Magyar Bancorp, Inc.
Form 10-Q
February 11, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

þ QUARTERLY REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2012

Commission File Number **000-51726**

Magyar Bancorp, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**20-4154978**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)
400 Somerset Street, New Brunswick, New Jersey	**08901**
(Address of Principal Executive Office)	(Zip Code)

(732) 342-7600

(Issuer's Telephone Number including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No o

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

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer (Do not check if a smaller reporting company)	o	Smaller reporting company	þ

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

Yes o No þ

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at February 1, 2013
Common Stock, $0.01 Par Value	5,807,344

MAGYAR BANCORP, INC.

Form 10-Q Quarterly Report

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PART I. FINANCIAL INFORMATION

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

MAGYAR BANCORP, INC. AND SUBSIDIARY

Consolidated Balance Sheets

(In Thousands, Except Share and Per Share Data)

	December 31, 2012 (Unaudited)	September 30, 2012
Assets		
Cash	$1,211	$ 930
Interest earning deposits with banks	10,616	9,114
Total cash and cash equivalents	11,827	10,044
Investment securities - available for sale, at fair value	14,739	16,786
Investment securities - held to maturity, at amortized cost (fair value of $42,268 and $42,130 at December 31, 2012 and September 30, 2012, respectively)	41,213	41,068
Federal Home Loan Bank of New York stock, at cost	2,322	2,385
Loans receivable, net of allowance for loan losses of $4,094 and $3,858 at December 31, 2012 and September 30, 2012, respectively)	391,722	385,270
Bank owned life insurance	10,094	10,010
Accrued interest receivable	1,833	1,894
Premises and equipment, net	21,390	21,541
Other real estate owned ("OREO")	12,979	13,381
Other assets	6,485	6,467
Total assets	$514,604	$ 508,846
Liabilities and Stockholders' Equity		
Liabilities		
Deposits	$424,377	$ 416,518
Escrowed funds	863	769
Federal Home Loan Bank of New York advances	35,103	36,503
Securities sold under agreements to repurchase	5,000	5,000
Accrued interest payable	216	196
Accounts payable and other liabilities	3,874	4,855
Total liabilities	469,433	463,841

Stockholders' equity		
Preferred stock: $.01 Par Value, 1,000,000 shares authorized; none issued	—	—
Common stock: $.01 Par Value, 8,000,000 shares authorized; 5,923,742 issued; 5,807,344 shares outstanding at December 31, 2012 and September 30, 2012, at cost	59	59
Additional paid-in capital	26,357	26,367
Treasury stock: 116,398 shares at December 31, 2012 and September 30, 2012, at cost	(1,301)	(1,301)
Unearned Employee Stock Ownership Plan shares	(1,087)	(1,116)
Retained earnings	21,882	21,600
Accumulated other comprehensive loss	(739)	(604)
Total stockholders' equity	45,171	45,005
Total liabilities and stockholders' equity	$514,604	$ 508,846

The accompanying notes are an integral part of these statements.

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MAGYAR BANCORP, INC. AND SUBSIDIARY

Consolidated Statements of Operations

(In Thousands, Except Per Share Data)

	For the Three Months Ended December 31,	
	2012	2011
	(Unaudited)	
Interest and dividend income		
Loans, including fees	$ 4,546	$ 4,706
Investment securities		
Taxable	379	541
Tax-exempt	1	1
Federal Home Loan Bank of New York stock	28	24
Total interest and dividend income	4,954	5,272
Interest expense		
Deposits	816	1,102
Borrowings	358	504
Total interest expense	1,174	1,606
Net interest and dividend income	3,780	3,666
Provision for loan losses	441	370
Net interest and dividend income after provision for loan losses	3,339	3,296
Other income		
Service charges	231	267
Income on bank owned life insurance	84	84
Other operating income	17	28
Gains on sales of loans	265	116
Gains on sales of investment securities	64	84
Total other income	661	579
Other expenses		
Compensation and employee benefits	1,798	1,855
Occupancy expenses	698	729
Professional fees	225	233
Data processing expenses	140	122
OREO expenses	141	258

FDIC deposit insurance premiums	174	176
Loan servicing expenses	52	96
Insurance expense	56	62
Other expenses	302	306
Total other expenses	3,586	3,837
Income before income tax expense	414	38
Income tax expense	132	7
Net income	$ 282	$ 31
Net income per share-basic and diluted	$ 0.05	$ 0.01

The accompanying notes are an integral part of these statements.

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MAGYAR BANCORP, INC. AND SUBSIDIARY

Consolidated Statements of Comprehensive Income

(In Thousands)

	For the Three Months Ended December 31,	
	2012	2011
	(Unaudited)	
Net income	$ 282	$ 31
Other comprehensive loss:		
Net unrealized (loss) gain on securities available for sale	(129)	73
Realized gains on sales of securities available for sale	(64)	(84)
Unrealized loss on derivatives	(20)	(23)
	(213)	(34)
Deferred income tax effect	78	11
Total other comprehensive loss	(135)	(23)
Total comprehensive income	$ 147	$ 8

The accompanying notes are an integral part of these statements.

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MAGYAR BANCORP, INC. AND SUBSIDIARY

Consolidated Statement of Changes in Stockholders' Equity

For the Three Months Ended December 31, 2012

(In Thousands, Except for Share Amounts)

	Common Stock Shares Outstanding	Par Value	Additional Paid-In Capital	Treasury Stock	Unearned ESOP Shares	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	(Unaudited)							
Balance, September 30, 2012	5,807,344	$ 59	$ 26,367	$ (1,301)	$ (1,116)	$ 21,600	$ (604)	$ 45,005
Net income	—	—	—	—	—	282	—	282
Other comprehensive loss	—	—	—	—	—	—	(135)	(135)
ESOP shares allocated	—	—	(14)	—	29	—	—	15
Stock-based compensation expense	—	—	4	—	—	—	—	4
Balance, December 31, 2012	5,807,344	$ 59	$ 26,357	$ (1,301)	$ (1,087)	$ 21,882	$ (739)	$ 45,171

The accompanying notes are an integral part of these statements.

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MAGYAR BANCORP, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows

(In Thousands)

	For the Three Months Ended December 31,	
	2012	2011
	(Unaudited)	
Operating activities		
Net income	$ 282	$ 31
Adjustment to reconcile net income to net cash provided by operating activities		
Depreciation expense	228	247
Premium amortization on investment securities, net	46	65
Provision for loan losses	441	370
Proceeds from the sales of loans	2,936	2,926
Gains on sale of loans	(265)	(116)
Gains on sales of investment securities	(64)	(84)
Losses on the sales of other real estate owned	8	32
ESOP compensation expense	15	8
Stock-based compensation expense	4	102
Deferred income tax benefit	132	5
Decrease (increase) in accrued interest receivable	61	(51)
Increase in surrender value bank owned life insurance	(84)	(84)
Increase in other assets	(90)	(213)
Increase in accrued interest payable	20	25
Increase (decrease) in accounts payable and other liabilities	(981)	272
Net cash provided by operating activities	2,689	3,535
Investing activities		
Net increase in loans receivable	(9,564)	(9,650)
Purchases of investment securities held to maturity	(4,069)	(5,988)
Purchases of investment securities available for sale	—	(6,123)
Sales of investment securities available for sale	1,064	2,479
Principal repayments on investment securities held to maturity	3,894	3,720
Principal repayments on investment securities available for sale	837	1,806
Purchases of premises and equipment	(77)	(19)
Investment in other real estate owned	(160)	(5)
Proceeds from the sale of other real estate owned	553	3,215
Redemption of Federal Home Loan Bank stock	63	—
Net cash used by investing activities	(7,459)	(10,565)
Financing activities		
Net increase in deposits	7,859	2,034

Stock compensation tax benefit	—	—
Net increase (decrease) in escrowed funds	94	(134)
Net change in short-term advances	(1,400)	—
Purchase of treasury stock	—	(21)
Net cash provided by financing activities	6,553	1,879
Net increase (decrease) in cash and cash equivalents	1,783	(5,151)
Cash and cash equivalents, beginning of period	10,044	15,034
Cash and cash equivalents, end of period	$ 11,827	$ 9,883
Supplemental disclosures of cash flow information		
Cash paid for		
Interest	$ 1,154	$ 1,581
Income taxes	$ 50	$ —
Non-cash investing activities		
Real estate acquired in full satisfaction of loans in foreclosure	$ —	$ 1,373

The accompanying notes are an integral part of these statements.

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MAGYAR BANCORP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(Unaudited)

NOTE A – BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Magyar Bancorp, Inc. (the "Company"), its wholly owned subsidiary, Magyar Bank (the "Bank"), and the Bank's wholly owned subsidiaries Magyar Service Corporation, Hungaria Urban Renewal, LLC, and MagBank Investment Company. All material intercompany transactions and balances have been eliminated. The Company prepares its financial statements on the accrual basis and in conformity with accounting principles generally accepted in the United States of America ("US GAAP"). The unaudited information furnished herein reflects all adjustments (consisting of normal recurring accruals) that are, in the opinion of management, necessary to a fair statement of the results for the interim periods presented.

Operating results for the three months ended December 31, 2012 are not necessarily indicative of the results that may be expected for the year ending September 30, 2013. The September 30, 2012 information has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by US GAAP for complete financial statements.

The preparation of financial statements in conformity with US GAAP 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 financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of other real estate owned, and the assessment of realizability of deferred income tax assets.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2012 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through the date these financial statements were issued.

NOTE B- RECENT ACCOUNTING PRONOUNCEMENTS

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

The FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs,* to amend FASB ASC Topic 820, Fair Value Measurements, to bring U.S. GAAP for fair value measurements in line with International Accounting Standards. The ASU clarifies existing guidance for items such as: the application of the highest and best use concept to non-financial assets and liabilities; the application of fair value measurement to financial instruments classified in a reporting entity’s stockholder’s equity; and disclosure requirements regarding quantitative information about unobservable inputs used in the fair value measurements of level 3 assets. The ASU also creates an exception to Topic 820 for entities which carry financial instruments within a portfolio or group, under which the entity is now permitted to base the price used for fair valuation upon a price that would be received to sell the net asset position or transfer a net liability position in an orderly transaction. The ASU also allows for the application of premiums and discounts in a fair value measurement if the financial instrument is categorized in level 2 or 3 of the fair value hierarchy. Lastly, the ASU contains new disclosure requirements regarding fair value amounts categorized as level 3 in the fair value hierarchy such as: disclosure of the valuation process used; effects of and relationships between unobservable inputs; usage of nonfinancial assets for purposes other than their highest and best use when that is the basis of the disclosed fair value; and categorization by level of items disclosed at fair value, but not measured at fair value for financial statement purposes. This ASU is effective for interim and annual periods beginning after December 15, 2011. The adoption of this ASU did not have a material impact on the consolidated financial statements.

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NOTE C - CONTINGENCIES

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

NOTE D - EARNINGS PER SHARE

Basic and diluted earnings per share for the three months ended December 31, 2012 and 2011 were calculated by dividing net income by the weighted-average number of shares outstanding for the period. All stock options and restricted stock awards were anti-dilutive for the three months ended December 31, 2012 and the three months ended December 31, 2011. The following table shows the Company's earnings per share for the periods presented:

	For the Three Months Ended December 31,					
	2012			2011		
	Income	Weighted average shares	Per share Amount	Income	Weighted average shares	Per share Amount
	(In thousands, except per share data)					
Basic EPS						
Net income available to common shareholders	$282	5,809	$0.05	$31	5,813	$0.01
Effect of dilutive securities						
Options and grants	—	—	—	—	—	—
Diluted EPS						
Net income available to common shareholders plus assumed conversion	$282	5,809	$0.05	$31	5,813	$0.01

Options to purchase 188,276 shares of common stock at a weighted average price of $14.61 and 10,364 shares of restricted shares at a weighted average price of $4.43 were outstanding and not included in the computation of diluted earnings per share for the three months ended December 31, 2012 because the grant (or option strike) price was greater than the average market price of the common shares during the periods. Options to purchase 188,276 shares of common stock at an average price of $14.61 and 17,030 restricted shares at a weighted average price of $9.22 were outstanding and not included in the computation of diluted earnings per share for the three months ended December 31, 2011 because the grant (or option strike) price was greater than the average market price of the common shares during the periods.

NOTE E – STOCK-BASED COMPENSATION AND STOCK REPURCHASE PROGRAM

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

ASC 718 also requires the Company to realize as a financing cash flow rather than an operating cash flow, as previously required, the benefits of realized tax deductions in excess of previously recognized tax benefits on compensation expense. In accordance with SEC Staff Accounting Bulletin (“SAB”) No. 107, the Company classified share-based compensation for employees and outside directors within “compensation and employee benefits” in the consolidated statement of operations to correspond with the same line item as the cash compensation paid.

Stock options generally vest over a five-year service period and expire ten years from issuance. Management recognizes compensation expense for all option grants over the awards’ respective requisite service periods. The fair values of all option grants were estimated using the Black-Scholes option-pricing model. Since there was limited historical information on the volatility of the Company’s stock, management also considered the average volatilities of similar entities for an appropriate period in determining the assumed volatility rate used in the estimation of fair value. Management estimated the expected life of the options using the simplified method allowed under SAB No. 107. The 7-year Treasury yield in effect at the time of the grant provided the risk-free rate for periods within the contractual life of the option. Management recognizes compensation expense for the fair values of these awards, which have graded vesting, on a straight-line basis over the requisite service period of the awards. Once vested, these awards are irrevocable. Shares will be obtained from either the open market or treasury stock upon share option exercise.

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Restricted shares generally vest over a five-year service period on the anniversary of the grant date. Once vested, these awards are irrevocable. The product of the number of shares granted and the grant date market price of the Company's common stock determine the fair value of restricted shares under the Company's restricted stock plans. Management recognizes compensation expense for the fair value of restricted shares on a straight-line basis over the requisite service period.

The following is a summary of the status of the Company's stock option activity and related information for its option plan for the three months ended December 31, 2012:

	Number of Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Balance at September 30, 2012	188,276	$ 14.61		
Granted	—	—		
Exercised	—	—		
Forfeited	—	—		
Balance at December 31, 2012	188,276	$ 14.61	4.2 years	$ —
Exercisable at December 31, 2012	188,276	$ 14.61	4.2 years	$ —

The following is a summary of the Company's non-vested stock awards as of December 31, 2012 and changes during the three months ended December 31, 2012:

	Number of Stock Awards	Weighted Average Grant Date Fair Value
Balance at September 30, 2012	13,402	$ 4.43
Granted	—	—
Vested	—	—
Forfeited	—	—
Balance at December 31, 2012	13,402	$ 4.43

Stock option and stock award expenses included with compensation expense were $0 and $4,000, respectively, for the three months ended December 31, 2012, and $40,000 and $62,000, respectively, for the three months ended December 31, 2011.

The Company announced in November 2007 its second stock repurchase program of up to 5% of its publicly-held outstanding shares of common stock, or 129,924 shares. Through December 31, 2012, the Company had repurchased a total of 81,000 shares of its common stock at an average cost of $8.33 per share under this program. No shares were repurchased during the three months ended December 31, 2012. Under the stock repurchase program, 48,924 shares of the 129,924 shares authorized remained available for repurchase as of December 31, 2012. The Company’s intended use of the repurchased shares is for general corporate purposes, including the funding of awards granted under the 2006 Equity Incentive Plan.

The Company has an Employee Stock Ownership Plan ("ESOP") for the benefit of employees of the Company and the Bank who meets the eligibility requirements as defined in the plan. The ESOP trust purchased 217,863 shares of common stock in the open market using proceeds of a loan from the Company. The total cost of shares purchased by the ESOP trust was $2.3 million, reflecting an average cost per share of $10.58. The Bank will make cash contributions to the ESOP on an annual basis sufficient to enable the ESOP to make the required loan payments to the Company. The loan bears a variable interest rate that adjusts annually every January 1st to the then published Prime Rate (3.25% at January 1, 2012) with principal and interest payable annually in equal installments over thirty years. The loan is secured by shares of the Company’s stock.

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As the debt is repaid, shares are released as collateral and allocated to qualified employees. Accordingly, the shares pledged as collateral are reported as unearned ESOP shares in the Consolidated Balance Sheet. As shares are released from collateral, the Company reports compensation expense equal to the then current market price of the shares, and the shares become outstanding for earnings per share computations.

At December 31, 2012, shares allocated to participants totaled 103,545. Unallocated ESOP shares held in suspense totaled 114,318 at December 31, 2012 and had a fair market value of $480,136. The Company's expense for the ESOP was $15,000 and $8,000 for the three months ended December 31, 2012 and 2011, respectively.

NOTE F – OTHER COMPREHENSIVE LOSS

The components of other comprehensive loss and the related income tax effects are as follows:

	Three Months Ended December 31,					
	2012			2011		
	Before Tax Amount	Tax Benefit (Expense)	Net of Tax Amount	Before Tax Amount	Tax Benefit (Expense)	Net of Tax Amount
	(Dollars in thousands)					
Unrealized holding gains (losses) arising during period on:						
Available-for-sale investments	$(129)	$ 44	$ (85)	$73	$ (32)	$ 41
Less reclassification adjustment for gains realized in net income	(64)	26	(38)	(84)	34	(50)
Interest rate derivatives	(20)	8	(12)	(23)	9	(14)
Other comprehensive loss, net	$(213)	$ 78	$ (135)	$(34)	$ 11	$ (23)

NOTE G – FAIR VALUE DISCLOSURES

We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Our securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other assets or liabilities on a non-recurring basis, such as held-to-maturity securities, mortgage servicing rights, loans receivable and other real estate owned, or OREO. These non-recurring fair value adjustments involve the application of lower-of-cost-or-market accounting or write-downs of individual assets.

In accordance with ASC 820, we group our assets and liabilities at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 -	Valuation is based upon quoted prices for identical instruments traded in active markets.
Level 2 -	Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market.
Level 3 -	Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques. The results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability.

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We base our fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

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

Securities available-for-sale

Our available-for-sale portfolio is carried at estimated fair value on a recurring basis, with any unrealized gains and losses, net of taxes, reported as accumulated other comprehensive income/loss in stockholders' equity. Our securities available-for-sale portfolio consists of U.S government and government-sponsored enterprise obligations, municipal bonds, and mortgage-backed securities. The fair values of these securities are obtained from an independent nationally recognized pricing service. Our independent pricing service provides us with prices which are categorized as Level 2, as quoted prices in active markets for identical assets are generally not available for the securities in our portfolio. Various modeling techniques are used to determine pricing for our mortgage-backed securities, including option pricing and discounted cash flow models. The inputs to these models include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data.

Derivative financial instruments

The Company uses interest rate floors to manage its interest rate risk. The interest rate floors have been designated as cash flow hedging instruments. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities.

The following table provides the level of valuation assumptions used to determine the carrying value of our assets measured at fair value on a recurring basis.

	Fair Value at December 31, 2012			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Securities available for sale:				
Obligations of U.S. government agencies:				
Mortgage backed securities - residential	$ 1,809	$ —	$ 1,809	$ —
Obligations of U.S. government-sponsored enterprises:				
Mortgage-backed securities-residential	7,744	—	7,744	—
Mortgage backed securities-commercial	4,174	—	4,174	—

Private label mortgage-backed securities-residential	1,012	—	1,012	—
Total securities available for sale	$ 14,739	$ —	$ 14,739	$ —

	Fair Value at September 30, 2012			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Securities available for sale:				
Obligations of U.S. government agencies:				
Mortgage backed securities - residential	$ 1,861	$ —	$ 1,861	$ —
Obligations of U.S. government-sponsored enterprises:				
Mortgage-backed securities-residential	8,575	—	8,575	—
Mortgage backed securities-commercial	4,228	—	4,228	—
Debt securities	1,067	—	1,067	—
Private label mortgage-backed securities-residential	1,055	—	1,055	—
Total securities available for sale	$ 16,786	$ —	$ 16,786	$ —

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

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Impaired Loans

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

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

Other Real Estate Owned

The fair value of other real estate owned is determined through current appraisals, and adjusted as necessary, by management, to reflect current market conditions. As such, other real estate owned is generally classified as Level 3.

The following table provides the level of valuation assumptions used to determine the carrying value of our assets measured at fair value on a non-recurring basis at December 31, 2012 and September 30, 2012.

	Fair Value at December 31, 2012			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			

Impaired loans	$ 3,755	$ —	$ —	$ 3,755
Other real estate owned	—	—	—	—
	$ 3,755	$ —	$ —	$ 3,755

	Fair Value at September 30, 2012			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Impaired loans	$ 5,984	$ —	$ —	$ 5,984
Other real estate owned	464	—	—	464
	$ 6,448	$ —	$ —	$ 6,448

The following methods and assumptions were used to estimate the fair value of each class of financial instruments not already disclosed above for which it is practicable to estimate fair value:

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

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

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

Federal Home Loan Bank of New York (“FHLB”) stock: The carrying amount of FHLB stock approximates fair value and considers the limited marketability of the investment.

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

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

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

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

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

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments carried at cost or amortized cost as of December 31, 2012 and September 30, 2012. This table excludes financial instruments for which the carrying amount approximates level 1 fair value. For short-term financial assets such as cash and cash equivalents, the carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization. For financial liabilities such as interest-bearing demand, NOW, and money market savings deposits, the carrying amount is a reasonable estimate of fair value due to these products having no stated maturity.

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	Carrying Value	Fair Value	Fair Value Measurement Placement (Level 1)	(Level 2)	(Level 3)
	(Dollars in thousands)				
December 31, 2012					
Financial instruments - assets					
Investment securities held-to-maturity	$41,213	$42,268	$ 2,999	$ 39,269	$ —
Loans	391,722	402,568	—	—	402,568
Financial instruments - liabilities					
Certificate of deposit	157,504	159,528	—	159,528	—
Borrowings	40,103	42,193	—	42,193	—
September 30, 2012					
Financial instruments - assets					
Investment securities held-to-maturity	$41,068	$42,130	$ 2,891	$ 39,239	$ —
Loans	385,270	396,111	—	—	396,111
Financial instruments - liabilities					
Certificate of deposit	158,461	160,753	—	160,753	—
Borrowings	41,503	43,898	—	43,898	—

NOTE H - INVESTMENT SECURITIES

The following tables summarize the amortized cost and fair values of securities available for sale at December 31, 2012 and September 30, 2012:

	At December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities available for sale:				
Obligations of U.S. government agencies:				
Mortgage backed securities - residential	$1,814	$ —	$ (5)	$1,809
Obligations of U.S. government-sponsored enterprises:				
Mortgage-backed securities-residential	7,614	130	—	7,744
Mortgage backed securities-commercial	4,031	143	—	4,174
Private label mortgage-backed securities-residential	990	23	(1)	1,012
Total securities available for sale	$14,449	$ 296	$ (6)	$14,739

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September 30, 2012			
	Gross	Gross	
Amortized	Unrealized	Unrealized	Fair