ESSA Bancorp, Inc.
Form 10-K
December 14, 2018

SECURITIES AND EXCHANGE COMMISSION

100 F Street NE

Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Fiscal Year Ended September 30, 2018

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to

Commission File No. 001-33384

ESSA Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania	20-8023072
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
200 Palmer Street, Stroudsburg, Pennsylvania	18360
(Address of Principal Executive Offices)	(Zip Code)

(570) 421-0531

(Registrant’s telephone number)

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

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 par value	The NASDAQ Stock Market, LLC

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.   YES   NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.   YES   NO

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such requirements for the past 90 days.   YES   NO .

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).   YES   NO .

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

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

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

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

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

As of December 1, 2018, there were 18,133,095 shares issued and 11,611,681 shares outstanding of the Registrant's Common Stock.

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, computed by reference to the last sale price on March 31, 2018, was $154,016,589.

DOCUMENTS INCORPORATED BY REFERENCE

- Proxy Statement for the 2019 Annual Meeting of Stockholders of the Registrant (Part III).

TABLE OF CONTENTS

PART I		
Item 1.	Business	2
Item 1A.	Risk Factors	24
Item 1B.	Unresolved Staff Comments	28
Item 2.	Properties	29
Item 3.	Legal Proceedings	30
Item 4.	Mine Safety Disclosures	30
PART II		
Item 5.	Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	31
Item 6.	Selected Financial Data	32
Item 7.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	33
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	43
Item 8.	Financial Statements and Supplementary Data	43
Item 9.	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	43
Item 9A.	Controls and Procedures	43
Item 9B.	Other Information	43
PART III		
Item 10.	Directors, Executive Officers and Corporate Governance	44
Item 11.	Executive Compensation	44
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	44
Item 13.	Certain Relationships and Related Transactions, and Director Independence	44
Item 14.	Principal Accounting Fees and Services	44
PART IV		
Item 15.	Exhibits and Financial Statement Schedules	45
Item 16.	Form 10-K Summary	46

Forward Looking Statements

This Annual Report on Form 10-K contains certain "forward-looking statements" which may be identified by the use of words such as "believe," "expect," "anticipate," "should," "planned," "estimated" and "potential." Examples of forward-looking statements include, but are not limited to, estimates with respect to our financial condition, results of operations and business that are subject to various factors which could cause actual results to differ materially from these estimates and most other statements that are not historical in nature. These factors include, but are not limited to, general and local economic conditions, changes in interest rates, deposit flows, demand for mortgage, and other loans, real estate values, competition, changes in accounting principles, policies, or guidelines, changes in legislation or regulation, and other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services and the ability to successfully complete or close transactions or to integrate acquired entities. Because of these and a wide variety of other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. Please also see "Item 1A. Risk Factors."

PART I

Item 1. Business
ESSA Bancorp, Inc.

ESSA Bancorp, Inc. ("ESSA Bancorp" or the "Company") is a Pennsylvania-chartered holding company for ESSA Bank & Trust (the "Bank"). ESSA Bancorp owns 100% of the outstanding shares of common stock of the Bank. Since being formed in 2006, ESSA Bancorp has engaged primarily in the business of holding the common stock of the Bank. Our executive offices are located at 200 Palmer Street, Stroudsburg, Pennsylvania 18360. Our telephone number at this address is (570) 421-0531. ESSA Bancorp is subject to comprehensive regulation and examination by the Federal Reserve Board of Governors. On July 31, 2012, ESSA Bancorp completed its acquisition of First Star Bancorp, Inc. and its wholly-owned subsidiary, First Star Bank ("First Star"). On April 4, 2014, ESSA Bancorp completed its acquisition of Franklin Security Bancorp, Inc. and its wholly owned subsidiary, Franklin Security Bank ("Franklin Security"). On December 4, 2015, ESSA Bancorp completed its acquisition of Eagle National Bancorp, Inc. ("ENB"), whereby ESSA Bancorp acquired ENB and its wholly owned subsidiary, Eagle National Bank. Effective November 14, 2014, ESSA Bancorp converted its holding company status from a savings and loan holding company to a bank holding company, and it elected the financial holding company designation as a bank holding company. At September 30, 2018, ESSA Bancorp had consolidated assets of $1.8 billion, consolidated deposits of $1.3 billion and consolidated stockholders' equity of $179.2 million. Consolidated net income for the fiscal year ended September 30, 2018 was $6.5 million. Results for the year ended September 30, 2018, reflected a one-time charge to income tax expense of $3.7 million related to the reduction in the carrying value of the Company's deferred tax assets, which resulted from the reduction in the Federal corporate income tax rate under the Tax Cuts and Jobs Act of 2017.

The Company is a public company, and files interim, quarterly and annual reports with the Securities and Exchange Commission ("SEC"). The SEC maintains an Internet site (www.sec.gov) that contains reports, proxy and information statements and other information regarding issuers such as the Company that file electronically with the SEC. All filed SEC reports and interim filings can also be obtained from the Bank's website (www.essabank.com), on the "Investor Relations" page, without charge from the Company.

ESSA Bank & Trust

General

The Bank was organized in 1916. The Bank is a Pennsylvania chartered full-service, community-oriented savings bank. We provide financial services to individuals, families and businesses through our 22 full-service banking offices, located in Monroe, Northampton, Lehigh, Lackawanna, Luzerne, Chester, Delaware and Montgomery Counties, Pennsylvania. The Bank is subject to comprehensive regulation and examination by the Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation. In March 2014, the Bank converted its charter from a Pennsylvania savings and loan association to a Pennsylvania savings bank. The charter change did not have a material effect on the operations of the Bank.

The Bank's business consists primarily of accepting deposits from the general public and investing those deposits, together with funds generated from operations and borrowings, in residential first mortgage loans (including construction mortgage loans), commercial real estate loans, home equity loans and lines of credit, commercial and consumer loans. We offer a variety of deposit accounts, including checking, savings and certificates of deposits. We

also offer asset management and trust services. We offer investment services through our relationship with Cetera Investment Services LLC, a third party broker/dealer and investment advisor. We offer insurance benefit consulting services through our wholly owned subsidiary, ESSA Advisory Services, LLC.

The Bank's executive offices are located at 200 Palmer Street, Stroudsburg, Pennsylvania 18360. Our telephone number at this address is (570) 421-0531. Our website address is www.essabank.com.

Market Area

At September 30, 2018, our 22 full-service banking offices consisted of 7 offices in Monroe County, 3 offices in Lehigh County, 6 offices in Northampton County, 1 office in Lackawanna County, 1 office in Luzerne County, 1 office in Chester County, 2 offices in Delaware County and 1 office in Montgomery County, Pennsylvania. Our primary market for deposits is currently concentrated around the areas where our full-service banking offices are located. Our primary lending area consists of the counties where our branch offices are located, and to a lesser extent, the contiguous counties in the Commonwealth of Pennsylvania.

Monroe County is located in eastern Pennsylvania, situated 90 miles north of Philadelphia, 75 miles west of New York and 116 miles northeast of Harrisburg. Monroe County is comprised of 611 square miles of mostly rural terrain. Major industries include tourism, healthcare and educational facilities. Northampton County is located south of Monroe County and directly borders New Jersey. Lehigh County is located southwest of Monroe County. Luzerne and Lackawanna Counties are located north of Monroe County. Chester and Montgomery Counties are located south and Delaware County southwest of Monroe County. As of June 30, 2018, the most recent FDIC market share data available, we had a deposit market share of approximately 29.3% in Monroe County, which represented the largest deposit market share in Monroe County, 2.9% in Northampton County, 1.9% in Lehigh County, 0.1% in Lackawanna County, 0.9% in Luzerne County, 0.1% in Chester County, 0.1% in Montgomery County and 0.6% in Delaware County.

Lending Activities

Historically, our principal lending activity has been the origination of first mortgage loans for the purchase, construction or refinancing of one- to four-family residential real estate property. In recent years, we have increased our originations of commercial loans and commercial real estate loans in an effort to increase interest income, diversify our loan portfolio, and better serve the community. Commercial real estate loans have increased from $288.4 million or 23.5% of our total loan portfolio at September 30, 2016 to $416.6 million, or 31.6%, of our total loan portfolio at September 30, 2018. One- to four-family residential real estate mortgage loans represented $580.6 million, or 44.1%, of our loan portfolio at September 30, 2018. Home equity loans and lines of credit totaled $44.0 million, or 3.3%, of our loan portfolio at September 30, 2018. Commercial loans totaled $49.5 million, or 3.8%, of our loan portfolio at September 30, 2018 and construction first mortgage loans totaled $3.9 million, or 0.3%, of the total loan portfolio at September 30, 2018. Obligations of states and political subdivisions totaled $73.4 million, or 5.6%, of our loan portfolio at September 30, 2018. Auto loans totaled $146.2 million or 11.1% of the total loan portfolio at September 30, 2018. As previously disclosed, the Bank discontinued originating indirect auto loans in July, 2018. We originate other consumer loans on a limited basis.

Loan Portfolio Composition. The following table sets forth the composition of our loan portfolio, by type of loan at the dates indicated, excluding loans held for sale.

	At September 30,					
	2018		2017		2016	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
Residential first mortgage loans:						
One- to four-family	$580,561	44.1 %	$586,708	47.1 %	$596,645	48.6 %
Construction	3,920	0.3	3,097	0.2	1,733	0.1
Commercial	49,479	3.8	44,129	3.5	39,978	3.3
Commercial real estate	416,573	31.6	318,323	25.6	288,447	23.5
Obligations of states and political subdivisions	73,362	5.6	58,079	4.7	56,923	4.6
Home equity loans and lines of credit	43,962	3.3	46,219	3.7	48,163	3.9
Auto loans	146,220	11.1	186,646	15.0	193,078	15.7
Other	2,682	0.2	2,845	0.2	3,302	0.3
Total loans receivable	$1,316,759	100.0 %	$1,246,046	100.0 %	$1,228,269	100.0 %
Allowance for loan losses	(11,688)		(9,365)		(9,056)	
Total loans receivable, net	$1,305,071		$1,236,681		$1,219,213	

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

	One-to four-family	Construction	Commercial	Commercial Real Estate
	(Dollars in thousands)			
Due During the Years Ending September 30,				
2019	$1,240	$ -	$ 13,698	$ 42,966
2020	1,691	-	4,012	26,744
2021	2,363	-	994	19,256
2022 to 2023	17,388	-	10,131	41,868
2024 to 2028	132,704	-	14,850	123,878
2029 to 2033	108,870	-	2,001	49,765
2033 and beyond	316,305	3,920	3,793	112,096
Total	$580,561	$ 3,920	$ 49,479	$ 416,573

3

	Obligations of States and Political subdivisions	Home Equity Loans and Lines of Credit	Auto Loans	Other	Total
	(Dollars in thousands)				
Due During the Years Ending September 30,					
2019	$689	$ 1,388	$ 2,003	$284	$62,268
2020	211	1,002	10,645	465	44,770
2021	6,909	2,023	30,777	343	62,665
2022 to 2023	11,066	5,126	82,544	692	168,815
2024 to 2028	20,762	10,133	20,251	348	322,926
2029 to 2033	14,255	12,861	-	339	188,091
2033 and beyond	19,470	11,429	-	211	467,224
Total	$73,362	$ 43,962	$ 146,220	$2,682	$1,316,759

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

	Due After September 30, 2019		
	Fixed	Adjustable	Total
	(In thousands)		
Residential first mortgage loans:			
One- to four-family	$543,665	$35,656	$579,321
Construction	3,920	-	3,920
Commercial	24,150	11,631	35,781
Commercial real estate	92,583	281,024	373,607
Obligations of states and political subdivisions	33,771	38,902	72,673
Home equity loans and lines of credit	19,392	23,182	42,574
Auto loans	144,217	-	144,217
Other	2,398	-	2,398
Total	$864,096	$390,395	$1,254,491

Loan Originations and Repayments. We originate residential mortgage loans pursuant to underwriting standards that generally conform to Fannie Mae and Freddie Mac guidelines. Loan origination activities are primarily concentrated in Monroe, Northampton, Lehigh, Lackawanna, Luzerne, Chester, Delaware, and Montgomery Counties, Pennsylvania and secondarily in other Pennsylvania counties contiguous to our primary market area. New loans are generated primarily from the efforts of employees and advertising, a network of select mortgage brokers, other parties with whom we do business, customer referrals, and from walk-in customers. Loan applications are centrally underwritten and processed at our corporate center. At September 30, 2018, $580.6 million, or 44.1%, of our loan portfolio, consisted of one- to four-family residential loans. Generally, one- to four-family residential mortgage loans are originated in amounts up to 80% of the lesser of the appraised value or purchase price of the property, although loans may be made with higher loan-to-value ratios private mortgage insurance is required to compensate for the risk. Fixed-rate loans are originated for terms of 10, 15, 20 and 30 years. At September 30, 2018, our largest loan secured by one- to four-family real estate had a principal balance of approximately $1.8 million and was secured by a single

family house. This loan was performing in accordance with its repayment terms.

We also offer adjustable-rate mortgage loans which have initial fixed terms of one, three, five or seven-years before converting to an annual adjustment schedule based on changes in a designated United States Treasury index. We originated $9.3 million of adjustable rate one- to four-family residential loans during the year ended September 30, 2018 and $5.0 million during the year ended September 30, 2017. Our adjustable rate mortgage loans provide for maximum rate adjustments of 200 basis points per adjustment, with a lifetime maximum adjustment of 500 basis points. Our adjustable rate mortgage loans amortize over terms of up to 30 years.

Adjustable rate mortgage loans decrease the risk associated with changes in market interest rates by periodically repricing, but involve other risks. As interest rates increase, the principal and interest payments on the loan increase, thus increasing the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Adjustment of the contractual interest rate is limited by the periodic and lifetime interest rate adjustments specified by our loan documents and therefore, is potentially limited in effectiveness during periods of rapidly rising interest rates. At September 30, 2018, $35.7 million, or 6.1%, of our one- to four-family residential loans had adjustable rates of interest.

All one- to four-family residential mortgage loans that we originate include “due-on-sale” clauses, which provides the right to declare a loan immediately due and payable in the event that the borrower sells or otherwise conveys title to the real property subject to the mortgage and the loan is not repaid.

Regulations limit the amount that a savings bank may lend relative to the value of the real estate securing the loan, as determined by an appraisal of the property at the time the loan is originated. For all purchase money loans, we utilize outside independent appraisers approved by our Management Loan Committee. All purchase money and most refinance loans require a lender’s title insurance policy. Certain modest refinance requests may utilize an exterior inspection report and title search. We also require fire and casualty insurance and, where circumstances warrant, flood insurance.

Home Equity Loans and Lines of Credit. Home equity loans and lines of credit are generated by our Mortgage Professionals. Eligible properties include primary and vacation homes located in Monroe, Northampton, Lackawanna, Luzerne, Lehigh, Chester, Delaware, and Montgomery Counties, Pennsylvania and secondarily in other Pennsylvania counties contiguous to our primary market area. As of September 30, 2018, home equity loans and lines totaled about $44.0 million, or 3.3%, of our loan portfolio.

The maximum combined loan-to-value originated is currently 80%, depending on the collateral and the holder of the first mortgage. There is a small portion of the portfolio originated in years past that contains original combined loan-to-values of up to 90%. Our home equity lines of credit typically feature a 10 year draw period with interest-only payments permitted, followed by another 10 years of fully amortizing payments with no further ability to draw funds. Similar combined loan-to-value characteristics and standards exist for the lines as are outlined above for the loans.

Loan underwriting standards limit the maximum size of a junior lien loan to between $250,000 and $500,000, depending on the loan type and collateral. All loans exceeding 75% of value require an appraisal by bank-approved, licensed appraisers. Loans up to $25,000 with lesser loan-to-value ratios may utilize an automated valuation model. Title/lien searches are secured on all home equity loans and lines.

Commercial Real Estate Loans. At September 30, 2018, $416.6 million, or 31.6%, of our total loan portfolio consisted of commercial real estate loans. Commercial real estate loans are secured by office buildings, multi-family, mixed-use properties and other commercial properties. We generally originate adjustable rate commercial real estate loans with an initial term of five years and a repricing option, and a maximum term of up to 25 years. The maximum loan-to-value ratio for most commercial real estate loans is 75% to 80% and 85% for select loans with faster amortizations. At September 30, 2018, our largest commercial real estate relationship balance was $23.2 million,

which was performing in accordance with its terms.

We consider a number of factors in originating commercial real estate loans. We evaluate the qualifications and financial condition of the borrower, including credit history, profitability and expertise, as well as the value and condition of the mortgaged property securing the loan. When evaluating the qualifications of the borrower, we consider the financial resources of the borrower, the borrower's experience in owning or managing similar property and the borrower's payment history with us and other financial institutions. In evaluating the property securing the loan, the factors we consider include the net operating income of the mortgaged property before debt service and depreciation, the ratio of the loan amount to the appraised value of the mortgaged property and the debt service coverage ratio (the ratio of net operating income to debt service) to ensure that it is at least 120% of the monthly debt service. All commercial real estate loans in excess of $500,000 are appraised by outside independent appraisers approved in accordance with the Bank's Appraisal Policy. Personal guarantees are obtained from commercial real estate borrowers although we may occasionally waive this requirement given very strong loan to value and debt service coverage ratios. All purchase money and most asset refinance borrowers are required to obtain title insurance. We also require fire and casualty insurance and, where circumstances warrant, flood insurance.

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

First Mortgage Construction Loans. At September 30, 2018, $3.9 million, or 0.3%, of our total loan portfolio consisted of first mortgage construction loans. Our first mortgage construction loans are for the construction of residential properties. We currently offer fixed and adjustable-rate residential first mortgage construction loans. First mortgage construction loans are generally structured for permanent mortgage financing once the construction is completed. At September 30, 2018, our largest first mortgage construction loan balance was $484,000. The loan was performing in accordance with its terms. First mortgage construction loans will generally be made in amounts of up to 80% of the appraised value of the completed property, or the actual cost of the improvements. First mortgage construction loans require only the payment of interest during the construction period. Once converted to permanent financing, they generally repay over a 30 year period. Funds are disbursed based on our inspections in accordance with a schedule reflecting the completion of portions of the project.

First mortgage construction loans generally involve a greater degree of credit risk than other one- to four-family residential mortgage loans. The risk of loss on a construction loan depends, in part, upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost of construction and the successful completion of construction within budget.

For all such loans, we utilize outside independent appraisers approved in accordance with the Bank’s Appraisal Policy. All borrowers are required to obtain title insurance. We also require fire and casualty insurance and, where circumstances warrant, flood insurance on properties.

Commercial Loans. At September 30, 2018, $49.5 million, or 3.8%, of our loan portfolio, consisted of commercial loans. We generally offer commercial loans to individuals and businesses located in our primary market area. The commercial loan portfolio includes lines of credit, equipment loans, vehicle loans, improvement loans and term loans. These loans are primarily secured by vehicles, machinery and equipment, inventory, accounts receivable, marketable securities, deposit accounts and real estate.

Obligations of States and Political Subdivisions. At September 30, 2018, $73.4 million, or 5.6%, of our total loan portfolio consisted of loan transactions including tax and revenue anticipation notes, general obligation notes, and authority general revenue notes. The financial strength of the state or political subdivision, type of transaction, relationship efforts, and profitability of return are considered when pricing and structuring each transaction.

Auto Loans. At September 30, 2018, $146.2 million, or 11.1% of our total loan portfolio consisted of auto loans. Although collateralized, these loans require stringent underwriting standards and procedures. Each loan decision is based primarily on the credit history of the individual(s) and their ability to repay the loan. Collision and comprehensive insurance is required and the Bank must be listed as the loss payee. As previously disclosed, the Bank discontinued originating indirect auto loans.

Indirect auto loans are inherently risky as they are often secured by assets that depreciate rapidly. In some cases, repossessed collateral for a defaulted automobile loan may not provide an adequate source of repayment for the outstanding loan and the remaining deficiency may not warrant further substantial collection efforts against the borrower. Automobile loan collections depend on the borrower’s continuing financial stability, and therefore, are more likely to be adversely affected by job loss, divorce, illness, or personal bankruptcy.

Other Loans. We offer a variety of loans that are either unsecured or secured by property other than real estate. These loans include loans secured by deposits and personal unsecured loans. At September 30, 2018, these other loans totaled $2.7 million, or 0.2%, of the total loan portfolio.

Loan Approval Procedures and Authority. The loan approval process is intended to assess the borrower’s ability to repay the loan, the viability of the loan, and the adequacy of the value of the property that will secure the loan. To assess the borrower’s ability to repay, we review each borrower’s employment and credit history and information on the historical and projected income and expenses of mortgagors. For all loans the Board has granted lending authority to prescribed loan committees. Larger and more complex loan requests require the involvement of senior management or the Board.

Non-Performing Loans and Problem Assets

Performance of the loan portfolio is reviewed on a regular basis by Bank Management. A number of factors regarding the borrower, such as overall financial strength, collateral values and repayment ability, are considered in deciding what actions should be taken when determining the collectability of interest for accrual purposes.

When a loan, including a loan that is impaired, is classified as nonaccrual, the accrual of interest on such a loan is discontinued. A loan is typically classified as nonaccrual when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about the 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 accrued interest is fully reversed. Interest payments received on nonaccrual loans are either applied against principal or reported as interest income, according to management’s judgment as to the collectability of principal.

Loans are usually restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

Non-performing Loans. At September 30, 2018, $10.5 million, or 0.80% of our total loans, were non-performing loans. The majority of these loans were commercial real estate loans and residential mortgage loans. Non-performing commercial real estate loans totaled $3.5 million at September 30, 2018. Residential first mortgage loans that were 90 days or more past due totaled $5.3 million at September 30, 2018.

Real Estate Owned. At September 30, 2018, the Company had $1.1 million of real estate owned consisting of 17 properties. These properties are being carried on the Company’s books at fair value less estimated costs to sell. All these properties are being actively marketed and additional losses may occur.

Non-Performing Assets. The table below sets forth the amounts and categories of our non-performing assets at the dates indicated.

	At September 30,		
	2018	2017	2016
	(Dollars in thousands)		
Non-accrual loans:			
Residential first mortgage loans:			
One- to four-family	$5,317	$6,592	$8,972
Construction	-	-	-
Commercial	876	813	874
Commercial real estate	3,497	5,441	8,144
Home equity loans and lines of credit	216	643	950
Auto loans	587	736	344
Other	18	38	31
Total	10,511	14,263	19,315
Accruing loans 90 days or more past due:			
Residential first mortgage loans:			
One- to four-family	-	-	-
Construction	-	-	-
Commercial	-	-	-
Commercial real estate	-	-	-
Home equity loans and lines of credit	-	-	-
Auto Loans	-	-	-
Other	-	-	-
Total loans 90 days or more past due	-	-	-
Non-performing troubled debt restructurings	-	-	-
Total non-performing loans	10,511	14,263	19,315
Real estate owned	1,141	1,424	2,659
Other repossessed assets	16	9	9
Total non-performing assets	$11,668	$15,696	$21,983
Troubled Debt Restructurings [(1)]:			
Residential first mortgage loans:			
One- to four-family	$3,260	$3,642	$4,981
Construction	-	-	-
Commercial	-	-	-
Commercial real estate	976	1,106	2,625
Home equity loans and lines of credit	66	120	234
Auto loans	58	-	-
Other	-	-	-
Total	$4,360	$4,868	$7,840
Ratios:			
Total non-performing loans to total loans	0.80 %	1.14 %	1.57 %
Total non-performing loans to total assets	0.57 %	0.80 %	1.09 %
Total non-performing assets to total assets	0.64 %	0.88 %	1.24 %

1) Non-performing troubled debt restructurings are included in total troubled debt restructurings as part of the non-performing assets table.

For the years ended September 30, 2018, 2017 and 2016, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was $171,000, $449,000 and $782,000 respectively.

At September 30, 2018, the principal balance of troubled debt restructurings (“TDRs”) was $4.4 million as compared to $4.9 million at September 30, 2017. Of the $4.4 million of TDRs at September 30, 2018, $106,000 were performing loans and $4.3 million were non-accrual loans.

TDRs at September 30, 2018 were comprised of 28 residential loans totaling $3.3 million, 6 commercial real estate loans totaling $976,000 and 8 consumer loans (home equity loans, home equity lines of credit, auto and other) totaling $124,000.

For the year ended September 30, 2018, 10 loans totaling $1.1 million were removed from TDR status, 2 loans totaling $269,000 were transferred to foreclosed real estate and 8 loans for $827,000 had completed timely payments.

We have modified terms of performing loans that do not meet the definition of a TDR. The vast majority of such loans were simply rate modifications of residential first mortgage loans in lieu of refinancing. The non-TDR rate modifications were all performing loans when the rates were reset to current market rates. For the year ended September 30, 2018, we modified 14 loans totaling $1.7 million. With regard to commercial loans, including commercial real estate loans, various non-troubled loans were modified, either for the purpose of a rate reduction to reflect current market rates (in lieu of a refinance) or the extension of a loan's maturity date. In total we modified 5 commercial loans with an aggregate balance of approximately $7.3 million for the year ended September 30, 2018.

Delinquencies. The following table sets forth certain information with respect to our loan portfolio delinquencies at the dates indicated. Loans delinquent for 90 days or more are generally classified as nonaccrual loans.

	Loans Delinquent For					
	60-89 Days		90 Days and Over		Total	
	Number	Amount	Number	Amount	Number	Amount
	(Dollars in thousands)					
At September 30, 2018						
Residential first mortgage loans:						
One- to four-family	5	$ 920	58	$ 5,317	63	$ 6,237
Construction	-	-	-	-	-	-
Commercial	1	11	9	876	10	887
Commercial real estate	-	-	16	3,497	16	3,497
Obligations of states and political subdivisions	-	-	-	-	-	-
Home equity loans and lines of credit	-	-	11	216	11	216
Auto loans	2	20	74	587	76	607
Other	-	-	4	18	4	18
Total	8	$ 951	172	$ 10,511	180	$ 11,462
At September 30, 2017						
Residential first mortgage loans:						
One- to four-family	8	$ 421	76	$ 6,592	84	7,013
Construction	-	-	-	-	-	-
Commercial	-	-	37	5,441	37	5,441
Commercial real estate	-	-	10	813	10	813
Obligations of states and political subdivisions	-	-	-	-	-	-
Home equity loans and lines of credit	1	15	17	643	18	658
Auto loans	2	32	61	736	63	768
Other	1	4	5	38	6	42
Total	12	$ 472	206	$ 14,263	218	$ 14,735
At September 30, 2016						
Residential first mortgage loans:						

One- to four-family	6	$ 660	92	$ 8,972	98	$ 9,632
Construction	-	-	-	-	-	-
Commercial	1	57	13	874	14	931
Commercial real estate	3	191	49	8,144	52	8,335
Obligations of states and political subdivisions	-	-	-	-	-	-
Home equity loans and lines of credit	2	147	17	950	19	1,097
Auto loans	12	232	22	344	34	576
Other	-	-	3	31	3	31
Total	24	$ 1,287	196	$ 19,315	220	$ 20,602

Classified Assets. Banking regulations and our Asset Classification Policy provide that loans and other assets considered to be of lesser quality should be classified as “Substandard,” “Doubtful” or “Loss” assets. An asset is considered Substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Assets classified as Doubtful have all of the weaknesses inherent in those classified Substandard, with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Assets classified as Loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. We classify an asset as “Special Mention” if the asset has a potential weakness that warrants management’s close attention. While such assets are not impaired, management has concluded that if the potential weakness in the asset is not addressed, the value of the asset may deteriorate, thereby adversely affecting the repayment of the asset.

At September 30, 2018, the Company classified approximately $10.3 million of our assets as Special Mention, of which $9.0 million were commercial and commercial real estate loans, and $22.7 million as Substandard, of which $16.4 million were commercial and commercial real estate loans. No loans were classified Doubtful or Loss. At September 30, 2017, we classified approximately $4.1 million of our assets as Special Mention, of which $3.4 million were commercial and commercial real estate loans, and $27.0 million as Substandard, of which $17.5 million were commercial and commercial real estate loans. No loans were classified as Doubtful or Loss.

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

Allowance for Loan Losses

Our allowance for loan losses is maintained at a level necessary to absorb loan losses that are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses inherent in its loan portfolio and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. Our allowance for loan losses consists of two elements: (1) an allocated allowance, which comprises allowances established on specific loans and class allowances based on historical loss experience and current trends, and (2) an unallocated allowance based on general economic conditions and other risk factors in our markets and portfolios. We maintain a loan review system, which allows for a periodic review (at least quarterly) of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified losses based on a review of such information. A loan evaluated for impairment is considered to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Loan impairment is measured based on the fair value of collateral method, taking into account the appraised value, any valuation assumptions used, estimated costs to sell and trends in the market since the appraisal date. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions, management’s judgment and losses which are probable and reasonably estimable. The allowance is increased through provisions charged against current earnings and recoveries of previously charged-off loans. Loans that are determined to be uncollectible are charged against the allowance. While management uses available information to recognize probable and reasonably estimable loan losses, future loss provisions may be necessary based on changing economic conditions. Payments received on impaired loans generally are either applied against principal or reported as interest income, according to management’s judgment as to the collectability of principal. The allowance for loan losses as of September 30, 2018 is maintained at a level that represents management’s best estimate of losses inherent in the loan

portfolio, and such losses were both probable and reasonably estimable.

In addition, the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”), the Federal Deposit Insurance Corporation (“FDIC”) and the Pennsylvania Department of Banking and Securities, as an integral part of their examination process, periodically review our allowance for loan losses. The banking regulators may require that we recognize additions to the allowance based on their analysis and review of information available to them at the time of their examination.

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

	At or For the Years Ended September 30,		
	2018	2017	2016
	(Dollars in thousands)		
Balance at beginning of year	$9,365	$9,056	$8,919
Charge-offs:			
Residential first mortgage loans:			
One- to four-family	(335)	(504)	(1,040)
Construction	-	-	-
Commercial	(151)	(31)	(18)
Commercial real estate	(54)	(1,352)	(266)
Obligations of states and political subdivisions	-	-	-
Home equity loans and lines of credit	(68)	(18)	(209)
Auto loans	(1,833)	(2,009)	(1,262)
Other	(21)	(9)	-
Total charge-offs	(2,462)	(3,923)	(2,795)
Recoveries:			
Residential first mortgage loans:			
One- to four-family	12	22	59
Construction	-	-	-
Commercial	10	1	7
Commercial real estate	49	27	52
Obligations of states and political subdivisions	-	-	-
Home equity loans and lines of credit	54	8	9
Auto loans	655	815	246
Other	5	9	9
Total recoveries	785	882	382
Net charge-offs	(1,677)	(3,041)	(2,413)
Provision for loan losses	4,000	3,350	2,550
Balance at end of year	$11,688	$9,365	$9,056
Ratios:			
Net charge-offs to average loans outstanding	0.13%	0.25%	0.20%
Allowance for loan losses to non-performing loans at end of year	111.20%	65.66%	46.89%
Allowance for loan losses to total loans at end of year	0.89%	0.75%	0.74%

See “Non-Performing Loans and Problem Assets.” There can be no assurance that we will not experience a deterioration of our loan portfolio, including increases in non-performing loans, problem assets and charge-offs, in the future.

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

	2018			2017			2016		
	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans
	(Dollars in thousands)								
Residential first mortgage loans:									
One- to four-family	$3,605	30.84 %	44.09 %	$3,878	41.41 %	47.08 %	$4,426	48.88 %	48.58 %
Construction	35	0.30	0.30	23	0.25	0.25	13	0.14	0.14
Commercial	1,462	12.51	3.76	987	10.54	25.55	882	9.74	3.25
Commercial real estate	3,458	29.59	31.64	1,758	18.77	3.54	852	9.41	23.49
Obligations of states and political subdivisions	323	2.76	5.57	248	2.65	4.66	215	2.37	4.63
Home equity loans and lines of credit	296	2.53	3.34	470	5.02	3.71	455	5.02	