,128** | 23,586 |
| Investments and mortgage-backed securities: | | |
| Available for sale (amortized cost – 2013, $3,345; 2012, $11,578) | **3,394** | 11,688 |
| Held to maturity (fair value – 2013, $275,093; 2012, $236,538) | **276,497** | 227,018 |
| Loans receivable (net of allowance for loan losses - 2013, $3,345; 2012, $4,032) | **476,319** | 494,367 |
| Loans held for sale | **373** | 3,515 |
| Accrued interest receivable | **2,413** | 2,638 |
| Federal Home Loan Bank stock - at cost | **9,070** | 10,165 |
| Foreclosed real estate | **28** | - |
| Office properties and equipment, net | **11,178** | 11,550 |
| Bank-owned life insurance | **14,465** | 14,028 |
| Prepaid expenses and other assets | **1,498** | 4,071 |
| TOTAL ASSETS | **$ 810,363** | $ 802,626 |
| **Liabilities and Stockholders' Equity** | | |
| Liabilities: | | |
| Deposits | **$ 534,718** | $ 540,578 |
| Short-term borrowings | **33,475** | 2,346 |
| Long-term debt | **174,583** | 192,483 |
| Accrued interest payable | **776** | 929 |
| Advances from borrowers for taxes and insurance | **1,329** | 1,241 |
| Accounts payable and accrued expenses | **3,780** | 5,313 |
| Income tax payable | **85** | - |
| Total liabilities | **748,746** | 742,890 |
| Commitments and contingencies (Notes 13 & 14) | **-** | - |
| Stockholders' Equity: | | |
| Preferred Stock: $.01 par value; 7,500,000 shares authorized; none issued | **-** | - |
| Common stock: $.01 par value; 15,000,000 shares authorized; 3,921,177 shares issued: shares outstanding 2013, 3,786,627; 2012, 3,768,931 | **39** | 39 |
| Additional paid-in capital | **8,763** | 8,717 |
| Treasury stock, at cost (2013, 134,550 shares; 2012, 152,246 shares) | **(2,158)** | (2,351) |
| Retained earnings - partially restricted | **54,940** | 53,258 |
| Accumulated other comprehensive income | **33** | 73 |
| Total stockholders' equity | **61,617** | 59,736 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | **$ 810,363** | $ 802,626 |

*See notes to consolidated financial statements.*

## Consolidated Statements of Income

| (In thousands, except share and per share data) | Year Ended September 30, 2013 | 2012 |
|---|---|---|
| **Interest and Dividend Income:** | | |
| Interest and fees on mortgage loans | **$ 15,519** | $ 17,843 |
| Interest on commercial loans | **5,789** | 5,634 |
| Interest on consumer and other loans | **3,470** | 3,686 |
| Interest on mortgage-backed securities | **4,156** | 5,199 |
| Interest on taxable investments | **1,101** | 1,463 |
| Interest on tax-exempt investments | **549** | 704 |
| Dividends on investment securities | **3** | 4 |
| **Total interest and dividend income** | **30,587** | 34,533 |
| **Interest Expense:** | | |
| Interest on deposits | **4,729** | 5,806 |
| Interest on short-term borrowings | **21** | 11 |
| Interest on long-term debt | **7,777** | 9,278 |
| **Total interest expense** | **12,527** | 15,095 |
| **Net Interest Income** | **18,060** | 19,438 |
| **Provision for Loan Losses** | **890** | 930 |
| **Net Interest Income, after Provision for Loan Losses** | **17,170** | 18,508 |
| **Other Income:** | | |
| Customer service fees | **564** | 578 |
| Realized gains on securities | **68** | 34 |
| Realized gains on loans, net | **624** | 34 |
| Income on bank-owned life insurance | **437** | 486 |
| Other income | **1,291** | 1,038 |
| **Total other income** | **2,984** | 2,170 |
| **Other Expenses:** | | |
| Salaries and employee benefits | **7,510** | 7,733 |
| Occupancy and equipment | **1,346** | 1,388 |
| Deposit insurance premiums | **575** | 553 |
| Data processing | **822** | 753 |
| Other | **2,729** | 3,061 |
| **Total other expenses** | **12,982** | 13,488 |
| **Income before Income Tax Expense** | **7,172** | 7,190 |
| Income tax expense | **2,359** | 2,137 |
| **Net Income** | **$ 4,813** | $ 5,053 |
| **Earnings Per Share:** | | |
| Basic | **$ 1.28** | $ 1.35 |
| Diluted | **$ 1.25** | $ 1.33 |
| **Weighted-Average Shares Outstanding:** | | |
| Basic | **3,774,419** | 3,747,729 |
| Diluted | **3,863,016** | 3,811,447 |

*See notes to consolidated financial statements.*

## Consolidated Statements of Comprehensive Income

| (In Thousands) | Year Ended September 30, 2013 | 2012 |
|---|---|---|
| **Net Income** | | |
| Other Comprehensive Income (Loss) | **$ 4,813** | $ 5,053 |
| Unrealized gains on available-for-sale-securities | **7** | 188 |
| Income tax effect | **(2)** | (64) |
| Reclassification adjustment for investment security gains included in net income | **(68)** | (34) |
| Income tax effect | **23** | 12 |
| Other comprehensive (loss) income, net of tax | **(40)** | 102 |
| **Comprehensive income** | **$ 4,773** | $ 5,155 |

*See notes to consolidated financial statements.*

## Consolidated Statements of Stockholders' Equity

| (In thousands, except share data) | Common Stock Shares Outstanding | Common Stock | Additional Paid-in Capital | Retained Earnings-Partially Restricted | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| Balance at September 30, 2011 | 3,758,751 | $ 39 | $ 8,346 | $ 51,131 | $ (29) | $ (2,405) | $ 57,082 |
| Net income | | | | 5,053 | | | 5,053 |
| Dividends - $.78 per share | | | | (2,926) | | | (2,926) |
| Restricted stock awards | 565 | | (8) | | | 8 | - |
| Stock based compensation | | | 189 | | | | 189 |
| Treasury stock delivered under 401(k) | 65,249 | | 93 | | | 897 | 990 |
| Treasury stock purchase | (115,546) | | | | | (1,679) | (1,679) |
| Treasury stock delivered under dividend reinvestment plan | 41,196 | | 116 | | | 569 | 685 |
| Employee options exercised | 18,716 | | (19) | | | 259 | 240 |
| Other comprehensive income | | | | | 102 | | 102 |
| Balance at September 30, 2012 | 3,768,931 | 39 | 8,717 | 53,258 | 73 | (2,351) | 59,736 |
| Net income | | | | **4,813** | | | **4,813** |
| Dividends - $.83 per share | | | | **(3,131)** | | | **(3,131)** |
| Restricted stock awards | **1,567** | | **(22)** | | | **22** | **-** |
| Stock based compensation | | | **185** | | | | **185** |
| Treasury stock delivered under 401(k) | **1,949** | | **8** | | | **36** | **44** |
| Treasury stock purchase | **(33,332)** | | | | | **(560)** | **(560)** |
| Treasury stock delivered under dividend reinvestment plan | **10,366** | | **32** | | | **153** | **185** |
| Employee options exercised | **37,146** | | **(157)** | | | **542** | **385** |
| Other comprehensive income | | | | | **(40)** | | **(40)** |
| Balance at September 30, 2013 | **3,786,627** | **$39** | **$ 8,763** | **$ 54,940** | **$ 33** | **$ (2,158)** | **$ 61,617** |

*See notes to consolidated financial statements.*

## Consolidated Statements of Cash Flows

| (In Thousands) | Year Ended September 30, 2013 | 2012 |
|---|---|---|
| **Operating Activities:** | | |
| Net Income | $ 4,813 | $ 5,053 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 605 | 611 |
| Provision for loan losses | 890 | 930 |
| Deferred income taxes | 192 | (365) |
| Gains on sales of securities | (68) | (34) |
| Gain on sale of foreclosed real estate | (50) | (9) |
| Gain on sale of mortgages | (624) | (34) |
| Origination of mortgage loans held for sale | (16,905) | (4,276) |
| Proceeds from sale of mortgage loans held for sale | 20,671 | 795 |
| Amortization of deferred fees | 341 | 251 |
| Net accretion of premiums and discounts | 1,810 | (352) |
| Increase in cash surrender value of bank-owned life insurance | (437) | (486) |
| Stock based compensation | 185 | 189 |
| Changes in assets and liabilities which provided (used) cash: | | |
| (Decrease) increase in accounts payable and accrued expenses | (1,449) | 3,961 |
| Decrease (increase) in prepaid expenses and other assets | 2,401 | (1,095) |
| Decrease in accrued interest receivable | 225 | 209 |
| Decrease in accrued interest payable | (153) | (386) |
| Net cash provided by operating activities | 12,447 | 4,962 |
| **Investing Activities:** | | |
| Purchase of mortgage-backed securities held to maturity | (126,575) | (72,576) |
| Purchase of investment securities held to maturity | (24,624) | (63,866) |
| Purchase of investment securities available-for-sale | (74,367) | (127,929) |
| Purchase of FHLB stock | (2,069) | - |
| Redemption of FHLB stock | 3,164 | 2,945 |
| Proceeds from the sale of investment securities available for -sale | 399 | 58 |
| Proceeds from the redemption of investment securities available for sale | 82,269 | 134,897 |
| Proceeds from maturities of investment securities held to maturity | 26,125 | 65,795 |
| Principal collected on mortgage-backed securities held to maturity | 73,785 | 331 |
| Proceeds from sale of foreclosed real estate | 278 | 75,737 |
| Decrease in loans, net | 16,561 | 22,812 |
| Net cash (used in) provided by investing activities | (233) | (156) |
| | (25,287) | 38,048 |
| **Financing Activities:** | | |
| Net increase in demand deposits, NOW accounts, and savings accounts | 25,088 | 34,801 |
| Net decrease in certificates of deposit | (30,946) | (16,279) |
| Cash dividends | (3,131) | (2,241) |
| Decrease in other borrowings – short term | 31,129 | 2,000 |
| Repayment of long-term debt | (17,900) | (59,711) |
| Acquisition of treasury stock | (560) | (1,679) |
| Sale of treasury stock delivered under employee stock plans | 614 | 1,230 |
| Net decrease (increase) in advances from borrowers for taxes and insurance | 88 | (127) |
| Net cash provided by (used in) financing activities | 4,382 | (42,006) |
| **(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS** | (8,458) | 1,004 |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR** | 23,586 | 22,582 |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | $ 15,128 | $ 23,586 |
| **Supplemental Disclosure of Cash Flow Information** | | |
| Cash paid during the period for: | | |
| Interest (credited and paid) | $ 12,679 | $ 15,481 |
| Income taxes | 2,150 | 2,520 |
| Non-cash transfer of loans to foreclosed real estate | 255 | 126 |

*See notes to consolidated financial statements*

**Notes to Consolidated Financial Statements**

**1. Nature of Operations and Organizational Structure**

Harleysville Savings Financial Corporation (the "Company") is a bank holding company that is regulated by the Federal Reserve Bank of Philadelphia. Harleysville Savings Bank (the "Bank") is a wholly owned subsidiary and is regulated by the FDIC and the Pennsylvania Department of Banking. The Bank is principally in the business of attracting deposits through its branch offices and investing those deposits, together with funds from borrowings and operations, primarily in single-family residential, commercial, consumer loans, and investments. The Bank's customers are primarily in southeastern Pennsylvania.

**2. Summary of Significant Accounting Policies**

**Principles of Consolidation -** The accompanying consolidated financial statements include the accounts of the Company, the Bank, and the Bank's wholly owned subsidiary, HSB Inc., a Delaware subsidiary which was formed in order to accommodate the transfer of certain assets, Freedom Financial Solutions LLC that allows the Company to offer non-deposit products and HARL, LLC that allows the Bank to invest in equity investments. All significant intercompany accounts and transactions have been eliminated in consolidation.

**Use of Estimates in Preparation of the Consolidated Financial Statements -** The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Statement of Financial Condition and the reported amounts of income and expenses during the reporting period. The most significant of these estimates and assumptions in the Company's consolidated financial statements is the allowance for loan losses and other-than-temporary impairment of investments. Actual results could differ from those estimates.

**Significant Group Concentrations of Credit Risk -** Most of the Company's activities are with customers located within the southeastern region of Pennsylvania. Note 3 discusses the types of securities that the Company invests in. Note 4 discusses the types of lending that the Company engages in. The Company does not have any significant concentrations to any one industry or customer.

**Cash and Cash Equivalents -** For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and amounts due from depository institutions, including interest-bearing demand deposits in banks with original maturities of less than 90 days.

**Investment and Mortgage-Backed Securities -** The Company classifies and accounts for debt and equity securities as follows:

**Held to Maturity -** Debt securities that management has the positive intent and ability to hold until maturity are classified as held to maturity and are carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts. Premiums are amortized and discounts are accreted using the interest method over the estimated remaining term of the underlying security.

**Available for Sale -** Debt and equity securities that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity and changes in the availability of and the yield of alternative investments are classified as available for sale. These assets are carried at fair value. Unrealized gains and losses are excluded from earnings and are reported net of tax in other comprehensive income. Realized gains and losses on the sale of investment securities are recorded as of the trade date, reported in the Consolidated Statement of Income and determined using the amortized cost of the specific security sold.

For all securities that are in an unrealized loss position for an extended period of time and for all securities whose fair value is significantly below amortized cost, the Company performs an evaluation of the specific events attributable to the market decline of the security. The Company considers the length of time and extent to which the security's fair value has been below cost as well as the general market conditions, industry characteristics, and the fundamental operating results of the issuer to determine if the decline is other-than-temporary. The Company also considers as part of the evaluation its intent and ability to hold the security and whether it is more likely than not that it will be required to sell the security before its fair value has recovered to a level at least equal to the amortized cost.

For equity securities, once a decline in value is determined to be other than temporary, the value of the equity security is reduced to fair value and a corresponding charge to earnings is recognized.

For debt securities, accounting guidance specifies that (a) if a company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security, and it is more likely than not, the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. For debt securities held to maturity, the amount of an other-than-temporary impairment recorded in other comprehensive income for the noncredit portion of a previous other-than-temporary impairment should be amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

When the Company determines that a security's unrealized loss is other than temporary, an impairment loss is recognized in the period in which the decline in value is determined to be other than temporary.

**Loans** - The Company grants commercial, mortgage, and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout southeastern Pennsylvania. The ability of the Company's debtors to honor their contracts is dependent upon the general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans.

**Loans Held For Sale** - Loans originated and intended for sale in the secondary market are carried at the lower of cost or market. Gains and losses on loan sales (sales proceeds minus carrying value) are recorded in noninterest income, and direct loan origination costs and fees are deferred at origination of the loan and are recognized in noninterest income upon sale of the loan.

**Interest Income on Loans** - Interest income is accrued on the unpaid principal balance. Interest on loans is recognized as income when earned. The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged-off are reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

**Deferred Loan Fees** - Loan origination fees, net of certain direct origination costs, are deferred and the balance is amortized to income as an adjustment over the life of the loan using the interest method.

**Allowance for Loan Losses** - The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. An allowance for loan losses is maintained at a level that management considers adequate to provide for losses based upon evaluation of known and inherent risks in the loan portfolio. The loan loss reserves are established as an allowance for estimated losses based on the probable losses of the loan portfolio. In assessing risk, management considers historical experience, volume and composition of lending conducted by the Company, industry standards, and status of nonperforming loans, general economic conditions as they relate to the Company's market area, and other factors related to the collectibility of the Company's loan portfolio.

The allowance for loan losses consists of three elements: (1) specific allowances for impaired loans; (2) a general valuation allowance on all classified loans which are not impaired; and (3) a general valuation allowance on the remainder of the loan portfolio. This is consistent with the regulatory method of classifying reserves. Although the amount of each element of the allowance is determined separately, the entire allowance for loan losses is available for the entire portfolio. An allowance for impaired loans is established in the amounts by which the discounted cash flows (or collateral value or observable market price) are lower than the carrying value of the loan. A general allowance is established for classified loans that are not impaired. These loans are segregated by loan category, and allowance percentages are assigned to each category based on inherent losses associated with each type of lending and consideration that these loans, in the aggregate, represent an above-average credit risk and that more of these loans will prove to be uncollectible compared to loans in the general portfolio.

**Foreclosed Real Estate -** Real estate acquired through, or in lieu of, loan foreclosures are carried at the lesser of cost or fair value of the property, based on an appraisal less cost to sell. Costs relating to the development and improvement of the property are capitalized, and those relating to holding the property are charged to expense. The Company had foreclosed real estate of $28,000 and $0 as of September 30, 2013 and 2012, respectively.

**Office Properties and Equipment -** Land is carried at cost. Office properties and equipment are recorded at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the expected useful lives of the assets that range from four to forty years. The costs of maintenance and repairs are expensed as they are incurred, and renewals and betterments are capitalized.

**Federal Home Loan Bank Stock -** Federal law requires a member institution of the Federal Home Loan Bank ("FHLB") to hold stock of its district FHLB according to a predetermined formula. The restricted stock is carried at cost. In December 2008, the FHLB of Pittsburgh notified member banks that it was suspending dividend payments and the repurchase of capital stock. During 2013 and 2012, the FHLB allowed certain redemptions. In February 2012, the FHLB of Pittsburgh issued its first dividend payment since 2008.

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

Management evaluated the stock and concluded that the stock was not impaired for the periods presented herein. More consideration was given to the long-term prospects for the FHLB as opposed to the recent stress caused by the extreme economic conditions the world is facing. Management also considered that the FHLB maintains regulatory capital ratios in excess of all regulatory capital requirements, liquidity appears adequate, new shares of FHLB Stock continue to change hands at the $100 par value, and the resumption of dividends.

**Cash Surrender Value of Bank-Owned Life Insurance ("BOLI") -** The Bank funded the purchase of insurance policies on the lives of officers and employees of the Bank. The Company has recognized any increase in cash surrender value of life insurance, net of insurance costs, in the Consolidated Statements of Income as income on BOLI. The cash surrender value of the insurance policies is recorded as an asset in other assets in the Consolidated Statements of Financial Condition and amounted to $14.0 million and $14.0 million at September 30, 2013 and 2012, respectively.

**Income Taxes -** Deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. The Company and its subsidiary file a consolidated federal income tax return.

The Company analyzes each tax position taken in its tax returns and determines the likelihood that the position will be realized. Only tax positions that are "more likely than not" to be realized can be recognized in the Company's financial statements. For tax positions that do not meet this recognition threshold, the Company will record an unrecognized tax benefit for the difference between the position taken on the tax return and the amount recognized in the financial statements. The Company does not have any material unrecognized tax benefits or accrued interest or penalties at September 30, 2013 and 2012, or during the years then ended. No unrecognized tax benefits are expected to arise within the next twelve months. The Company's policy is to account for interest as a component of interest expense and penalties as a component of other expenses. The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax of the Commonwealth of Pennsylvania. The Company is no longer subject to examination by taxing authorities for the years before October 1, 2008.

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

**Treasury Stock -** The Company records treasury stock purchases at cost. Gains and losses on subsequent reissuance of shares are credited or charged to additional paid-in capital using the average-cost method.

**Stock Based Compensation -** The Company currently has several stock based compensation plans in place for employees and directors of the Company. The Company recognizes the cost of employee services received in exchange for an award of equity investment based on grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. Stock-based compensation expense for the years ended September 30, 2013 and 2012 was $185,000 and $189,000, respectively. The tax benefit recognized related to the compensation expense for the years ended September 30, 2013 and 2012 was $19,000 and $16,000, respectively.

**Earnings Per Share -** Basic earnings per common share is computed based on the weighted-average number of shares outstanding. Diluted earnings per share is computed based on the weighted-average number of shares outstanding, increased by additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate to outstanding stock options and unvested stock awards, and are determined using the treasury stock method. The number of anti-dilutive options that are excluded from the earnings per share calculation for the years ended September 30, 2013 and 2012 were 23,550 and 168,334, respectively. The weighted-average shares outstanding used to calculate earnings per share were as follows:

| | Year Ended September 30, | |
|---|---|---|
| | **2013** | **2012** |
| Weighted-average shares outstanding – basic | **3,774,419** | 3,747,729 |
| Increase in shares due to dilutive potential common shares | **88,597** | 63,718 |
| Weighted-average shares outstanding – diluted | **3,863,016** | 3,811,447 |

**Other Comprehensive Income -** The Company presents, as a component of comprehensive income, amounts from transactions and other events, which are currently excluded from the statement of income and are recorded directly to stockholders' equity. The Company's other comprehensive income consists of net unrealized holding gains or losses on securities available for sale, net of income taxes.

**Reclassifications -** Certain amounts in the prior period's financial statements have been reclassified to conform with the current year classifications. The reclassifications had no effect on net income.

**Recent Accounting Pronouncements -** In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.* The standard requires that companies present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. The new requirements will take effect for public companies in fiscal years, and interim periods within those years, beginning after December 15, 2012. The Company adopted this standard on January 1, 2013. The effect of adopting this standard increased our disclosure surrounding reclassification items out of accumulated other comprehensive income.

In February 2013, the FASB issued ASU 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date*. The ASU requires the measurement of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement with its co-obligors as well as any additional amount that the entity expects to pay on behalf of its co-obligors. The new standard is effective retrospectively for fiscal years and interim periods within those years, beginning after December 15, 2013, and early adoption is permitted. This ASU is not expected to have a significant impact on the Company's financial statements.

In April 2013, the Financial Accounting Standards Board FASB issued ASU 2013-07, *Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting.* The amendments in this Update are being issued to clarify when an entity should apply the liquidation basis of accounting. In addition, the guidance provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. The amendments require an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent. Liquidation is imminent when the likelihood is remote that the entity will return from liquidation and either (a) a plan for liquidation is approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan will be blocked by other parties or (b) a plan for liquidation is being imposed by other forces (for example, involuntary bankruptcy). If a plan for liquidation was specified in the entity's governing documents from the entity's inception (for example, limited-life entities), the entity should apply the liquidation basis of accounting only if the approved plan for liquidation differs from the plan for liquidation that was specified at the entity's inception. The amendments are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted. Entities that use the liquidation basis of accounting as of the effective date in accordance with other Topics (for example, terminating employee benefit plans) are not required to apply the amendments. Instead, those entities should continue to apply the guidance in those other Topics until they have completed liquidation. This ASU is not expected to have a significant impact on the Company's financial statements.

In June 2013, the FASB issued ASU 2013-08, *Financial Services – Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements.* The amendments in this Update affect the scope, measurement, and disclosure requirements for investment companies under U.S. GAAP. The amendments do all of the following: 1. Change the approach to the investment company assessment in Topic 946, clarify the characteristics of an investment company, and provide comprehensive guidance for assessing whether an entity is an investment Company. 2. Require an investment company to measure noncontrolling ownership interests in other investment companies at fair value rather than using the equity method of accounting. 3. Require the following additional disclosures: (a) the fact that the entity is an investment company and is applying the guidance in Topic 946, (b) information about changes, if any, in an entity's status as an investment company, and (c) information about financial support provided or contractually required to be provided by an investment company to any of its investees. The amendments in this Update are effective for an entity's interim and annual reporting periods in fiscal years that begin after December 15, 2013. Earlier application is prohibited. This ASU is not expected to have a significant impact on the Company's financial statements.

In July 2013, the FASB issued ASU 2013-10, *Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes.* The amendments in this Update permit the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to UST and LIBOR. The amendments also remove the restriction on using different benchmark rates for similar hedges. The amendments are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. This ASU did not have a significant impact on the Company's financial statements.

In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists.* This Update applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. For nonpublic entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. This ASU is not expected to have a significant impact on the Company's financial statements.

## 3. INVESTMENT AND MORTGAGE-BACKED SECURITIES

The amortized cost and fair value of the Company's securities with gross unrealized gains and losses, as of September 30, 2013 and 2012 are as follows:

**Available for sale securities:**

| | September 30, 2013 | | | |
|---|---|---|---|---|
| **(In Thousands)** | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** |
| Collateralized mortgage obligations | **$ 785** | **$ 49** | **$ -** | **$ 834** |
| U.S. Government money market funds | **2,560** | **-** | **-** | **2,560** |
| Total Available for Sale Securities | **$ 3,345** | **$ 49** | **$ -** | **$ 3,394** |

| | September 30, 2012 | | | |
|---|---|---|---|---|
| **(In Thousands)** | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Equity securities | $ 331 | $ 106 | $ (49) | $ 388 |
| Collateralized mortgage obligations | 785 | 53 | - | 838 |
| U.S. Government money market funds | 10,462 | - | - | 10,462 |
| Total Available for Sale Securities | $ 11,578 | $ 159 | $ (49) | $ 11,688 |

**Held to maturity securities:**

| | September 30, 2013 | | | |
|---|---|---|---|---|
| **(In Thousands)** | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** |
| Mortgage-backed securities- U.S. Government-Sponsored Enterprises ("GSEs") | **$ 208,058** | **$ 3,872** | **$ (2,345)** | **$ 209,585** |
| Collateralized mortgage obligations | **4,733** | **72** | **(26)** | **4,779** |
| Municipal bonds | **15,817** | **476** | **(528)** | **15,765** |
| U.S. Government Agencies | **47,889** | **3** | **(2,928)** | **44,964** |
| Total Held to Maturity Securities | **$ 276,497** | **$ 4,423** | **$ (5,827)** | **$ 275,093** |

| | September 30, 2012 | | | |
|---|---|---|---|---|
| **(In Thousands)** | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Fair Value** |
| Mortgage-backed securities- U.S. Government-Sponsored Enterprises ("GSEs") | $ 153,032 | $ 8,020 | $ - | $ 161,052 |
| Collateralized mortgage obligations | 8,840 | 128 | - | 8,968 |
| Municipal bonds | 13,270 | 1,174 | - | 14,444 |
| U.S. Government Agencies | 51,876 | 198 | - | 52,074 |
| Total Held to Maturity Securities | $ 227,018 | $ 9,520 | $ - | $ 236,538 |

All the Company's mortgage-backed securities and collateralized mortgage obligations are residential. At September 30, 2013, the Bank held $5.6 million in Collateralized Mortgage Obligations ("CMOs") of which $4.6 million were issued by Government-Sponsored Enterprises and $1.0 million were privately-issued. These private-label securities are adequately rated.

A summary of securities with unrealized losses, aggregated by category, at September 30, 2013 is as follows:

| | Less than 12 Months | | 12 Months or Longer | | | |
|---|---|---|---|---|---|---|
| **(In Thousands)** | **Fair Value** | **Unrealized Losses** | **Fair Value** | **Unrealized Losses** | **Total Fair Value** | **Total Unrealized Losses** |
| Mortgage-backed securities | $ 115,453 | $ (2,345) | $ - | $ - | $ 115,453 | $ (2,345) |
| Collateralized mortgage obligations | 1,402 | (26) | - | - | 1,402 | (26) |
| Municipal bonds | 4,669 | (528) | - | - | 4,669 | (528) |
| U.S. Government Agencies | 41,961 | (2,928) | - | - | 41,961 | (2,928) |
| Total temporarily impaired securities | $ 163,485 | $ (5,827) | $ - | $ - | $ 163,485 | $ (5,827) |

At September 30, 2013, debt securities in a gross unrealized loss position consisted of 70 securities that at such date had an aggregate depreciation of 3.56% from the Company's amortized cost basis. Management believes that the estimated fair value of the securities disclosed above is primarily dependent upon the movement in market interest rates. Management evaluated the length of time and the extent to which the fair value has been less than cost, the financial condition, and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer. The Company has the ability and intent to hold these securities until maturity and the Company does not believe it will be required to sell such securities prior to the recovery of the amortized cost basis. Management does not believe any individual unrealized loss on debt securities as of September 30, 2013, represents an other-than-temporary impairment.

At September 30, 2012, the Company had unrealized losses of $49,000 on equity securities with a fair market value of $163,000. The securities were in an unrealized loss position for greater than twelve months. There were no securities in an unrealized loss position for less than twelve months.

The following table sets forth the stated maturities of the investment and mortgage-backed securities at September 30, 2013. Money market funds and equity securities are not included in the table based on lack of maturity.

| | September 30, 2013 | |
|---|---|---|
| (In Thousands) | **Amortized Cost** | **Fair Value** |
| Available for sale: | | |
| Due after ten years | $ 785 | $ 834 |
| Total | $ 785 | $ 834 |
| | | |
| Held to maturity: | | |
| Due in one year or less | $ 304 | $ 321 |
| Due after on year through five years | 2,085 | 2,202 |
| Due after five years through ten years | 93,048 | 93,127 |
| Due after ten years | 181,060 | 179,443 |
| Total | $ 276,497 | $ 275,093 |

During fiscal 2013, the Company liquidated its investment in the HARL program which consisted of five equity securities. The bank sold the five equity securities with proceeds totaling $399,000 with gross gains of $122,000 and gross losses of $54,000.

There was one sale of an investment security with proceeds totaling $58,000 and a gross gain of $34,000 during the year ended September 30, 2012.

Certain of the Company's investment securities, totaling $7.6 million and $16.6 million at September 30, 2013 and 2012, respectively, were pledged as collateral to secure deposit sweep accounts and public deposits as required or permitted by law. Other securities totaling $58.0 million and $55.7 million at September 30, 2013 and 2012, respectively, were pledged for long-term advances of $50 million as described in Note 7.

## 4. LOANS RECEIVABLE

Loans receivable consists of the following:

| (In Thousands) | September 30, 2013 | 2012 |
|---|---|---|
| Residential Mortgages | **$ 274,629** | $ 312,126 |
| Construction | **1,870** | 3,258 |
| Home Equity | **83,514** | 80,402 |
| Commercial Mortgages | **116,778** | 97,659 |
| Commercial Business Loans | **3,209** | 6,059 |
| Consumer Non-Real Estate | **853** | 1,272 |
| Total | **480,853** | 500,776 |
| Undisbursed portion of loans in process | **(713)** | (1,362) |
| Deferred loan fees | **(476)** | (1,015) |
| Allowance for loan losses | **(3,345)** | (4,032) |
| Loans Receivable - net | **$ 476,319** | $ 494,367 |

At September 30, 2013 and 2012, the Company was servicing residential mortgage loans for others amounting to approximately $20.3 million and $1.2 million, 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 recognized over the life of the loan. The Company receives a servicing fee of 0.25% on sold loans, which totaled $126,000 as of September 30, 2013. These servicing fees are included in prepaid expenses and other assets on the Consolidated Statement of Financial Condition. In connection with the loans serviced for others, the Company held borrowers' escrow balances of approximately $78,500 and $5,000 at September 30, 2013 and 2012, respectively. The net gain on residential mortgage sales is directly related to the volume of mortgages sold and the timing of the sales relative to the interest rate environment. Residential mortgage loans to be sold are identified at origination. The net gain on the sale of residential mortgage loans was $624,000 and $34,000 for 2013 and 2012, respectively. This $590,000 increase in the net gain on sale of loans was result of new residential mortgage activity during 2013. Proceeds from the sale of residential mortgages were $20.7 million and $795,000 for 2013 and 2012, respectively.

The Bank has had, and may be expected to have in the future, loan transactions in the ordinary course of business with directors, officers, principal stockholders, their immediate families, and affiliated companies (commonly referred to as related parties) on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. Loans to related parties at September 30, 2013 and 2012, were approximately $642,000 and $692,000, respectively. Additional loans and repayments, net, for the year ended September 30, 2013 were $50,000 compared to $44,000 for the year ended September 30, 2012.

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

The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Because all identified losses are immediately charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

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

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These significant factors may include changes in lending policies and procedures, changes in existing general economic and business conditions affecting our primary lending areas, credit quality trends, collateral value, loan volumes and concentrations, seasoning of the loan portfolio, recent loss experience in particular segments of the portfolio, duration of the current business cycle, and bank regulatory examination results. The applied loss factors are reevaluated quarterly to ensure their relevance in the current economic environment.

Residential mortgage lending generally entails a lower risk of default than other types of lending. Other consumer loans and commercial real estate loans generally involve more risk of collectability because of the type and nature of the collateral and, in certain cases, the absence of collateral. It is the Company's policy to establish specific reserves for losses on delinquent commercial loans when it determines that losses are probable.

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

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

An allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of substantially all of the Company's impaired loans are measured based on the estimated fair value of the loans' collateral. Interest payments on impaired loans and nonaccrual loans are applied to principal unless the ability to collect the principal amount is fully secured, in which case interest is recognized on the cash basis.

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

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

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors, and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial and consumer loans. Credit quality risk ratings include regulatory classifications of Special Mention, Substandard, Doubtful, and Loss. Loans criticized Special Mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified Substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified Doubtful have all the weaknesses inherent in loans classified Substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a Loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated Pass.

In addition, federal regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of Special Mention, Substandard, and Doubtful within the Company's internal risk rating system as of September 30, 2013 and 2012:

**September 30, 2013**

| **(In Thousands)** | **Pass** | **Special Mention** | **Substandard** | **Doubtful** | **Total** |
|---|---|---|---|---|---|
| Residential Mortgages | **$ 269,793** | **$ 201** | **$ 3,134** | **$ 1,501** | **$ 274,629** |
| Construction | **1,870** | **-** | **-** | **-** | **1,870** |
| Home Equity | **82,871** | **241** | **377** | **25** | **83,514** |
| Commercial Mortgages | **100,621** | **7,870** | **8,084** | **203** | **116,778** |
| Commercial Business Loans | **3,111** | **98** | **-** | **-** | **3,209** |
| Consumer Non-Real Estate | **817** | **-** | **-** | **36** | **853** |
| Total | **$ 459,083** | **$ 8,410** | **$ 11,595** | **$ 1,765** | **$ 480,853** |

September 30, 2012

| (In Thousands) | Pass | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|
| Residential Mortgages | $ 305,352 | $ 221 | $ 5,343 | $ 1,210 | $ 312,126 |
| Construction | 3,258 | - | - | - | 3,258 |
| Home Equity | 80,081 | - | 321 | - | 80,402 |
| Commercial Mortgages | 85,206 | 4,463 | 7,990 | - | 97,659 |
| Commercial Business Loans | 6,059 | - | - | - | 6,059 |
| Consumer Non-Real Estate | 1,269 | - | 3 | - | 1,272 |
| Total | $ 481,225 | $ 4,684 | $ 13,657 | $ 1,210 | $ 500,776 |

The following table summarizes information in regards to impaired loans by loan portfolio class as of September 30, 2013, and for the year then ended:

| (In Thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Residential Mortgages | $ 2,394 | $ 2,504 | $ - | $ 2,521 | $ 49 |
| Construction | - | - | - | - | - |
| Home Equity | 231 | 346 | - | 348 | 5 |
| Commercial Mortgages | 2,236 | 2,603 | - | 2,611 | 87 |
| Commercial Business Loans | - | - | - | - | - |
| Consumer Non-Real Estate | - | 2 | - | 2 | - |
| Subtotal: | 4,861 | 5,455 | - | 5,482 | 141 |
| With an allowance recorded: | | | | | |
| Residential Mortgages | 2,241 | 2,377 | (164) | 2,386 | 46 |
| Construction | - | - | - | - | - |
| Home Equity | 171 | 170 | (76) | 171 | 4 |
| Commercial Mortgages | 5,474 | 5,683 | (530) | 5,707 | 134 |
| Commercial Business Loans | - | - | - | - | - |
| Consumer Non-Real Estate | 37 | 37 | (37) | 39 | 1 |
| Subtotal: | 7,923 | 8,267 | (807) | 8,303 | 185 |
| Total: | | | | | |
| Residential Mortgages | 4,635 | 4,881 | (164) | 4,907 | 95 |
| Construction | - | - | - | - | - |
| Home Equity | 402 | 516 | (76) | 519 | 9 |
| Commercial Mortgages | 7,710 | 8,286 | (530) | 8,318 | 221 |
| Commercial Business Loans | - | - | - | - | - |
| Consumer Non-Real Estate | 37 | 39 | (37) | 41 | 1 |
| Total: | $ 12,784 | $ 13,722 | $ (807) | $ 13,785 | $ 326 |

The following table summarizes information in regards to impaired loans by loan portfolio class as of September 30, 2012 and for the year then ended:

| (In Thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Residential Mortgages | $ 1,957 | $ 1,967 | $ - | $ 1,339 | $ 50 |
| Construction | - | - | - | - | - |
| Home Equity | 107 | 107 | - | 65 | 3 |
| Commercial Mortgages | 1,976 | 1,976 | - | - | - |
| Commercial Business Loans | - | - | - | - | - |
| Consumer Non-Real Estate | 1 | 1 | - | 3 | - |
| Subtotal: | 4,041 | 4,051 | - | 1,407 | 53 |
| With an allowance recorded: | | | | | |
| Residential Mortgages | 4,596 | 4,628 | (685) | 2,563 | 13 |
| Construction | - | - | - | - | - |
| Home Equity | 214 | 214 | (109) | 181 | 1 |
| Commercial Mortgages | 6,014 | 6,079 | (748) | 3,689 | 90 |
| Commercial Business Loans | - | - | - | - | - |
| Consumer Non-Real Estate | 2 | 2 | (2) | - | - |
| Subtotal: | 10,826 | 10,923 | (1,544) | 6,433 | 104 |
| Total: | | | | | |
| Residential Mortgages | 6,553 | 6,595 | (685) | 3,902 | 63 |
| Construction | - | - | - | - | - |
| Home Equity | 321 | 321 | (109) | 246 | 4 |
| Commercial Mortgages | 7,990 | 8,055 | (748) | 3,689 | 90 |
| Commercial Business Loans | - | - | - | - | - |
| Consumer Non-Real Estate | 3 | 3 | (2) | 3 | - |
| Total: | $ 14,867 | $ 14,974 | $ (1,544) | $ 7,840 | $ 157 |

The performance and credit quality of the loan portfolio is also monitored by the analyzing the age of the loans receivable 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 past due status as of September 30, 2013 and 2012:

**September 30, 2013**

| (In Thousands) | **30-89 Days Past Due** | **Greater than 90 Days** | **Total Past Due** | **Current** | **Total Loans Receivable** | **Loans Receivable > 90 Days and Accruing** |
|---|---|---|---|---|---|---|
| Residential Mortgages | **$ 7,940** | **$ 5,298** | **$ 13,238** | **$261,391** | **$ 274,629** | **$ -** |
| Construction | **-** | **-** | **-** | **1,870** | **1,870** | **-** |
| Home Equity | **230** | **51** | **281** | **83,233** | **83,514** | **-** |
| Commercial Mortgages | **2,638** | **3,676** | **6,314** | **110,464** | **116,778** | **-** |
| Commercial Business Loans | **-** | **-** | **-** | **3,209** | **3,209** | **-** |
| Consumer Non-Real Estate | **33** | **38** | **71** | **782** | **853** | **1** |
| Total | **$ 10,841** | **$ 9,063** | **$ 19,904** | **$460,949** | **$ 480,853** | **$ 1** |

September 30, 2012

| (In Thousands) | 30-89 Days Past Due | Greater than 90 Days | Total Past Due | Current | Total Loans Receivable | Loans Receivable > 90 Days and Accruing |
|---|---|---|---|---|---|---|
| Residential Mortgages | $ 6,002 | $ 5,004 | $ 11,006 | $301,120 | $ 312,126 | $ 47 |
| Construction | - | - | - | 3,258 | 3,258 | - |
| Home Equity | 169 | 53 | 222 | 80,180 | 80,402 | - |
| Commercial Mortgages | 58 | 5,653 | 5,711 | 91,948 | 97,659 | - |
| Commercial Business Loans | - | - | - | 6,059 | 6,059 | - |
| Consumer Non-Real Estate | 28 | 4 | 32 | 1,240 | 1,272 | 1 |
| Total | $ 6,257 | $ 10,714 | $ 16,971 | $483,805 | $ 500,776 | $ 48 |

The following table presents nonaccrual loans by classes of the loan portfolio for the years ended September 30, 2013 and 2012:

| (In Thousands) | **September 30, 2013** | September 30, 2012 |
|---|---|---|
| Residential Mortgages | **$ 5,346** | $ 5,041 |
| Home Equity | **51** | 53 |
| Commercial Mortgages | **5,648** | 5,653 |
| Consumer Non-Real Estate | **38** | 4 |
| Total | **$ 11,083** | $ 10,751 |

Interest income on nonaccrual loans not recognized during 2013 and 2012 was $136,000 and $264,600 respectively.

The following table provides the activity in the allowance for loan losses by loan class for the years ended September 30, 2013 and 2012, and the balance in the allowance for loan losses at September 30, 2013 and 2012, disaggregated on the basis of the Company's impairment method by loan class along with the balance of loans receivable by class disaggregated on the basis of the Company's impairment methodology.

| | September 30, 2013 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| (In Thousands) | Residential Mortgages | Construction | Home Equity | Commercial Mortgages | Commercial Business Loans | Consumer Non-Real Estate | Unallocated | Totals |
| **Beginning Balance, September 30, 2012** | $ 1,644 | $ - | $ 351 | $ 1,729 | $ 65 | $ 45 | $ 198 | $ 4,032 |
| **Charge-offs** | (750) | - | - | (689) | - | (183) | - | (1,622) |
| **Recoveries** | - | - | - | - | - | 45 | - | 45 |
| **Provisions** | (76) | - | (14) | 710 | (14) | 174 | 110 | 890 |
| **Ending balance, September 30, 2013** | $ 818 | $ - | $ 337 | $ 1,750 | $ 51 | $ 81 | $ 308 | $ 3,345 |
| **Ending balance:** | | | | | | | | |
| **Individually evaluated for impairment** | $ 164 | $ - | $ 76 | $ 530 | $ - | $ 37 | $ - | $ 807 |
| **Ending balance:** | | | | | | | | |
| **Collectively evaluated for impairment** | $ 654 | $ - | $ 261 | $ 1,220 | $ 51 | $ 44 | $ 308 | $ 2,538 |
| **Loans:** | | | | | | | | |
| **Ending balance:** | $ 274,629 | $ 1,870 | $ 83,514 | $ 116,778 | $ 3,209 | $ 853 | $ - | $ 480,853 |
| **Ending balance:** | | | | | | | | |
| **Individually evaluated for impairment** | $ 4,635 | $ - | $ 402 | $ 7,710 | $ - | $ 37 | $ - | $ 12,784 |
| **Ending balance:** | | | | | | | | |
| **Collectively evaluated for impairment** | $ 269,994 | $ 1,870 | $ 83,112 | $ 109,068 | $ 3,209 | $ 816 | $ - | $ 468,069 |

| | September 30, 2012 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| (In Thousands) | Residential Mortgages | Construction | Home Equity | Commercial Mortgages | Commercial Business Loans | Consumer Non-Real Estate | Unallocated | Totals |
| Beginning Balance, September 30, 2011 | $ 871 | $ 33 | $ 431 | $ 1,516 | $ 214 | $ 5 | $ 241 | $ 3,311 |
| Charge-offs | (190) | - | - | - | - | (29) | - | (219) |
| Recoveries | - | - | - | - | - | 10 | - | 10 |
| Provisions | 963 | (33) | (80) | 213 | (149) | 59 | (43) | 930 |
| Ending balance, September 30, 2012 | $ 1,644 | $ - | $ 351 | $ 1,729 | $ 65 | $ 45 | $ 198 | $ 4,032 |
| Ending balance: | | | | | | | | |
| Individually evaluated for impairment | $ 685 | $ - | $ 109 | $ 748 | $ - | $ 2 | $ - | $ 1,544 |
| Ending balance: | | | | | | | | |
| Collectively evaluated for impairment | $ 959 | $ - | $ 242 | $ 981 | $ 65 | $ 43 | $ 198 | $ 2,488 |
| Loans: | | | | | | | | |
| Ending balance: | $ 312,126 | $ 3,258 | $ 80,402 | $ 97,659 | $ 6,059 | $ 1,272 | $ - | $ 500,776 |
| Ending balance: | | | | | | | | |
| Individually evaluated for impairment | $ 6,553 | $ - | $ 321 | $ 7,990 | $ - | $ 3 | $ - | $ 14,867 |
| Ending balance: | | | | | | | | |
| Collectively evaluated for impairment | $ 305,573 | $ 3,258 | $ 80,081 | $ 89,669 | $ 6,059 | $ 1,269 | $ - | $ 485,909 |

A troubled debt restructuring ("TDR") is a formal restructure of a loan when the lender, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms, including reduction in the stated interest rate, reduction in the loan balance or accrued interest, or extension of the maturity date.

The following table summarizes information in regards to troubled debt restructurings for the twelve months ended September 30, 2013 (dollars in thousands):

| | **Number of Contracts** | **Pre-Modification Outstanding Recorded Investments** | **Post-Modification Outstanding Recorded Investments** |
|---|---|---|---|
| Troubled Debt Restructurings | | | |
| Commercial real estate | **4** | **$ 4,748** | **$ 4,724** |

As indicated in the table above, the Company modified three commercial real estate loans and one mortgage loan with a recorded investment of $4.7 million during the twelve months ended September 30, 2013. As a result of the modified terms of the new loans, the Company extended the maturity on one of the four modified loans and modified the interest rate on the remaining three modified loans. The effective interest rate of the new terms of the modified loans was reduced when compared to the weighted-average interest rate of the original terms of the modified loans. Two of the TDRs that were modified to reduce the interest rate, totaling $2.6 million, subsequently defaulted.

The following table summarizes information in regards to troubled debt restructurings for the twelve months ended September 30, 2012 (dollars in thousands):

| | Number of Contracts | Pre-Modification Outstanding Recorded Investments | Post-Modification Outstanding Recorded Investments |
|---|---|---|---|
| Troubled Debt Restructurings | | | |
| Commercial real estate | 3 | $ 4,632 | $ 4,676 |

As indicated in the table above, the Company modified three commercial real estate loans with a recorded investment of $4.7 million during the twelve months ended September 30, 2012. As a result of the modified terms of the new loans, the Company extended the maturity on one of the three modified loans and modified the interest rate on the remaining two modified loans. The effective interest rate of the new terms of the modified loans was reduced when compared to the weighted-average interest rate of the original terms of the modified loans. One of the TDRs that was modified to extend the maturity date, totaling $2.0 million, subsequently defaulted.

## 5. OFFICE PROPERTIES AND EQUIPMENT

Office properties and equipment are summarized by major classifications as follows:

| | **September 30,** | |
|---|---|---|
| (In Thousands) | **2013** | **2012** |
| Land | **$ 3,277** | $ 3,277 |
| Buildings | **10,305** | 10, 291 |
| Furniture, fixtures, and equipment | **5,630** | 5,623 |
| Data processing | **212** | - |
| Automobiles | **60** | 60 |
| Total | **19,484** | 19,251 |
| Less accumulated depreciation | **(8,306)** | (7,701) |
| Net | **$11,178** | $11,550 |

Depreciation expense for the years ended September 30, 2013 and 2012, amounted to approximately $605,000 and $611,000, respectively.

## 6. DEPOSITS

Deposits are summarized as follows:

| | September 30, | | | |
|---|---|---|---|---|
| | **2013** | | 2012 | |
| (In Thousands) | **Amount** | **Weighted Interest Rate** | Amount | Weighted Interest Rate |
| Noninterest-bearing checking accounts | **$ 30,937** | **0.00%** | $ 26,166 | 0.00% |
| NOW accounts | **43,770** | **0.04** | 37,997 | 0.04 |
| Interest-bearing checking accounts | **35,876** | **0.14** | 34,525 | 0.11 |
| Money market deposit accounts | **171,862** | **0.18** | 157,980 | 0.24 |
| Passbook and club accounts | **4,048** | **0.64** | 4,739 | 0.69 |
| Certificate of deposit accounts | **248,225** | **1.49** | 279,171 | 1.76 |
| Total Deposits | **$534,718** | **0.76%** | $540,578 | 1.00% |

At September 30, 2013, the amounts of scheduled maturities of certificate of deposit accounts were as follows:

| | | |
|---|---|---|
| For the year ended September 30: | 2014 | **$ 130,863** |
| | 2015 | **48,712** |
| | 2016 | **34,295** |
| | 2017 | **26,121** |
| | 2018 | **8,234** |
| Total | | **$ 248,225** |

The aggregate amount of certificate accounts in denominations of $100,000 or more at September 30, 2013 and 2012 amounted to approximately $49.1 million and $56.2 million, respectively. On October 3, 2008, FDIC deposit insurance temporarily increased from $100,000 to $250,000 per depositor through December 31, 2013 and was permanently increased to $250,000 in July 2010.

Interest expense on savings deposits is composed of the following:

| | Year Ended September 30, | |
|---|---|---|
| (In Thousands) | **2013** | **2012** |
| NOW, interest-bearing checking, and MMDA accounts | **$ 388** | $ 565 |
| Passbook and club accounts | **51** | 56 |
| Certificate accounts | **4,290** | 5,185 |
| Total | **$ 4,729** | $ 5,806 |

## 7. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

The Bank's Short-Term borrowings activities are summarized as follows:

FHLB Repo Plus Advance

| | **2013** | 2012 |
|---|---|---|
| (Dollar in thousands) | | |
| Balance at year-end | **$33,475** | $2,346 |
| Maximum amount of outstanding at any month-end | **33,475** | 3,781 |
| Average balance outstanding during the year | **7,476** | 2,120 |
| Weighted-average interest rate: | | |
| As of year-end | **0.06%** | 0.45% |
| Paid during the year | **0.28%** | 0.50% |

Average amounts outstanding during the year represent daily average balances, while weighted-average interest rates represent interest expense divided by the related average balance for the period indicated.

The Bank maintains the Repo Plus Advance credit arrangement, which is renewable annually, with the FHLB. The line maintains a variable rate of interest that may be reset daily at the FHLB's discretion. The Bank's maximum borrowing capacity under the credit arrangement with the FHLB as of September 30, 2013, is approximately $308.2 million. FHLB advances are secured by a blanket security agreement that includes the Company's FHLB stock as well as certain residential mortgage loans and investments. In addition, there are four long-term advances from other financial institutions that are secured by investment and mortgage-backed securities totaling $50 million.

Long-term debt consists of the following:

| | **Maturity Range** | | **Weighted-Average Interest** | **Stated Interest Rate Range** | | | |
|---|---|---|---|---|---|---|---|
| **Description** | **From** | **To** | **Rate** | **From** | **To** | **2013** | **2012** |
| Fixed rate | 12/30/2013 | 12/30/2013 | 3.01% | 3.01% | 3.01% | **$ 4,500** | $ 19,955 |
| Convertible | 2/13/2014 | 9/19/2018 | 4.22% | 3.40% | 5.29% | **120,083** | 122,528 |
| Other long-term debt | 1/31/2014 | 2/2/2018 | 4.34% | 3.29% | 4.80% | **50,000** | 50,000 |
| | | | | | | **$174,583** | $192,483 |

Maturities of long-term advances as of September 30, 2013, are summarized as follows:

| | | Amount | Weighted Average Rate |
|---|---|---|---|
| *(Dollars in Thousands)* | | | |
| FHLB long-term debt: | | | |
| | 2014 | **$ 11,352** | **3.35%** |
| | 2015 | **15,884** | **3.89%** |
| | 2016 | **10,504** | **4.68%** |
| | 2017 | **35,526** | **4.56%** |
| | 2018 | **51,317** | **4.08%** |
| Total FHLB long-term debt | | **124,583** | **4.18%** |
| Other long-term debt: | | | |
| | 2014 | **15,000** | **4.80%** |
| | 2017 | **10,000** | **4.37%** |
| | 2018 | **25,000** | **4.05%** |
| Total other long-term debt fixed | | **50,000** | **4.34%** |
| Total long-term debt | | **$174,583** | **4.22%** |

## 8. INCOME TAXES

The Company computes its reserve for bad debts under the specific charge-off method. The bad debt deduction allowable under this method is available to large banks with assets greater than $500 million. Generally, this method allows the Company to deduct an annual addition to the reserve for bad debts equal to its net charge-offs. Retained earnings at September 30, 2013 and 2012, includes approximately $1,325,000 representing bad debt deductions for which no deferred income taxes have been provided.

The expense for income taxes differs from that computed at the statutory federal corporate tax rate as follows:

| | **Year Ended September 30,** | | | |
|---|---|---|---|---|
| | **2013** | | 2012 | |
| (Dollars in Thousands) | **Amount** | **Percentage of Pretax Income** | Amount | Percentage of Pretax Income |
| At statutory rate | **$ 2,439** | **34.0%** | $ 2,444 | 34.0% |
| Adjustments resulting from: | | | | |
| Tax-exempt income | **(325)** | **(4.5)** | (394) | (5.5) |
| State tax,-net of federal tax benefit | **177** | **2.5** | 116 | 1.6 |
| Other | **68** | **0.9** | (29) | (0.4) |
| Expense per consolidated statements of income | **$ 2,359** | **32.9%** | $ 2,137 | 29.7% |

Income tax expense is summarized as follows:

| (In Thousands) | Year Ended September 30, 2013 | 2012 |
|---|---|---|
| Current | **$2,167** | $ 2,502 |
| Deferred | **192** | (365) |
| Total Income Tax Expense | **$ 2,359** | $ 2,137 |

Items that gave rise to significant portions of the deferred tax accounts are as follows:

| (In Thousands) | September 30, 2013 | 2012 |
|---|---|---|
| Deferred Tax Assets: | | |
| Deferred Loan Fees | **$ 1** | $ 1 |
| Allowance for Loan Losses | **1,137** | 1,371 |
| Nonaccrual interest | **-** | 146 |
| Non-deductible capital losses | **169** | 36 |
| Securities impairment | **-** | 156 |
| Other | **278** | 92 |
| Subtotal | **1,585** | 1,802 |
| Deferred Tax Liabilities: | | |
| Unrealized gain on investment securities | **(16)** | (37) |
| Properties and equipment | **(798)** | (823) |
| Subtotal | **(814)** | (860) |
| Total | **$ 771** | $ 942 |

## 9. REGULATORY CAPITAL REQUIREMENTS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to assets (as defined). Management believes, as of September 30, 2013, that the Bank meets all capital adequacy requirements to which it is subject.

As of September 30, 2013, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios are also presented in the table.

| (Dollars in Thousands) | Actual | | For Capital Adequacy Purposes | | To Be Considered Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | **Amount** | **Ratio** | **Amount** | **Ratio** | **Amount** | **Ratio** |
| At September 30, 2013 | | | | | | |
| Tier 1 Capital (to assets) | **$61,524** | **7.64%** | **$32,217** | **4.00%** | **$40,272** | **5.00%** |
| Tier 1 Capital (to risk-weighted assets) | **61,524** | **13.08%** | **18,810** | **4.00%** | **28,216** | **6.00%** |
| Total Capital (to risk-weighted assets) | **64,954** | **13.81%** | **37,621** | **8.00%** | **47,026** | **10.00%** |
| At September 30, 2012 | | | | | | |
| Tier 1 Capital (to assets) | $59,548 | 7.38% | $32,286 | 4.00% | $40,357 | 5.00% |
| Tier 1 Capital (to risk-weighted assets) | 59,548 | 13.12% | 18,154 | 4.00% | 27,231 | 6.00% |
| Total Capital (to risk-weighted assets) | 63,606 | 14.02% | 36,307 | 8.00% | 45,384 | 10.00% |

The Company's capital ratios are not significantly different than the Bank's capital ratios disclosed above.

## 10. RETIREMENT SAVINGS PLANS

The Company has a qualified 401(k) retirement savings plan covering all full-time employees meeting certain eligibility requirements. Contributions for the plan are at the discretion of the Company's Board of Directors. Compensation expense related to the plan was $478,000 and $445,000 for the years ended September 30, 2013 and 2012, respectively.

## 11. STOCK BASED COMPENSATION AND EMPLOYEE STOCK PURCHASE PLAN

In January 1996, the stockholders approved the 1995 Stock Option Plan. This plan consists of two parts: Plan I - incentive stock options and Plan II - compensatory stock options. There are no shares remaining for grant under this plan.

In January 2001, the stockholders approved the 2000 Stock Option Plan. This plan consists of two parts: Plan I - incentive stock options and Plan II - compensatory stock options. There are 20,969 shares unissued under this plan.

In January 2006, the stockholders approved the 2005 Stock Option Plan. This plan consists of two parts: Plan I - incentive stock options and Plan II - compensatory stock options. There are 18,822 shares remaining for grant under this plan.

In January 2010, the stockholders approved the 2009 Stock Incentive Plan which provides 300,000 shares for the granting of incentive stock options, compensatory stock options, stock appreciation rights, and share awards of restrictive stock. The number of shares available to be issued as share awards will not exceed 75,000 shares. There are 103,504 shares remaining for grant under this plan.

The life of the options under the above plans is ten years. The vesting period for the options is between one and five years.

A summary of transactions under these plans follow:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| | **Options** | **Weighted Average Price** | Options | Weighted Average Price |
| Outstanding, beginning of year | **534,017** | **$ 14.82** | 502,798 | $ 14.75 |
| Exercised | **(69,046)** | **14.47** | (18,716) | 12.81 |
| Canceled | **(8,269)** | **15.06** | (10,483) | 15.12 |
| Granted | **43,385** | **17.80** | 60,418 | 14.84 |
| Outstanding, end of year | **500,087** | **$ 15.12** | 534,017 | $ 14.82 |
| Options exercisable, end of year | **234,863** | **$ 16.00** | 227,651 | $ 16.55 |

A summary of the exercise price ranges at September 30, 2013 and 2012, is as follows:

**2013**

| **Number of Option Shares** | **Exercise Price Range** | **Weighted Average Remaining Contractual Life** | **Weighted Average Exercise Price per Share** |
|---|---|---|---|
| **176,822** | **$ 11.85-13.05** | **5.28** | **$ 12.74** |
| **88,318** | **13.13-14.84** | **7.40** | **14.43** |
| **234,947** | **15.15-18.00** | **4.51** | **17.17** |
| **500,087** | **$ 11.85-18.00** | **5.29** | **$ 15.12** |

2012

| Number of Option Shares | Exercise Price Range | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price per Share |
|---|---|---|---|
| 2,200 | $ 8.10-12.00 | 6.07 | $ 11.88 |
| 363,483 | 12.01-16.00 | 6.80 | 13.53 |
| 168,334 | 16.01-18.00 | 3.06 | 17.63 |
| 534,017 | $ 8.10-18.00 | 5.62 | $ 14.82 |

At September 30, 2013 and 2012, the aggregate intrinsic value of options outstanding was $1.7 million and $1.1 million, respectively. At September 30, 2013 and 2012, the aggregate intrinsic value of options exercisable was $586,000 and $173,000, respectively. For the years ended September 30, 2013 and 2012, the aggregate intrinsic value of options exercised was $267,500 and $68,000, respectively.

The aggregate intrinsic value of a stock option represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holder had all option holders exercised their options on September 30, 2013. This amount changes based on changes in the market value of the Company's common stock.

The weighted-average fair value of stock options granted in the years ended September 30, 2013 and 2012, was $2.10 and $1.53, respectively, and was estimated at the date of grant using a Binomial Option Pricing Model with the following weighted-average assumptions while the market price of the Company's common stock at the date of grant is used for restricted stock awards:

| | **Year Ended September 30,** | |
|---|---|---|
| | **2013** | **2012** |
| Risk-free interest rate of return | **1.23%** | 1.43% |
| Expected option life | **84 months** | 84 months |
| Expected volatility | **20.00%** | 17.50% |
| Expected dividends | **4.80%** | 5.12% |

The expected volatility is based on historic volatility. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life is based on historical exercise experience. The dividend yield assumption is based on the Company's history and expectation of dividend payouts.

Stock based compensation expense related to stock options for the years ended September 30, 2013 and 2012, was $155,000 or $148,000 net of tax, and $154,000, or $147,000 net of tax, respectively. As of September 30, 2013, there was approximately $138,000 of total unrecognized compensation cost related to non-vested stock options under the plans.

On November 12, 2010, 2,822 shares of restricted stock were awarded. The restricted shares awarded had a grant date fair value of $15.15 per share. The restricted stock awarded vest 20% annually beginning November 14, 2011. On November 3, 2011, 3,006 shares of restricted stock were awarded. The restricted shares awarded had a grant date fair value of $14.84 per share. The restricted stock awarded vests 33% annually beginning November 4, 2012. On April 4, 2013, 2,601 shares of restricted stock were awarded. The restricted shares awarded had a grant date fair value of $17.80 per share. The restricted stock awarded vests 33% annually beginning April 4, 2014. During the years ended September 30, 2013 and 2012, $30,000 and $35,000, respectively in compensation expense was recognized in regard to these restricted stock awards. At September 30, 2013, there was $49,000 of unrecognized compensation expense related to the restricted stock awards which is expected to be recognized over a period of 3 years. Restricted stock award activity for the year ended September 30, 2013, was as follows:

| | Number of Shares | Weighted-Average Grant Date Fair Value | |
|---|---|---|---|
| Unvested restricted stock, beginning of year | **5,263** | **$** | **14.97** |
| Granted | **2,601** | | **17.80** |
| Forfeited | - | | - |
| Vested | **(1,567)** | | **14.95** |
| Unvested restricted stock, end of year | **6,297** | **$** | **16.15** |

Restricted stock award activity for the year ended September 30, 2012, was as follows:

| | Number of Shares | Weighted-Average Grant Date Fair Value | |
|---|---|---|---|
| Unvested restricted stock, beginning of year | 2,822 | $ | 15.15 |
| Granted | 3,006 | | 14.84 |
| Forfeited | - | | - |
| Vested | (565) | | 15.15 |
| Unvested restricted stock, end of year | 5,263 | $ | 14.97 |

The Company also has established an Employee Stock Purchase Plan (the "Purchase Plan") whereby employees may elect to make contributions to the Purchase Plan in an aggregate amount not less than 2% or more than 10% of such employee's total compensation. These contributions would then be used to purchase stock during an offering period determined by the Company's Salary and Benefits Committee. The purchase price of the stock would be the lesser of 85% of the market price on the first day or the last day of the offering period. During 2013 and 2012, no shares were issued to employees, respectively. At September 30, 2013 and 2012, there were 53,583 shares available for future purchase. The Company suspended participation in the Purchase Plan in March 2005 and the plan is not currently active.

## 12. ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table presents the changes in accumulated other comprehensive income by component net of tax for the year ended September 30, 2013.

| | Unrealized Gains on Securities Available for Sale (a) |
|---|---|
| (In Thousands) | |
| Balance as of September 30, 2012 | $ 73 |
| Other comprehensive gain before reclassification | 5 |
| Amount reclassified from accumulated other comprehensive income | (45) |
| Total other comprehensive loss | (40) |
| Balance as of September 30, 2013 | $ 33 |

(a) All amounts are net of tax. Amounts in parentheses indicate debits.

The following table presents significant amounts reclassified out of each component of accumulated other comprehensive income (in thousands) for the year ended September 30, 2013.

| | Amount Reclassified From Accumulated Other Comprehensive Income (a) | Affected Line Item in Statement Where Net Income Is Presented |
|---|---|---|
| | Year Ended September 30, 2013 | |
| Unrealized gains on securities available for sale | $ 68 | Realized gains on sale of securities |
| | (23) | Income tax expense |
| | $ 45 | Net of tax |

(a) Amounts in parenthesis indicate debits to net income

## 13. COMMITMENTS

At September 30, 2013, the Company had approximately $7.5 million in outstanding commitments to originate mortgage loans, of which $6.6 million were fixed rates ranging from 3.25% to 5.75%, $850,000 were adjustable rates ranging from 3.75% to 4.75%, and $373,000 were mortgage loans held for sale with a rate of 3.75%. The unfunded home equity line of credit commitments at September 30, 2013, were $57.4 million. The Company had $600,000 and $1.1 million of committed commercial and consumer loans, respectively, at September 30, 2013. In addition, the Company had $7.8 million of unused commercial lines of credit at September 30, 2013. The amounts of undisbursed portions of loans in process at September 30, 2013, were $713,000. The Company had a total of $228,000 in standby letters of credit. Also, at September 30, 2013, the Company had no outstanding futures or options positions.

Outstanding letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Company requires collateral supporting these letters of credit as deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of September 30, 2013, for guarantees under standby letters of credit issued is not material.

The Company leases land for two of its branch offices. Rent expense amounted to $132,000 and $130,000 for the years ended September 30, 2013 and 2012. Minimum rental commitments for the next five years at September 30, 2013, are summarized below:

| | Fiscal Year | Rental Amount |
|---|---|---|
| | | (In Thousands) |
| | 2014 | $ 139 |
| | 2015 | 142 |
| | 2016 | 144 |
| | 2017 | 150 |
| | 2018 | 157 |
| Total | | $ 732 |

The Company is required to maintain reserve funds in cash or on deposit with the Federal Reserve Bank. The required reserve was $3.7 million for the year ended September 30, 2013.

## 14. LEGAL CONTINGENCIES

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

## 15. RESTRICTED RETAINED EARNINGS

At the time of conversion to a stock savings bank, in 1987, the Bank established a liquidation account in an amount equal to the Bank's net worth as reflected in the latest Consolidated Statement of Financial Condition of the Bank contained in the offering circular utilized in the conversion. The function of the liquidation account is to establish a priority on liquidation and, except with respect to the payment of cash dividends on, or the re-purchase of, any of the common stock by the Bank, the existence of the liquidation account will not operate to restrict the use or application of any of the net worth accounts of the Bank. In the event of a complete liquidation of the Bank (and only in such event), each eligible account holder will be entitled to receive a pro rata distribution from the liquidation account, based on such holder's proportionate amount of the total current adjusted balances from deposit accounts then held by all eligible account holders, before any liquidation distribution may be made with respect to stockholders. The liquidation account was approximately $2,300,000 at September 30, 2013. Furthermore, the Company may not repurchase any of its stock if the effect thereof would cause the Company's net worth to be reduced below (i) the amount required for the liquidation account or (ii) the regulatory capital requirements.

## 16. FAIR VALUE MEASUREMENTS AND DISCLOSURES

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with accounting guidance, the fair value of a financial instrument 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. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumption used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is determined at a reasonable point within the range that is most representative of fair value under current market conditions.

The guidance establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2013 and 2012, are as follows (in thousands):

| Description | Total | (Level 1) Quoted Prices in Active Markets for Identical Assets | (Level 2) Significant Other Observable Inputs | (Level 3) Significant Unobservable Inputs |
|---|---|---|---|---|
| September 30, 2013 | | | | |
| Available for sale securities: | | | | |
| U.S. Government money market funds | $ 2,560 | $ 2,560 | $ -- | $ -- |
| Collateralized mortgage obligations | 834 | -- | 834 | -- |
| Total | $ 3,394 | $ 2,560 | $ 834 | $ -- |

| Description | Total | (Level 1) Quoted Prices in Active Markets for Identical Assets | (Level 2) Significant Other Observable Inputs | (Level 3) Significant Unobservable Inputs |
|---|---|---|---|---|
| September 30, 2012 | | | | |
| Available for sale securities: | | | | |
| Equity securities | $ 388 | $ 388 | $ -- | $ -- |
| U.S. Government money market funds | 10,462 | 10,462 | -- | -- |
| Collateralized mortgage obligations | 838 | -- | 838 | -- |
| Total | $ 11,688 | $ 10,850 | $ 838 | $ -- |

There were no transfers in and out of Level 1 and Level 2 fair value measurements for the year ended September 30, 2013.

For assets measured at fair value on a non recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2013 and 2012, are as follows (in thousands):

| **Description** | **September 30, 2013** | **(Level 1) Quoted Prices in Active Markets for Identical Assets** | **(Level 2) Significant Other Observable Inputs** | **(Level 3) Significant Unobservable Inputs** |
|---|---|---|---|---|
| Impaired Loans | **$ 11,977** | **$ -** | **$ -** | **$ 11,977** |
| Foreclosed Real Estate | **28** | **-** | **-** | **28** |
| Total | **$ 12,005** | **$ -** | **$ -** | **$ 12,005** |

| Description | September 30, 2012 | (Level 1) Quoted Prices in Active Markets for Identical Assets | (Level 2) Significant Other Observable Inputs | (Level 3) Significant Unobservable Inputs |
|---|---|---|---|---|
| Impaired Loans | $ 13,323 | $ - | $ - | $ 13,323 |
| Total | $ 13,323 | $ - | $ - | $ 13,323 |

The following valuation techniques were used to measure fair value of the Company's financial instruments in the tables above and below.

The following table below presents additional quantitative information about Level 3 assets measured at fair value on a nonrecurring basis (in thousands):

**Quantitative Information about Level 3 Fair Value Measurements**

| | **September 30, 2013** | | | |
|---|---|---|---|---|
| **Description** | **Fair Value** | **Valuation Technique** | **Unobservable Input** | **Range (Weighted Average) (3)** |
| Impaired loans | **$ 11,977** | **Fair Value of Collateral (1)** | **Appraised Value (2)** | **10% - 32% (21%)** |
| Foreclosed Real Estate | **28** | **Appraised Value (2)** | **Appraised Value (2)** | **17%** |

Quantitative Information about Level 3 Fair Value Measurements

| | September 30, 2012 | | | |
|---|---|---|---|---|
| Description | Fair Value | Valuation Technique | Unobservable Input | Range (Weighted Average) (3) |
| Impaired loans | $ 13,323 | Fair Value of Collateral (1) | Appraised Value (2) | 10% - 38% (25%) |

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which include Level 3 inputs that are not identifiable.
(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses.
(3) The range and weighted average of qualitative factors such as economic conditions and estimated liquidation expenses are presented as a percent of the appraised value.

The significant unobservable inputs for impaired loans are the appraised value or an agreed upon sales price. These values are adjusted for estimated costs to sell which are incremental direct costs to transact a sale such as broker commission, legal fees, closing costs and title transfer fees. The costs must be considered essential to the sale and would not have been incurred if the decision to sell had not been made. The costs to sell are based on costs associated with the Company's actual sales of other real estate owned which are assessed annually.

Other real estate owned is measured at fair value, less costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of the carrying amount or fair value, less costs to sell.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at September 30, 2013 and 2012.

**Cash and Cash Equivalents (Carried at Cost)**

The carrying amounts reported in the statement of financial condition for cash and short-term instruments approximate those assets' fair values.

**Securities**

The fair value of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. The Company currently holds U.S. Government money market funds and equity securities both of which are classified as Level 1, because quoted prices are available for these securities in an active market.

The Bank's investment portfolio is maintained by FTN Financial. FTN Financial utilizes interactive Data Corporation ("IDC") as their primary source for security valuations. IDC is not affiliated with or owned by a securities broker, dealer or underwriter, nor is it actively involved in the business of investment management or securities trading. Some of the major asset classes that IDC provides pricing and market inputs are as follows: U.S. Agency/Government-Sponsored Enterprise ("GSE") issues, U.S. high grade municipal issues, and U.S. Structured Securities Agency/GSE Collateralized Mortgage Obligation issues. The methodology used to price the above asset classes include: broker quotes, proprietary modes, vast descriptive terms, and conditions databases, as well as extensive quality control programs. Market inputs used to help determine the fair value hierarchy include but not limited to: security characteristics, ratings updates, prepayment schedules, cash flows, and yield to maturity. Based on these methodologies employed by IDC, FTN Financial and HSB considers these evaluations Level 2 in reference to ASC 820 with the exception of inactive markets. There are no securities in an inactive environment.

**Loans Receivable (Carried at Cost)**

The fair values of loans, excluding impaired loans are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired loans are those loans which the Company has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined base upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 values, based upon the lowest level of input that is significant to the fair value measurements.

**Loans Held For Sale (Carried at Lower of Cost or Fair Value)**

The fair value of loans held for sale is determined, when possible, using quoted secondary-market prices. If no such quoted prices exist, the fair value of a loan is determined using quoted prices for a similar loan or loans, adjusted for the specific attributes of that loan.

**Federal Home Loan Bank Stock (Carried at Cost)**

The carrying amount of this restricted investment in bank stock approximates fair value, and considers the limited marketability of this security.

**Accrued Interest Receivable and Payable (Carried at Cost)**

The carrying amount of accrued interest receivable and accrued interest payable approximates their fair value.

**Deposit Liabilities (Carried at Cost)**

The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings, and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of an aggregated expected monthly maturities on time deposits.

**Borrowings (Carried at Cost)**

Fair values of borrowings are estimated using discounted cash flow analysis, based on quoted prices for new advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

**Off-Balance Sheet Financial Instruments (Disclosed at Cost)**

Fair values for the Company's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remain terms of the agreements and the counterparties' credit standing. The fair value of these off-balance sheet financial instruments are not considered material as of September 30, 2013 and 2012.

The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret the data to develop the estimates.

The carrying amounts and estimated fair values of all the Company's financial instruments as of September 30, 2013 and 2012, are as follows:

| | | | Fair Value Measurements at September 30, 2013 | | |
|---|---|---|---|---|---|
| (In Thousands) | Carrying Amount | Estimated Fair Value | Quoted Prices in Active Markets For Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | | |
| Cash and cash equivalents | $ 15,128 | $ 15,128 | $ 15,128 | $ - | $ - |
| Securities held to maturity | 276,497 | 275,093 | - | 275,093 | - |
| Securities available for sale | 3,394 | 3,394 | 2,560 | 834 | - |
| Loans held for sale | 373 | 373 | 373 | - | - |
| Loans receivable - net | 476,319 | 524,351 | - | - | 524,351 |
| Federal Home Loan Bank stock | 9,070 | 9,070 | 9,070 | - | - |
| Bank-owned life insurance | 14,465 | 14,465 | 14,465 | - | - |
| Accrued interest receivable | 2,413 | 2,413 | 2,413 | - | - |
| Liabilities: | | | | | |
| Checking, passbook, club, and NOW deposit accounts | 114,631 | 114,631 | 114,631 | - | - |
| Money Market deposit accounts | 171,862 | 171,862 | 171,862 | - | - |
| Certificate of deposit accounts | 248,225 | 256,478 | - | - | 256,478 |
| Short-term borrowings | 33,475 | 33,475 | 33,475 | - | - |
| Long-term borrowings | 174,583 | 208,384 | - | - | 208,384 |
| Accrued interest payable | 776 | 776 | 776 | - | - |
| Off-balance sheet financial instruments | - | - | - | - | - |

| (In Thousands) | Carrying Amount | Estimated Fair Value | Fair Value Measurements at September 30, 2012 Quoted Prices in Active Markets For Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|---|
| Assets: | | | | | |
| Cash and cash equivalents | $ 23,586 | $ 23,586 | $ 23,586 | $ - | $ - |
| Securities held to maturity | 227,018 | 236,538 | - | 236,538 | - |
| Securities available for sale | 11,688 | 11,688 | 10,850 | 838 | - |
| Loans held for sale | 3,515 | 3,649 | 3,649 | - | |
| Loans receivable - net | 494,367 | 525,578 | - | - | 525,578 |
| Federal Home Loan Bank stock | 10,165 | 10,165 | 10,165 | - | - |
| Bank-owned life insurance | 14,028 | 14,028 | 14,028 | - | - |
| Accrued interest receivable | 2,638 | 2,638 | 2,638 | - | - |
| Liabilities: | | | | | |
| Checking, passbook, club, and NOW deposit accounts | 103,427 | 103,427 | 103,427 | - | - |
| Money Market deposit accounts | 157,980 | 157,980 | 157,980 | - | - |
| Certificate of deposit accounts | 279,171 | 289,471 | - | - | 289,471 |
| Short-term borrowings | 2,346 | 2,346 | 2,346 | - | |
| Long-term borrowings | 192,483 | 252,387 | - | - | 252,387 |
| Accrued interest payable | 929 | 929 | 929 | - | - |
| Off-balance sheet financial instruments | - | - | - | - | - |

## 17. PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION

Condensed financial statements of Harleysville Savings Financial Corporation are as follows:

| (In Thousands) | September 30, | |
|---|---|---|
| **Condensed Statements of Financial Condition** | **2013** | **2012** |
| **Assets** | | |
| Cash | **$ 81** | $ 194 |
| Investment in subsidiary | **61,556** | 59,647 |
| **Total Assets** | **$ 61,637** | $ 59,841 |
| **Liabilities and Stockholders' Equity** | | |
| Other liabilities | **$ 20** | $ 105 |
| Stockholders' equity | **61,617** | 59,736 |
| **Total Liabilities and Stockholders' Equity** | **$ 61,637** | $ 59,841 |

| | For the Year Ended September 30, | |
|---|---|---|
| **Condensed Statements of Income** | **2013** | **2012** |
| Equity in income of subsidiary | **$ 1,764** | $ 2,258 |
| Distributed earnings of subsidiary | **3,350** | 3,400 |
| Other expense | **301** | 605 |
| **Net income** | **$ 4,813** | $ 5,053 |

| | For the Year Ended September 30, | |
|---|---|---|
| **Condensed Statements of Cash Flows** | **2013** | **2012** |
| Net income | **$ 4,813** | $ 5,053 |
| (Decrease) increase in other liabilities | **(85)** | 12 |
| Income of Harleysville Savings Bank | **(5,114)** | (5,658) |
| Net cash used by operating activities | **(386)** | (593) |
| **Investing activities:** | | |
| Dividends received from subsidiary | **3,350** | 3,400 |
| Net cash provided by investing activities | **3,350** | 3,400 |
| **Financing activities:** | | |
| Acquisition of treasury stock | **(560)** | (1,679) |
| Treasury stock delivered under employee stock plan | **229** | 990 |
| Sale of treasury stock delivered under employee stock plans | **385** | 240 |
| Dividends paid | **(3,131)** | (2,241) |
| Net cash used in financing activities | **(3,077)** | (2,690) |
| **Increase (decrease) in cash and cash equivalents** | **(113)** | 117 |
| **Cash and cash equivalents at the beginning of the period** | **194** | 77 |
| **Cash and cash equivalents at the end of the period** | **$ 81** | $ 194 |

## 18. SUBSEQUENT EVENTS

Management has reviewed events occurring through December 6, 2013, the date the financial statements were issued, and no subsequent events occurred requiring accrual or disclosures.

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