

Magyar Bancorp, Inc.  
Form 10-K  
December 21, 2010

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SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended September 30, 2010

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-51726

Magyar Bancorp, Inc.  
(Exact Name of Registrant as Specified in its Charter)

Delaware  
(State or Other Jurisdiction of Incorporation or  
Organization)

20-4154978  
(I.R.S. Employer Identification Number)

400 Somerset Street, New Brunswick, New Jersey  
(Address of Principal Executive Office)

08901  
(Zip Code)

(732) 342-7600  
(Issuer's Telephone Number including area code)

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

Title of Class  
Common Stock, par value \$0.01 per share

Name of Each Exchange On Which Registered  
The NASDAQ Stock Market, LLC

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

None  
(Title of Class)

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

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

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

Indicate by check mark whether the registrant has submitted electronically 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  No

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

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 | <input type="checkbox"/> | Accelerated filer         | <input type="checkbox"/>            |
| Non-accelerated filer   | <input type="checkbox"/> | Smaller reporting company | <input checked="" type="checkbox"/> |

(Do not check if a smaller reporting company)

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

The aggregate value of the voting stock held by non-affiliates of the registrant, computed by reference to the closing price of the Common Stock as of March 31, 2010 was \$10.4 million. As of December 15, 2010, there were 5,923,742 shares issued and 5,783,131 outstanding of the registrant's Common Stock, including 3,200,450 shares owned by Magyar Bancorp, MHC, the registrant's mutual holding company.

DOCUMENTS INCORPORATED BY REFERENCE

1. Proxy Statement for the 2011 Annual Meeting of Stockholders (Part III)

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Magyar Bancorp, Inc.  
Annual Report On Form 10-K  
For The Fiscal Year Ended  
September 30, 2010

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PART I

ITEM 1. Business

Forward Looking Statements

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

Magyar Bancorp, MHC

Magyar Bancorp, MHC is the New Jersey-chartered mutual holding company of Magyar Bancorp, Inc. Magyar Bancorp, MHC’s only business is the ownership of 54.03% of the issued shares of common stock of Magyar Bancorp, Inc. So long as Magyar Bancorp, MHC exists, it will be required to own a majority of the voting stock of Magyar Bancorp, Inc. The executive office of Magyar Bancorp, MHC is located at 400 Somerset Street, New Brunswick, New Jersey 08903, and its telephone number is (732) 342-7600. Magyar Bancorp, MHC is subject to comprehensive regulation and examination by the Board of Governors of the Federal Reserve System and the New Jersey Department of Banking and Insurance.

Magyar Bancorp, Inc.

Magyar Bancorp, Inc. is the mid-tier stock holding company of Magyar Bank. Magyar Bancorp, Inc. is a Delaware-chartered corporation and owns 100% of the outstanding shares of common stock of Magyar Bank. Magyar Bancorp, Inc. has not engaged in any significant business activity other than owning all of the shares of common stock of Magyar Bank. At September 30, 2010, Magyar Bancorp, Inc. had consolidated assets of \$537.9 million, total deposits of \$427.9 million and stockholders’ equity of \$44.2 million. Magyar Bancorp, Inc.’s net income for the fiscal year ended September 30, 2010 was \$3.9 million. The executive offices of Magyar Bancorp, Inc. are located at 400 Somerset Street, New Brunswick, New Jersey 08903, and its telephone number is (732) 342-7600. Magyar Bancorp, Inc. is subject to comprehensive regulation and examination by the Board of Governors of the Federal Reserve System and the New Jersey Department of Banking and Insurance.

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On January 23, 2006, Magyar Bancorp, Inc. sold 2,618,550 shares of its common stock at a price of \$10.00 per share, issued an additional 3,200,450 shares of its common stock to Magyar Bancorp, MHC, and contributed 104,742 shares to Magyar Bank Charitable Foundation.

### Magyar Bank

Magyar Bank is a New Jersey-chartered savings bank headquartered in New Brunswick, New Jersey that was originally founded in 1922 as a New Jersey building and loan association. In 1954, Magyar Bank converted to a New Jersey savings and loan association, before converting to the New Jersey savings bank charter in 1993. We conduct business from

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our main office located at 400 Somerset Street, New Brunswick, New Jersey, and our six branch offices located in New Brunswick, North Brunswick, South Brunswick, Branchburg, and Bridgewater, New Jersey. The telephone number at our main office is (732) 342-7600.

### General

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

### Market Area

We are headquartered in New Brunswick, New Jersey, and our primary deposit market area is concentrated in the communities surrounding our headquarters branch and our branch offices located in Middlesex and Somerset Counties, New Jersey. Our primary lending market area is broader than our deposit market area and includes all of New Jersey. At September 30, 2010, 53.3% of our mortgage loan portfolio consisted of loans secured by real estate located in Middlesex and Somerset Counties in New Jersey.

The economy of our primary market area is largely urban and suburban with a broad economic base that is typical for counties surrounding the New York metropolitan area. The median household income in Middlesex and Somerset county rank among the highest in the nation, and both counties are expected to see moderate population growth in 2011.

### Competition

We face intense competition within our market area both in making loans and attracting deposits. Our market area has a high concentration of financial institutions including large money center and regional banks, community banks and credit unions. Some of our competitors offer products and services that we currently do not offer, such as trust services and private banking. According to the Federal Deposit Insurance Corporation’s annual Summary of Deposit report, at June 30, 2010 our market share of deposits was 1.81% and 0.36% in Middlesex and Somerset Counties, respectively. Our market share of deposits was 1.93% and 0.35%, respectively, at June 30, 2009.

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

### Lending Activities

We originate residential mortgage loans to purchase or refinance residential real property. Residential mortgage loans represented \$165.5 million, or 40.5% of our total loans at September 30, 2010. Historically, we have not originated a significant number of loans for the purpose of reselling them in the secondary market. In the future, however, to help manage interest rate risk and to increase fee income, we may increase our origination and sale of residential mortgage loans. No loans were held for sale at September 30, 2010. We also originate commercial real estate, commercial business and construction loans. At September 30, 2010, these loans totaled \$116.2 million, \$33.7 million and \$57.1 million, respectively. We also offer consumer loans, which consist primarily of home equity lines of credit and stock-secured



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demand loans. At September 30, 2010, home equity lines of credit and stock-secured demand loans totaled \$22.8 million and \$12.8 million, respectively.

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

|                                | 2010       |          | 2009       |          | September 30,<br>2008 |          | 2007       |          | 2006       |          |
|--------------------------------|------------|----------|------------|----------|-----------------------|----------|------------|----------|------------|----------|
|                                | Amount     | Percent  | Amount     | Percent  | Amount                | Percent  | Amount     | Percent  | Amount     | Percent  |
| (Dollars in thousands)         |            |          |            |          |                       |          |            |          |            |          |
| One-to-four-family residential | \$ 165,462 | 40.50 %  | \$ 172,415 | 38.76 %  | \$ 157,867            | 38.44 %  | \$ 152,474 | 39.54 %  | \$ 143,245 | 40.65 %  |
| Commercial real estate         | 116,222    | 28.45 %  | 105,764    | 23.78 %  | 92,823                | 22.60 %  | 81,275     | 21.08 %  | 68,567     | 19.46 %  |
| Construction                   | 57,086     | 13.97 %  | 93,217     | 20.96 %  | 92,856                | 22.61 %  | 97,150     | 25.20 %  | 90,342     | 25.64 %  |
| Home equity lines of credit    | 22,823     | 5.59 %   | 22,528     | 5.07 %   | 15,893                | 3.87 %   | 12,894     | 3.34 %   | 10,843     | 3.08 %   |
| Commercial business            | 33,676     | 8.24 %   | 37,372     | 8.40 %   | 35,995                | 8.76 %   | 26,630     | 6.91 %   | 24,510     | 6.96 %   |
| Other                          | 13,277     | 3.25 %   | 13,484     | 3.03 %   | 15,294                | 3.72 %   | 15,159     | 3.93 %   | 14,846     | 4.21 %   |
| Total loans receivable         | \$ 408,546 | 100.00 % | \$ 444,780 | 100.00 % | \$ 410,728            | 100.00 % | \$ 385,582 | 100.00 % | \$ 352,353 | 100.00 % |
| Net deferred loan costs        | 106        |          | 24         |          | (77 )                 |          | (214 )     |          | (492 )     |          |
| Allowance for loan losses      | (4,766 )   |          | (5,807 )   |          | (4,502 )              |          | (3,754 )   |          | (3,892 )   |          |
| Total loans receivable, net    | \$ 403,886 |          | \$ 438,997 |          | \$ 406,149            |          | \$ 381,614 |          | \$ 347,969 |          |

Loan Portfolio Maturities and Yields. The following table summarizes the scheduled repayments of our loan portfolio at September 30, 2010. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in one year or less.

| Due During the Fiscal Years Ending September 30, | One-to-Four Family Residential |                       | Commercial Real Estate |                       | Construction |                       | Home Equity Lines of Credit |                       |
|--|--------------------------------|-----------------------|------------------------|-----------------------|--------------|-----------------------|-----------------------------|-----------------------|
|  | Amount                         | Weighted Average Rate | Amount                 | Weighted Average Rate | Amount       | Weighted Average Rate | Amount                      | Weighted Average Rate |
| (Dollars in thousands)                           |                                |                       |                        |                       |              |                       |                             |                       |

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|                 |                  |             |          |                  |             |          |                 |             |          |                 |             |          |
|-----------------|------------------|-------------|----------|------------------|-------------|----------|-----------------|-------------|----------|-----------------|-------------|----------|
| 2011            | \$4,426          | 5.28        | %        | \$19,525         | 6.37        | %        | \$57,086        | 5.81        | %        | \$4,771         | 4.98        | %        |
| 2012            | 2,064            | 5.32        | %        | 3,918            | 4.03        | %        | -               | -           |          | -               | -           |          |
| 2013            | 2,315            | 5.47        | %        | 229              | 5.08        | %        | -               | -           |          | 205             | 3.39        | %        |
| 2014 to 2015    | 4,346            | 6.46        | %        | 3,876            | 5.94        | %        | -               | -           |          | -               | -           |          |
| 2016 to 2020    | 18,473           | 5.43        | %        | 14,808           | 6.48        | %        | -               | -           |          | 8               | 3.25        | %        |
| 2021 to 2025    | 16,683           | 5.19        | %        | 12,830           | 6.43        | %        | -               | -           |          | 585             | 3.05        | %        |
| 2026 and beyond | 117,155          | 5.67        | %        | 61,036           | 6.37        | %        | -               | -           |          | 17,254          | 3.67        | %        |
| <b>Total</b>    | <b>\$165,462</b> | <b>5.60</b> | <b>%</b> | <b>\$116,222</b> | <b>6.30</b> | <b>%</b> | <b>\$57,086</b> | <b>5.81</b> | <b>%</b> | <b>\$22,823</b> | <b>3.93</b> | <b>%</b> |

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| Due During<br>the<br>Fiscal Years<br>Ending<br>September 30, | Commercial Business |                             | Other                  |                             | Total             |                             |
|--|---------------------|-----------------------------|------------------------|-----------------------------|-------------------|-----------------------------|
|  | Amount              | Weighted<br>Average<br>Rate | Amount                 | Weighted<br>Average<br>Rate | Amount            | Weighted<br>Average<br>Rate |
|  |                     |                             | (Dollars in thousands) |                             |                   |                             |
| 2011   | \$ 24,079           | 4.87 %                      | \$ 11,099              | 2.35 %                      | \$ 120,986        | 5.35 %                      |
| 2012   | 958                 | 5.12 %                      | 1,719                  | 2.56 %                      | 8,659             | 4.16 %                      |
| 2013   | 1,221               | 6.33 %                      | 15                     | 13.95 %                     | 3,985             | 5.64 %                      |
| 2014 to 2015   | 1,911               | 6.66 %                      | 112                    | 6.29 %                      | 10,245            | 6.30 %                      |
| 2016 to 2020   | 2,335               | 6.84 %                      | 20                     | 7.59 %                      | 35,644            | 5.96 %                      |
| 2021 to 2025   | 1,905               | 6.71 %                      | 1                      | 13.00 %                     | 32,004            | 5.74 %                      |
| 2026 and<br>beyond   | 1,267               | 7.38 %                      | 311                    | 5.01 %                      | 197,023           | 5.72 %                      |
| <b>Total</b>   | <b>\$ 33,676</b>    | <b>5.37 %</b>               | <b>\$ 13,277</b>       | <b>2.50 %</b>               | <b>\$ 408,546</b> | <b>5.61 %</b>               |

The following table sets forth the scheduled repayments of fixed- and adjustable-rate loans at September 30, 2010 that are contractually due after September 30, 2011.

|                                | Due After September 30, 2011 |                   | Total             |
|--------------------------------|------------------------------|-------------------|-------------------|
|                                | Fixed                        | Adjustable        |                   |
|                                | (Dollars in thousands)       |                   |                   |
| One-to four-family residential | \$ 113,925                   | \$ 47,111         | \$ 161,036        |
| Commercial real estate         | 20,475                       | 76,222            | 96,697            |
| Home equity lines of credit    | -                            | 18,052            | 18,052            |
| Commercial business            | 3,293                        | 6,304             | 9,597             |
| Other                          | 139                          | 2,039             | 2,178             |
| <b>Total</b>                   | <b>\$ 137,832</b>            | <b>\$ 149,728</b> | <b>\$ 287,560</b> |

**Residential Mortgage Loans.** We originate residential mortgage loans, most of which are secured by properties located in our primary market area and most of which we hold in portfolio. At September 30, 2010, \$165.5 million, or 40.5% of our total loan portfolio, consisted of residential mortgage loans (including home equity loans). Residential mortgage loan originations are generally obtained from our in-house loan representatives, from existing or past customers, through advertising, and through referrals from local builders, real estate brokers and attorneys, and are underwritten pursuant to Magyar Bank's policies and standards. Generally, residential mortgage loans are originated in amounts up to 80% of the lesser of the appraised value or purchase price of the property, with private mortgage insurance required on loans with a loan-to-value ratio in excess of 80%. We generally will not make residential mortgage loans with a loan-to-value ratio in excess of 95%, which is the upper limit that has been established by the Board of Directors. Mortgage loans have been primarily originated for terms of up to 30 years and are currently offered for terms up to 40 years. Magyar Bank has not participated in "sub-prime" (mortgages granted to borrowers whose credit history is not sufficient to get a conventional mortgage) or option ARM mortgage lending. At September 30, 2010, non-performing residential mortgage loans totaled \$2.5 million, or 1.5% of the total residential loan portfolio. Interest income not recorded on non-performing residential mortgage loans for the year ended September

30, 2010 was \$291,000. During the year ended September 30, 2010, \$61,000 had been charged-off against the allowance for loan loss for two impaired residential real estate loans.

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

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Generally, all fixed-rate residential mortgage loans are underwritten according to Federal Home Loan Mortgage Corporation (“Freddie Mac”) guidelines, policies and procedures. Historically, we have not originated a significant number of loans for the purpose of reselling them in the secondary market. However, to help manage interest rate risk and to increase fee income during fiscal year 2010, fourteen (14) loans totaling \$2.8 million were originated and sold to Freddie Mac. In the future we may increase our origination and sale of fixed-rate residential mortgage loans to help manage interest rate risk and to increase fee income. No loans were held for sale at September 30, 2010.

We generally do not purchase residential mortgage loans, except for loans to low-income borrowers to enhance our Community Reinvestment Act performance. At September 30, 2010, we had \$3.6 million of purchased one-to four-family residential mortgage loans. No loans were purchased in the fiscal year ended September 30, 2010.

At September 30, 2010, we had \$116.8 million of fixed-rate residential mortgage loans, which represented 70.6% of our total residential mortgage loan portfolio. At September 30, 2010, our largest fixed-rate residential mortgage loan was for \$4.5 million. The loan was performing in accordance with its terms at September 30, 2010.

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

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

At September 30, 2010, adjustable-rate residential mortgage loans totaled \$48.7 million, or 29.4% of our total residential mortgage loan portfolio. Of these loans, \$16.5 million were interest-only loans originated with an average original loan-to-value ratio of 67.2%. Interest-only loans allow the borrower to make interest-only payments during an initial fixed-rate period. Following the initial period, the borrower is required to make principal and interest payments. At September 30, 2010, our largest adjustable-rate residential mortgage loan was for \$3.3 million. The loan was performing in accordance with its terms at September 30, 2010.

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

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

Commercial Real Estate Loans. As part of our strategy to add to and diversify our loan portfolio, we have continued our focus on increasing our originations of commercial real estate loans. At September 30, 2010, \$116.2 million, or 28.5%, of our total loan portfolio consisted of these types of loans. Commercial real estate loans are generally secured by five-or-more-unit apartment buildings, industrial properties and properties used for business purposes such as small office buildings and retail facilities primarily located in our market area. We generally originate adjustable-rate commercial real estate loans with a maximum term of 25 years, provided adjustable rate periods limit the initial payment period to no more than five years. The maximum loan-to-value ratio for our commercial real estate loans is 75%, based on the appraised value of the property.

We consider a number of factors when we originate commercial real estate loans. During the underwriting process we evaluate the business qualifications and financial condition of the borrower, including credit history, profitability of the

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

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

The maximum amount of a commercial real estate loan is limited by our Board-established loans-to-one-borrower limit, which is currently 15% of Magyar Bank's capital, or \$6.9 million. At September 30, 2010, our largest commercial real estate loan was \$5.5 million and was secured by a mixed use building currently used for retail office space and a senior living facility. The loan was performing in accordance with its terms at September 30, 2010. At September 30, 2010, seven commercial real estate loans totaling \$8.2 million were non-performing. During the year ended September 30, 2010, \$321,000 had been charged-off against the allowance for loan loss for one impaired commercial real estate loan. Interest income not recorded on non-performing commercial real estate loans for the year ended September 30, 2010 was \$576,000. All other loans secured by commercial real estate were performing in accordance with their terms.

Construction Loans. We also originate construction loans for the development of one-to four-family homes, town homes, condominiums, apartment buildings and commercial properties. Construction loans are generally offered to experienced local developers operating in our primary market area and to individuals for the construction of their personal residences. The Bank ceased originating new construction loans for the development of non-owner occupied real estate in 2008.

At September 30, 2010, construction loans for the development of one-to four-family residential properties totaled \$27.7 million, or 6.8% of total loans. These construction loans generally have a maximum term of 24 months. We provide financing for land acquisition, site improvement and construction of individual homes. Land acquisition funds are limited to 50% to 75% of the sale price of the land. Site improvement funds are limited to 100% of the bonded site improvement costs. Construction funds are limited to 75% of the lesser of the contract sale price or appraised value of the property (less funds already advanced for land acquisition and site improvement).

At September 30, 2010, construction loans for the development of town homes, condominiums and apartment buildings totaled \$23.6 million, or 5.8% of total loans. These construction loans also generally have a maximum term of 24 months. The maximum loan-to-value ratio limit applicable to these loans has been 75% of the appraised value of the property, but was decreased to 70% in 2007 to reduce Magyar Bank's potential exposure to a downturn in the real estate market. Properties must maintain a debt service coverage ratio of 125%. Finally, we may retain up to 10% of each loan advance until the property attains a 90% occupancy level.

At September 30, 2010, construction loans for the development of commercial properties totaled \$5.8 million, or 1.4% of total loans. These construction loans have a maximum term of 24 months. The maximum loan-to-value ratio limit applicable to these loans is 75% of the appraised value of the property. In addition, the property must maintain a debt service coverage ratio of 125%.

The maximum amount of a construction loan is limited by our loans-to-one-borrower limit, which is currently 15% of Magyar Bank's capital, or \$6.9 million. At September 30, 2010, our largest outstanding construction loan balance was for \$4.8 million. The loan was secured by a twenty-eight unit condominium project in Jersey City, New Jersey. The loan was performing according to its terms at September 30, 2010. At September 30, 2010, fourteen construction loans totaling \$14.0 million (see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations for details on these loans), were non-performing. During the year ended September 30, 2010, \$3.1 million had been charged-



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off against the allowance for loan loss for the impaired construction loans. Interest income not recorded on non-performing construction loans for the year ended September 30, 2010 was \$1.4 million.

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

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

Commercial Business Loans. At September 30, 2010, our commercial business loans totaled \$33.7 million, or 8.2% of total loans. We make commercial business loans primarily in our market area to a variety of professionals, sole proprietorships and small and mid-sized businesses. Our commercial business loans include term loans and revolving lines of credit. The maximum term of a commercial business loan is 15 years. Such loans are generally used for longer-term working capital purposes such as purchasing equipment or furniture. Commercial business loans are made with either adjustable or fixed rates of interest. The interest rates for adjustable commercial business loans are based on the prime rate as published in The Wall Street Journal.

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

Commercial business loans generally have greater credit risk than residential mortgage loans. Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to repay the loan from his or her employment income, and which are secured by real property with ascertainable value, commercial business loans generally are made on the basis of the borrower's ability to repay the loan from the cash flow of the borrower's business. As a result, the repayment of commercial business loans may depend substantially on the success of the borrower's business. Further, any collateral securing commercial business loans may depreciate over time, may be difficult to appraise and may fluctuate in value. We try to minimize these risks through our underwriting standards. The maximum amount of a commercial business loan is limited by our loans-to-one-borrower limit, which is 15% of Magyar Bank's capital, or \$6.9 million currently. At September 30, 2010, our largest commercial business loan was a \$2.8 million loan to a company that provides janitorial services and was secured by the accounts receivable of the company. This loan was performing according to its terms at September 30, 2010. At September 30, 2010, five commercial business loans totaling \$1.5 million were non-performing. Interest income not recorded on non-performing commercial business loans for the year ended September 30, 2010 was \$145,000. During the year ended September 30, 2010, \$196,000 had been charged-off against the allowance for loan loss for impaired commercial business loans.

Home Equity Lines of Credit and Other Loans. We originate home equity lines of credit secured by residences located in our market area. At September 30, 2010, these loans totaled \$22.8 million, or 5.6% of our total loan portfolio. The

underwriting standards we use for home equity lines of credit include a determination of the applicant's credit history, an assessment of the applicant's ability to meet existing obligations, the ongoing payments on the proposed loan and the value of the collateral securing the loan. The maximum combined (first and second mortgage liens) loan-to-value ratio for home equity lines of credit is 80%. Home equity lines of credit have adjustable rates of interest, indexed to the prime rate, as reported in The Wall Street Journal, with terms of up to 25 years.

The maximum amount of a home equity line of credit loan is limited by our loans-to-one-borrower limit, which is 15% of Magyar Bank's capital, or \$6.9 million currently. At September 30, 2010, our largest home equity line of credit was a non-performing \$902,000 loan. This loan was secured by a first lien position on two separate 1-4 family residential properties on which the Bank was in the process of foreclosure at September 30, 2010. At September 30, 2010, all home equity lines of credit were performing in accordance with their terms with the exception of three non-performing loans

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totaling \$1.3 million. During the year ended September 30, 2010, \$93,000 had been charged-off against the allowance for loan loss for one impaired home equity line of credit. Interest income not recorded on non-performing home equity lines of credit for the year ended September 30, 2010 was \$184,000.

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

At September 30, 2010, stock-secured loans totaled \$12.8 million, or 3.1% of our total loan portfolio. Generally, we limit the aggregate amount of loans secured by the common stock of any one corporation to 15% of Magyar Bank's capital, with the exception of Johnson & Johnson, for which the collateral concentration limit is 150% of Magyar Bank's capital. At September 30, 2010, \$12.7 million, or 3.1% of our loan portfolio, was secured by the common stock of Johnson & Johnson, a New York Stock Exchange company that operates a number of facilities in our market area and employs a substantial number of residents. Although these loans are underwritten based on the ability of the individual borrower to repay the loan, the concentration of our portfolio secured by this stock subjects us to the risk of a decline in the market price of the stock and, therefore, a reduction in the value of the collateral securing these loans. As of September 30, 2010, the aggregate loan-to-value ratio of the stock-secured portfolio was 40.0%.

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

Generally, we retain in our portfolio substantially all loans that we originate. Historically, we have not originated a significant number of loans for the purpose of reselling them in the secondary market. In the future, however, to help manage our interest rate risk and to increase fee income, we may increase our origination and sale of fixed-rate residential loans and commercial business loans guaranteed by the SBA. All one-to four-family residential mortgage loans that we sell in the secondary market are sold with servicing rights retained pursuant to master commitments negotiated with Freddie Mac. We sell our loans to Freddie Mac without recourse. No loans were held for sale at September 30, 2010.

At September 30, 2010, we were servicing loans sold to Freddie Mac in the amount of \$10.7 million and SBA guaranteed loans sold in the amount of \$4.2 million. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent mortgagors, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans.

From time-to-time, we will also participate in loans, sometimes as the "lead lender." Whether we are the lead lender or not, we underwrite our participation portion of the loan according to our own underwriting criteria and procedures. At September 30, 2010, we had \$22.2 million of loan participation interests in which we were the lead lender, and \$6.4 million in loan participations in which we were not the lead lender. We have entered into loan participations when the aggregate outstanding balance of a particular customer relationship exceeds our loan-to-one-borrower limit. All loan participations are loans secured by real estate that adhere to our loan policies. During the year ended September 30, 2010, we experienced loan losses totaling \$321,000 in our loan participations portfolio due to one non-performing acquisition and development loan in which the Bank was a participant and not the lead lender.

During the fiscal year ended September 30, 2010, we originated \$17.9 million of fixed-rate and adjustable-rate one-to four-family residential mortgage loans. The fixed-rate loans are primarily of loans with terms of 30 years or less. We also originated \$20.3 million of commercial real estate loans, \$814,000 of construction loans, \$2.0 million of commercial business loans, and \$1.5 million of home equity lines of credit and other loans during the fiscal year ended September 30, 2010.

We generally do not purchase residential mortgage loans, except for loans to low-income borrowers as part of our Community Reinvestment Act lenders program. At September 30, 2010, we had \$3.6 million of one-to four-family residential mortgage loans that were purchased from other lenders. No loans were purchased in the fiscal year ended September 30, 2010.

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Loan Approval Procedures and Authority. Our lending activities follow written, non-discriminatory underwriting standards and loan origination procedures established by our Board of Directors. In the approval process for loans, we assess the borrower's ability to repay the loan and the value of the property securing the loan. To assess an individual borrower's ability to repay, we review income and expense, employment and credit history. To assess a business entity's ability to repay, we review financial statements (including balance sheets, income statements and cash flow statements), rent rolls, other debt service, and projected income and expense.

We generally require appraisals for all real estate securing loans. Appraisals are performed by independent licensed appraisers who are approved annually by our Board of Directors. We require borrowers to obtain title, fire and casualty, general liability, and, if warranted, flood insurance in amounts at least equal to the principal amount of the loan. For construction loans, we require a detailed plan and cost review, to be reviewed by an outside engineering firm, and all construction-related state and local approvals necessary for a particular project.

Our loan approval policies and limits are established by our Board of Directors. All loans are approved in accordance with the loan approval policies and limits. Lending authorities are approved annually by the Board of Directors, and Magyar Bank lending staff members are authorized to approve loans up to their lending authority limits, provided the loan meets all of our underwriting guidelines.

Loan requests for aggregate borrowings up to \$1.5 million must be approved by Magyar Bank's Chief Lending Officer or President. Other members of our lending staff have lesser amounts of lending authority based on their experience as lending officers. Loan requests for aggregate borrowings up to 35% of Magyar Bank's loans-to-one-borrower limit, or \$2.4 million, must be approved by Magyar Bank's Management Loan Committee. The Management Loan Committee is comprised of the President, Chief Lending Officer, Chief Financial Officer and various bank officers appointed by the Board of Directors. A quorum of three members including either the President or the Chief Lending Officer is required for all Management Loan Committee meetings. The Directors Loan Committee must approve all loan requests for aggregate borrowings in excess of 35% of Magyar Bank's loans-to-one-borrower limit, or \$2.4 million. The Board of Directors must approve all loan requests for aggregate borrowings in excess of 80% of Magyar Bank's loans-to-one-borrower limit, or \$5.5 million.

## Asset Quality

We commence collection efforts when a loan becomes 15 days past due with system-generated reminder notices. Subsequent late charge and delinquent notices are issued and the account is monitored on a regular basis thereafter. Personal, direct contact with the borrower is attempted early in the collection process as a courtesy reminder and later to determine the reason for the delinquency and to safeguard our collateral. When a loan is more than 60 days past due, the credit file is reviewed and, if deemed necessary, information is updated or confirmed and collateral re-evaluated. We make every effort to contact the borrower and develop a plan of repayment to cure the delinquency. Loans are placed on non-accrual status when they are delinquent for more than three months. When loans are placed on non-accrual status, unpaid accrued interest is fully reversed, and further income is recognized only to the extent received.

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

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

presented.

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|  | 2010                   | 2009            | September 30,<br>2008 |                 | 2007           | 2006 |      |   |      |   |
|--|------------------------|-----------------|-----------------------|-----------------|----------------|------|------|---|------|---|
|  | (Dollars in thousands) |                 |                       |                 |                |      |      |   |      |   |
| Non-accrual loans:   |                        |                 |                       |                 |                |      |      |   |      |   |
| One-to four-family residential   | \$2,451                | \$4,565         | \$772                 | \$65            | \$56           |      |      |   |      |   |
| Commercial real estate   | 8,228                  | 7,439           | 3,400                 | 1,936           | -              |      |      |   |      |   |
| Construction   | 13,969                 | 19,515          | 8,224                 | 6,008           | 5,135          |      |      |   |      |   |
| Home equity lines of credit  | 1,304                  | 1,086           | 731                   | -               | -              |      |      |   |      |   |
| Commercial business  | 1,465                  | 879             | 176                   | 21              | 188            |      |      |   |      |   |
| Other  | -                      | -               | -                     | 3               | -              |      |      |   |      |   |
| <b>Total</b>   | <b>27,417</b>          | <b>33,484</b>   | <b>13,303</b>         | <b>8,033</b>    | <b>5,379</b>   |      |      |   |      |   |
| Accruing loans three months or more past due:                                |                        |                 |                       |                 |                |      |      |   |      |   |
| One-to four-family residential   | -                      | -               | 65                    | -               | 88             |      |      |   |      |   |
| Commercial real estate   | -                      | -               | -                     | -               | 1,933          |      |      |   |      |   |
| Construction   | -                      | -               | 6,700                 | -               | -              |      |      |   |      |   |
| Home equity lines of credit  | -                      | -               | -                     | -               | -              |      |      |   |      |   |
| Commercial business  | -                      | -               | -                     | 15              | -              |      |      |   |      |   |
| Other  | -                      | -               | -                     | -               | -              |      |      |   |      |   |
| <b>Total loans three months or more past due</b>                             | <b>-</b>               | <b>-</b>        | <b>6,765</b>          | <b>15</b>       | <b>2,021</b>   |      |      |   |      |   |
| <b>Total non-performing loans</b>  | <b>27,417</b>          | <b>33,484</b>   | <b>20,068</b>         | <b>8,048</b>    | <b>7,400</b>   |      |      |   |      |   |
| <b>Other real estate owned</b>   | <b>12,655</b>          | <b>5,562</b>    | <b>4,666</b>          | <b>2,238</b>    | <b>-</b>       |      |      |   |      |   |
| <b>Total non-performing assets</b>   | <b>40,072</b>          | <b>39,046</b>   | <b>24,734</b>         | <b>10,286</b>   | <b>7,400</b>   |      |      |   |      |   |
| <b>Troubled debt restructurings</b>  | <b>3,610</b>           | <b>458</b>      | <b>-</b>              | <b>-</b>        | <b>-</b>       |      |      |   |      |   |
| <b>Troubled debt restructurings and total non-performing assets</b>          | <b>\$43,682</b>        | <b>\$39,504</b> | <b>\$24,734</b>       | <b>\$10,286</b> | <b>\$7,400</b> |      |      |   |      |   |
| Ratios:  |                        |                 |                       |                 |                |      |      |   |      |   |
| Total non-performing loans to total loans                                    | 6.71                   | %               | 7.53                  | %               | 4.89           | %    | 2.09 | % | 2.10 | % |
| Total non-performing loans and troubled debt restructurings to total loans   | 7.59                   | %               | 7.63                  | %               | 4.89           | %    | 2.09 | % | 2.10 | % |
| Total non-performing assets to total assets                                  | 7.45                   | %               | 6.91                  | %               | 4.81           | %    | 2.17 | % | 1.70 | % |
| Total non-performing assets and troubled debt restructurings to total assets | 8.12                   | %               | 6.99                  | %               | 4.81           | %    | 2.17 | % | 1.70 | % |

At September 30, 2010, our portfolio of commercial business, commercial real estate and construction loans totaled \$207.0 million, or 50.7% of our total loans, compared to \$236.4 million, or 53.1% of our total loans, at September 30, 2009. Commercial business, commercial real estate and construction loans generally have more risk than one-to four-family residential mortgage loans. As shown in the table above, our troubled debt restructuring and total non-performing assets increased \$4.2 million to \$43.7 million at September 30, 2010 from \$39.5 million at September 30, 2009, and increased \$18.9 million from \$24.7 million at September 30, 2008, reflecting the recent adverse

economic conditions. The repayment of the Company's construction loan portfolio is dependent upon the sale of the collateral securing the loans and has been particularly impacted by the rapid deterioration in the housing market and decreased buyer demand. (See Item 7. -



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Management's Discussion and Analysis of Financial Condition and Results of Operations for additional discussion of non-performing assets).

Additional interest income of approximately \$2.6 million and \$2.5 million would have been recorded during the fiscal years ended September 30, 2010 and 2009, respectively, if the non-accrual loans summarized in the above table had performed in accordance with their original terms.

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

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

Troubled debt restructurings ("TDRs") occur when a creditor, for economic or legal reasons related to a debtor's financial condition, grants a concession to the debtor that it would not otherwise consider, such as a below market interest rate, extending the maturity of a loan, or a combination of both. At September 30, 2010, there were seven loans totaling \$3.6 million that were classified as TDRs by the Company. These loans are not included in the non-performing loan figures listed above, as they continue to perform under their modified terms.

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

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|                                | Loans Delinquent For   |         |                  |          |        |          |
|--------------------------------|------------------------|---------|------------------|----------|--------|----------|
|                                | 60-89 Days             |         | 90 Days and Over |          | Total  |          |
|                                | Number                 | Amount  | Number           | Amount   | Number | Amount   |
|                                | (Dollars in thousands) |         |                  |          |        |          |
| At September 30, 2010          |                        |         |                  |          |        |          |
| One-to four-family residential | 4                      | \$721   | 4                | \$2,451  | 8      | \$3,172  |
| Commercial real estate         | 2                      | 2,147   | 6                | 6,081    | 8      | 8,228    |
| Construction                   | -                      | -       | 15               | 14,552   | 15     | 14,552   |
| Home equity lines of credit    | -                      | -       | 3                | 1,304    | 3      | 1,304    |
| Commercial business            | -                      | -       | 5                | 1,465    | 5      | 1,465    |
| Other                          | -                      | -       | -                | -        | -      | -        |
| Total                          | 6                      | \$2,868 | 33               | \$25,853 | 39     | \$28,721 |
| At September 30, 2009          |                        |         |                  |          |        |          |
| One-to four-family residential | 1                      | \$150   | 9                | \$4,565  | 10     | \$4,715  |
| Commercial real estate         | -                      | -       | 7                | 7,439    | 7      | 7,439    |
| Construction                   | 2                      | 1,642   | 10               | 17,873   | 12     | 19,515   |
| Home equity lines of credit    | -                      | -       | 2                | 1,086    | 2      | 1,086    |
| Commercial business            | 1                      | 15      | 5                | 864      | 6      | 879      |
| Other                          | -                      | -       | -                | -        | -      | -        |
| Total                          | 4                      | \$1,807 | 33               | \$31,827 | 37     | \$33,634 |
| At September 30, 2008          |                        |         |                  |          |        |          |
| One-to four-family residential | 3                      | \$216   | 4                | \$837    | 7      | \$1,053  |
| Commercial real estate         | -                      | -       | 2                | \$3,400  | 2      | 3,400    |
| Construction                   | 3                      | 5,476   | 7                | 9,395    | 10     | 14,871   |
| Home equity lines of credit    | -                      | -       | 1                | 731      | 1      | 731      |
| Commercial business            | 1                      | 157     | 1                | 176      | 2      | 333      |
| Other                          | -                      | -       | -                | -        | -      | -        |
| Total                          | 7                      | \$5,849 | 15               | \$14,539 | 22     | \$20,388 |
| At September 30, 2007          |                        |         |                  |          |        |          |
| One-to four-family residential | -                      | \$-     | 2                | \$65     | 2      | \$65     |
| Commercial real estate         | 3                      | 2,214   | 1                | 1,936    | 4      | 4,150    |
| Construction                   | -                      | -       | 4                | 6,008    | 4      | 6,008    |
| Home equity lines of credit    | -                      | -       | -                | -        | -      | -        |
| Commercial business            | -                      | -       | 3                | 36       | 3      | 36       |
| Other                          | -                      | -       | 2                | 3        | 2      | 3        |
| Total                          | 3                      | \$2,214 | 12               | \$8,048  | 15     | \$10,262 |
| At September 30, 2006          |                        |         |                  |          |        |          |
| One-to four-family residential | -                      | \$-     | 3                | \$144    | 3      | \$144    |
| Commercial real estate         | -                      | -       | 1                | 1,933    | 1      | 1,933    |
| Construction                   | -                      | -       | -                | -        | -      | -        |
| Home equity lines of credit    | -                      | -       | -                | -        | -      | -        |
| Commercial business            | -                      | -       | 3                | 188      | 3      | 188      |
| Other                          | -                      | -       | 1                | -        | 1      | -        |
| Total                          | -                      | \$-     | 8                | \$2,265  | 8      | \$2,265  |



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

The Company held \$12.7 million of real estate owned properties at September 30, 2010 and \$5.6 million of real estate owned properties at September 30, 2009. During the year ended September 30, 2010, the Company was able to successfully dispose of four properties with an aggregate carrying value of \$3.5 million at September 30, 2009 for a net profit of \$61,000 and the Company was able to secure the title for 26 other properties totaling \$10.0 million which is expected to help facilitate the sales process.

Other real estate owned at September 30, 2010 consisted of five residential properties, two substantially completed condominium projects, four partially completed residential properties, and eighteen real estate lots approved for residential homes. The Bank is determining the proper course of action for its other real estate owned, which may include holding the properties until the real estate market improves, selling the properties to a developer and completing partially completed homes for either rental or sale.

The Company did not incur any further write downs on properties foreclosed upon during the year ended September 30, 2010. Further declines in real estate values may result in a charge to expense in the future. Routine holding costs are charged to expense as incurred and improvements to real estate owned that enhance the value of the real estate are capitalized.

Classified Assets. Federal banking regulations provide that loans and other assets of lesser quality should be classified as “substandard,” “doubtful” or “loss” assets. An asset is considered “substandard” if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. “Substandard” assets include those characterized by the “distinct possibility” we will sustain “some loss” if the deficiencies are not corrected. Assets classified as “doubtful” have all of the weaknesses inherent in those classified “substandard,” with the added characteristic that the weaknesses present make “collection or liquidation in full,” on the basis of currently existing facts, conditions, and values, “highly questionable and improbable.” Assets classified as “loss” are those considered “un-collectible” and of such little value their continuance as assets without the establishment of a specific loss reserve is not warranted. We classify an asset as “special mention” if the asset has a potential weakness that warrants management’s close attention. While such assets are not impaired, management has concluded that if the potential weakness in the asset is not addressed, the value of the asset may deteriorate, adversely affecting the repayment of the asset. On the basis of our review of assets at September 30, 2010, classified assets consisted of \$29.9 million of special mention assets, \$36.0 million of substandard assets and \$99,000 of doubtful assets.

We are required to establish an allowance for loan losses in an amount deemed prudent by management for loans classified substandard or doubtful, as well as for other problem loans. General allowances represent loss allowances which have been established to recognize the inherent losses associated with lending activities, but which, unlike impairment allowances, have not been allocated to particular problem assets. When we classify problem assets, we are required to determine whether or not impairment exists. A loan is impaired when, based on current information and events, it is probable that Magyar Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. When it is determined that impairment exists, a specific allowance for loss is established. For collateral-dependent loans, the loan is reduced by the impairment amount via a reduction to the loan and the allowance for loan loss. Our determination as to the classification of our assets and the amount of our valuation allowances is subject to review by the New Jersey Department of Banking and Insurance and the Federal Deposit Insurance Corporation, which can direct us to establish additional loss allowances.

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

#### Allowance for Loan Losses

Our allowance for loan losses is maintained at a level management deems necessary to absorb loan losses that are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses in our loan portfolio both probable and reasonably estimable, and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. The allowance for loan losses as of September 30, 2010 was maintained at a level that represents management's best estimate of losses in the loan portfolio both probable and reasonably estimable. However, this analysis process is inherently subjective, as it requires us to make estimates that are

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susceptible to revisions as more information becomes available. Although we believe we have established the allowance at levels to absorb probable and estimable losses, future additions may be necessary if economic or other conditions in the future differ from the current environment.

In addition, as an integral part of their examination process, the New Jersey Department of Banking and Insurance and the Federal Deposit Insurance Corporation will periodically review our allowance for loan losses. Such agencies may require us to recognize additions to the allowance based on their judgments of information available to them at the time of their examination.

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

|  | 2010                   | 2009    | September 30,<br>2008 |         | 2007    | 2006 |
|--|------------------------|---------|-----------------------|---------|---------|------|
|  | (Dollars in thousands) |         |                       |         |         |      |
| Balance at beginning of period   | \$5,807                | \$4,502 | \$3,754               | \$3,892 | \$3,129 |      |
| <b>Charge-offs:</b>  |                        |         |                       |         |         |      |
| One-to four-family residential   | 61                     | 39      | 31                    | -       | 13      |      |
| Commercial real estate   | 321                    | 1,063   | 111                   | -       | -       |      |
| Construction   | 3,102                  | 4,120   | 3,084                 | 652     | -       |      |
| Home equity lines of credit  | 93                     | 724     | 69                    | -       | 2       |      |
| Commercial business  | 196                    | 963     | 227                   | -       | 180     |      |
| Other  | -                      | 1       | 3                     | 4       | 3       |      |
| Total charge-offs  | 3,773                  | 6,910   | 3,525                 | 656     | 198     |      |
| <b>Recoveries:</b>   |                        |         |                       |         |         |      |
| One-to four-family residential   | -                      | -       | 13                    | -       | -       |      |
| Commercial real estate   | -                      | -       | -                     | -       | -       |      |
| Construction   | 1                      | 2       | -                     | -       | -       |      |
| Home equity lines of credit  | -                      | -       | -                     | -       | -       |      |
| Commercial business  | -                      | -       | -                     | 120     | -       |      |
| Other  | 2                      | 1       | 5                     | -       | -       |      |
| Total recoveries   | 3                      | 3       | 18                    | 120     | -       |      |
| Net charge-offs  | 3,770                  | 6,907   | 3,507                 | 536     | 198     |      |
| Provision for loan losses  | 2,729                  | 8,212   | 4,255                 | 398     | 961     |      |
| Balance at end of period   | \$4,766                | \$5,807 | \$4,502               | \$3,754 | \$3,892 |      |
| <b>Ratios:</b>   |                        |         |                       |         |         |      |
| Net charge-offs to average loans outstanding                             | 0.89                   | % 1.61  | % 0.88                | % 0.14  | % 0.06  |      |
| Allowance for loan losses to total non performing loans at end of period | 17.38                  | % 17.34 | % 22.43               | % 46.64 | % 52.59 |      |
| Allowance for loan losses to total loans at end of period                | 1.17                   | % 1.31  | % 1.10                | % 0.97  | % 1.11  |      |



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

|                                 | Amount  | Percent of<br>Allowance<br>In<br>Category to<br>Total<br>Allowance | Percent of<br>Loans<br>In<br>Category to<br>Total<br>Loans |        |   |
|---------------------------------|---------|--|--|--------|---|
| (Dollars in thousands)          |         |  |  |        |   |
| At September 30, 2010           |         |  |  |        |   |
| One-to four-family residential  | \$589   | 12.35  | %  | 40.50  | % |
| Commercial real estate          | 1,123   | 23.56  | %  | 28.45  | % |
| Construction                    | 2,020   | 42.39  | %  | 13.97  | % |
| Home equity lines of credit     | 83      | 1.75   | %  | 5.59   | % |
| Commercial business             | 866     | 18.17  | %  | 8.24   | % |
| Other                           | 11      | 0.23   | %  | 3.25   | % |
| Unallocated                     | 74      | 1.55   | %  | 0.00   | % |
| Total allowance for loan losses | \$4,766 | 100.00   | %  | 100.00 | % |
| At September 30, 2009           |         |  |  |        |   |
| One-to four-family residential  | \$455   | 7.83   | %  | 38.76  | % |
| Commercial real estate          | 1,235   | 21.27  | %  | 23.78  | % |
| Construction                    | 2,967   | 51.09  | %  | 20.96  | % |
| Home equity lines of credit     | 60      | 1.04   | %  | 5.08   | % |
| Commercial business             | 957     | 16.48  | %  | 8.40   | % |
| Other                           | 15      | 0.26   | %  | 3.02   | % |
| Unallocated                     | 118     | 2.03   | %  | 0.00   | % |
| Total allowance for loan losses | \$5,807 | 100.00   | %  | 100.00 | % |
| At September 30, 2008           |         |  |  |        |   |
| One-to four-family residential  | \$429   | 9.53   | %  | 38.44  | % |
| Commercial real estate          | 603     | 13.39  | %  | 22.60  | % |
| Construction                    | 2,846   | 63.22  | %  | 22.61  | % |
| Home equity lines of credit     | 48      | 1.07   | %  | 3.87   | % |
| Commercial business             | 476     | 10.57  | %  | 8.76   | % |
| Other                           | 4       | 0.09   | %  | 3.72   | % |
| Unallocated                     | 96      | 2.13   | %  | 0.00   | % |
| Total allowance for loan losses | \$4,502 | 100.00   | %  | 100.00 | % |
| At September 30, 2007           |         |  |  |        |   |
| One-to four-family residential  | \$473   | 12.60  | %  | 38.37  | % |
| Commercial real estate          | 576     | 15.34  | %  | 21.54  | % |
| Construction                    | 1,982   | 52.80  | %  | 23.72  | % |
| Home equity lines of credit     | 40      | 1.07   | %  | 3.49   | % |
| Commercial business             | 675     | 17.98  | %  | 8.72   | % |
| Other                           | 8       | 0.21   | %  | 4.16   | % |
| Unallocated                     | -       | 0.00   | %  | 0.00   | % |
| Total allowance for loan losses | \$3,754 | 100.00   | %  | 100.00 | % |



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At September 30, 2006

|                                 |         |        |   |        |   |
|---------------------------------|---------|--------|---|--------|---|
| One-to four-family residential  | \$327   | 8.40   | % | 40.65  | % |
| Commercial real estate          | 601     | 15.44  | % | 19.46  | % |
| Construction                    | 1,519   | 39.03  | % | 25.64  | % |
| Home equity lines of credit     | 82      | 2.12   | % | 3.08   | % |
| Commercial business             | 1,153   | 29.63  | % | 6.96   | % |
| Other                           | 210     | 5.38   | % | 4.21   | % |
| Unallocated                     | -       | 0.00   | % | 0.00   | % |
| Total allowance for loan losses | \$3,892 | 100.00 | % | 100.00 | % |

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### Investments

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

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

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

At September 30, 2010, our securities portfolio totaled \$58.7 million, or 10.9% of our total assets. Securities are classified as held-to-maturity or available-for-sale when purchased. At September 30, 2010, \$44.5 million of our securities were classified as held-to-maturity and reported at amortized cost, and \$14.2 million were classified as available-for-sale and reported at fair value. At September 30, 2010, we held no investment securities classified as held-for-trading.

**U.S. Government Agency and Government-Sponsored Enterprise Obligations.** At September 30, 2010, our U.S. Government Agency and Government-Sponsored Enterprise Obligations totaled \$54.6 million, or 93.1% of our total securities portfolio. Of this amount, \$49.1 million were mortgage-backed securities and \$5.5 million were debt securities. While these securities generally provide lower yields than other securities in our securities portfolio, we hold these securities, to the extent appropriate, for liquidity purposes and as collateral for certain borrowings. We invest in these securities to achieve positive interest rate spreads with minimal administrative expense, and to lower our credit risk as a result of the guarantees provided by these issuers.

**Mortgage-Backed Securities.** We purchase mortgage-backed pass through and collateralized mortgage obligation ("CMO") securities insured or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. To a lesser extent, we also invest in mortgage-backed securities issued or sponsored by private issuers. At September 30, 2010, our mortgage-backed securities, including CMOs, totaled \$53.1 million, or 90.5% of our total securities portfolio. Included in this balance was \$4.0 million of mortgage-backed securities issued by private issuers. Our policy is to limit purchases of privately issued mortgage-backed securities to non-high risk securities rated "AAA" by a nationally recognized credit rating agency. High risk securities generally are defined as those exhibiting significantly greater volatility of estimated average life and price due to changes in interest rates than 30-year fixed rate securities.

Mortgage-backed pass through securities are created by pooling mortgages and issuing a security with an interest rate less than the interest rate on the underlying mortgages. Mortgage-backed pass through securities represent a

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

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

Our mortgage-backed securities portfolio had a weighted average yield of 3.96% at September 30, 2010. The estimated fair value of our mortgage-backed securities portfolio at September 30, 2010 was \$53.9 million, which was \$691,000 more than the amortized cost of \$53.2 million. Mortgage-backed securities in Magyar Bank's portfolio do not contain sub-prime mortgage loans.

Corporate and Other Securities. At September 30, 2010, we held \$97,000 in bonds issued by the State of New Jersey which are classified as held to maturity and have a total amortized cost value of \$97,000, or 0.2% of our total securities portfolio. Our Investment Policy allows for the purchase of such instruments and requires that corporate debt obligations be rated in one of the four highest categories by a nationally recognized rating service. We may invest up to 25% of Magyar Bank's investment portfolio in corporate debt obligations and up to 15% of Magyar Bank's capital in any one issuer.

Equity Securities. At September 30, 2010, we held no equity securities other than \$2.8 million in Federal Home Loan Bank of New York stock. The investment in Federal Home Loan Bank of New York stock is classified as a restricted security, carried at cost and evaluated for impairment. Equity securities are not insured or guaranteed investments and are affected by market interest rates and stock market fluctuations. Such investments other than the Federal Home Loan Bank of New York are carried at their fair value and fluctuations in the fair value of such investments, including temporary declines in value, directly affect our net capital position.

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

|   | At September 30, |                 | 2009            |                 | 2008            |                 |
|---|------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|   | 2010             |                 |                 |                 |                 |                 |
|   | Amortized        | Fair            | Amortized       | Fair            | Amortized       | Fair            |
|   | Cost             | Value           | Cost            | Value           | Cost            | Value           |
|   | (In thousands)   |                 |                 |                 |                 |                 |
| Securities available for sale:                                  |                  |                 |                 |                 |                 |                 |
| U.S. government and government-sponsored enterprise obligations | \$12,012         | \$12,090        | \$2,237         | \$2,243         | \$2,237         | \$2,123         |
| Municipal bonds   | -                | -               | -               | -               | 3,211           | 3,104           |
| Private label mortgage-backed securities                        | 2,362            | 2,097           | 15,930          | 15,840          | 44,566          | 44,099          |
| <b>Total securities available for sale</b>                      | <b>\$14,374</b>  | <b>\$14,187</b> | <b>\$18,167</b> | <b>\$18,083</b> | <b>\$50,014</b> | <b>\$49,326</b> |
| Securities held to maturity:                                    |                  |                 |                 |                 |                 |                 |
| U.S. government and government-sponsored enterprise obligations | \$42,511         | \$43,394        | \$8,020         | \$8,063         | \$99            | \$98            |
| Municipal bonds   | 97               | 102             | 122             | 131             | 132             | 140             |

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|  |          |          |          |          |         |         |
|--|----------|----------|----------|----------|---------|---------|
| Private label mortgage-backed securities | 1,871    | 1,902    | 43,809   | 43,687   | 9,387   | 9,391   |
| Corporate notes                          | -        | -        | 4,000    | 4,116    | -       | -       |
| Total securities held to maturity        | \$44,479 | \$45,398 | \$55,951 | \$55,997 | \$9,618 | \$9,629 |

At September 30, 2010, a total of 6 securities with an aggregate fair value of \$11.1 million had gross unrealized losses of \$365,000, or approximately 3.3% of fair value. None of these unrealized losses were considered other-than-temporary.

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Portfolio Maturities and Yields. The composition, maturities and weighted average yields of the investment debt securities portfolio and the mortgage-backed securities portfolio at September 30, 2010 are summarized in the following table. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur. State and municipal bond yields have been adjusted to a tax-equivalent basis.

|  | One Year or Less |       | More Than One Year Through Five Years |       | More Than Five Years Through Ten Years |       | More Than Ten Years |       | Total Securities |       |
|--|------------------|-------|---------------------------------------|-------|--|-------|---------------------|-------|------------------|-------|
|  | Amortized Cost   | Yield | Amortized Cost                        | Yield | Amortized Cost                         | Yield | Amortized Cost      | Yield | Amortized Cost   | Yield |
| Securities available for sale:                         |                  |       |                                       |       |  |       |                     |       |                  |       |
| Obligations of U.S. government agencies:               |                  |       |                                       |       |  |       |                     |       |                  |       |
| Mortgage backed securities - residential               | \$-              | -     | % \$-                                 | -     | % \$-                                  | -     | % \$3,904           | 3.60  | % \$3,904        | 3.60  |
| Obligations of U.S. government-sponsored enterprises:  |                  |       |                                       |       |  |       |                     |       |                  |       |
| Mortgage-backed securities - residential               | -                | -     | % -                                   | -     | % -                                    | -     | % 2,833             | 3.14  | % 2,833          | 3.14  |
| Mortgage backed securities - commercial                | -                | -     | % 4,274                               | 5.07  | % -                                    | -     | % -                 | -     | % 4,274          | 5.07  |
| Debt securities  | -                | -     | % 1,001                               | 0.80  | % -                                    | -     | % -                 | -     | % 1,001          | 0.80  |
| Private label mortgage-backed securities - residential |                  |       |                                       |       |  |       |                     |       |                  |       |
|  | -                | -     | % -                                   | -     | % -                                    | -     | % 2,362             | 5.44  | % 2,362          | 5.44  |
| Total securities available for sale                    | \$-              | -     | % \$5,275                             | 4.26  | % \$-                                  | -     | % \$9,099           | 3.94  | % \$14,374       | 4.06  |
| Securities held to maturity:                           |                  |       |                                       |       |  |       |                     |       |                  |       |
| Obligations of U.S. government agencies:               |                  |       |                                       |       |  |       |                     |       |                  |       |
| Mortgage-backed securities - residential               | -                | -     | % -                                   | -     | % -                                    | -     | % \$18,407          | 4.25  | % \$18,407       | 4.25  |
| Mortgage-backed securities - commercial                | -                | -     | % -                                   | -     | % \$81                                 | 1.60  | % 1,644             | 0.66  | % 1,725          | 0.70  |
| Obligations of U.S. government-sponsored enterprises:  |                  |       |                                       |       |  |       |                     |       |                  |       |
| Mortgage backed securities - residential               | 555              | 4.50  | % 636                                 | 4.00  | % 3                                    | 4.50  | % \$16,686          | 3.74  | % 17,880         | 3.77  |

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|  |       |      |   |       |      |   |         |      |   |          |      |   |          |      |   |
|--|-------|------|---|-------|------|---|---------|------|---|----------|------|---|----------|------|---|
| Debt securities  | -     | -    | % | -     | -    | % | 1,999   | 3.00 | % | 2,500    | 4.84 | % | 4,499    | 4.02 | % |
| Private label mortgage-backed securities - residential | -     | -    | % | -     | -    | % | -       | -    | % | 1,871    | 3.61 | % | 1,871    | 3.61 | % |
| Obligations of U.S. states and political subdivisions  | -     | -    | % | 97    | 6.00 | % | -       | -    | % | -        | -    | % | 97       | 6.00 | % |
| Total securities held to maturity                      | \$555 | 4.50 | % | \$733 | 4.26 | % | \$2,083 | 2.95 | % | \$41,108 | 3.91 | % | \$44,479 | 3.87 | % |

Sources of Funds

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

Deposits. Our deposits are generated primarily from residents within our primary market area. We offer a selection of deposit accounts, including demand accounts, NOW accounts, money market accounts, savings accounts, retirement accounts and certificates of deposit. Deposit account terms vary, with the principal differences being the minimum balance required, the amount of time the funds must remain on deposit and the interest rate. Historically, we also accepted brokered deposits and did so when attractive rates were available. At September 30, 2010, we had \$14.7 million in brokered deposits as compared to \$15.9 million at September 30, 2009. The Company is restricted from accepting new brokered deposits or renewing its existing brokered deposits in accordance with the Consent Orders (see Supervision and Regulation- General).

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

The flow of deposits is influenced significantly by general economic conditions, changes in money market and other prevailing interest rates and competition. The variety of deposit accounts offered allows us to be competitive in obtaining funds and responding to changes in consumer demand. Based on experience, we believe that our deposits are relatively stable. However, the ability to attract and maintain deposits, and the rates paid on these deposits, has been and will continue to be significantly affected by market conditions. At September 30, 2010, \$188.0 million, or 43.9% of our deposit accounts, were certificates of deposit (including individual retirement accounts).

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

| Deposit Types:          | 2010       |          |                       | September 30, 2009 |          |                       | 2008       |          |                       |  |
|-------------------------|------------|----------|-----------------------|--------------------|----------|-----------------------|------------|----------|-----------------------|--|
|                         | Balance    | Percent  | Weighted Average Rate | Balance            | Percent  | Weighted Average Rate | Balance    | Percent  | Weighted Average Rate |  |
| (Dollars in thousands)  |            |          |                       |                    |          |                       |            |          |                       |  |
| Demand accounts         | \$ 37,298  | 8.72 %   | 0.00 %                | \$ 35,221          | 7.85 %   | 0.00 %                | \$ 24,699  | 6.58 %   | 0.00 %                |  |
| Savings accounts        | 61,867     | 14.46 %  | 0.83 %                | 57,864             | 12.90 %  | 1.08 %                | 34,081     | 9.07 %   | 0.76 %                |  |
| NOW accounts            | 51,473     | 12.03 %  | 1.11 %                | 49,456             | 11.03 %  | 1.16 %                | 36,163     | 9.63 %   | 0.95 %                |  |
| Money market accounts   | 89,279     | 20.86 %  | 0.91 %                | 85,535             | 19.07 %  | 1.07 %                | 73,775     | 19.64 %  | 2.41 %                |  |
| Certificates of deposit | 156,528    | 36.58 %  | 1.85 %                | 187,289            | 41.76 %  | 2.45 %                | 177,279    | 47.20 %  | 3.45 %                |  |
| Retirement accounts     | 31,487     | 7.36 %   | 3.02 %                | 33,152             | 7.39 %   | 3.37 %                | 29,563     | 7.87 %   | 3.81 %                |  |
| Total deposits          | \$ 427,932 | 100.00 % | 1.34 %                | \$ 448,517         | 100.00 % | 1.74 %                | \$ 375,560 | 100.00 % | 2.56 %                |  |

As of September 30, 2010, the aggregate amount of outstanding certificates of deposit in amounts greater than or equal to \$100,000 was \$81.8 million. The following table sets forth the maturity of these certificates as of September 30, 2010 (in thousands):

|                                      |           |
|--------------------------------------|-----------|
| Three months or less                 | \$ 17,090 |
| Over three months through six months | 10,469    |
| Over six months through one year     | 12,276    |
| Over one year to three years         | 38,230    |
| Over three years                     | 3,777     |



Total \$81,842

At September 30, 2010, \$97.5 million of our certificates of deposit had maturities of one year or less. We monitor activity on these accounts and, based on historical experience and our current pricing strategy, we believe we will retain a large portion of these accounts upon maturity. The following table sets forth the interest-bearing deposit activities for the periods indicated.

|   | 2010                   | September 30,<br>2009 | 2008       |
|---|------------------------|-----------------------|------------|
|   | (Dollars in thousands) |                       |            |
| Beginning balance                                   | \$ 413,296             | \$ 350,861            | \$ 347,263 |
| Net deposits (withdrawals) before interest credited | (28,766 )              | 53,727                | (6,935 )   |
| Interest credited                                   | 6,104                  | 8,708                 | 10,533     |
| Ending balance                                      | \$ 390,634             | \$ 413,296            | \$ 350,861 |

Borrowings. Our borrowings consist of short- and long-term advances from the Federal Home Loan Bank of New York and securities sold under agreements to repurchase with CitiGroup Global Markets Inc.

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As of September 30, 2010, we had long-term advances from the Federal Home Loan Bank in the amount of \$45.8 million. In addition, our repurchase agreements totaled \$15.0 million at September 30, 2010. These aggregate borrowings represent 12.3% of total liabilities and had a weighted average rate of 4.00% at September 30, 2010. Based on eligible collateral pledged to the Federal Home Loan Bank of New York at September 30, 2010, we had an aggregate borrowing capacity of \$94.5 million with the Federal Home Loan Bank.

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

Long-term Federal Home Loan Bank of New York advances as of September 30, 2010 mature as follows (in thousands):

| Year Ending September 30, |           |
|---------------------------|-----------|
| 2011                      | \$ 10,853 |
| 2012                      | 2,813     |
| 2013                      | 9,143     |
| 2014                      | 8,700     |
| 2015                      | 5,000     |
| Thereafter                | 9,260     |
|                           | \$ 45,769 |

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

|   | September 30,          |           |
|---|------------------------|-----------|
|   | 2010                   | 2009      |
|   | (Dollars in thousands) |           |
| Balance at end of year                            | \$ -                   | \$ -      |
| Weighted average interest rate at the end of year | N/A                    | N/A       |
| Weighted average balance during the year          | \$ 700                 | \$ 12,541 |
| Maximum month-end balance during the year         | \$ 8,150               | \$ 42,350 |
| Average interest rate during the year             | 0.37 %                 | 0.70 %    |

The outstanding securities sold under agreements to repurchase totaled \$15.0 million at September 30, 2010. \$10.0 million are callable by the issuer, CitiGroup Global Markets Inc., quarterly beginning July 31, 2010 and mature July 31, 2012. The interest rate is 4.92% as long as the 3 month LIBOR remains below 5.50%. Should the 3 month LIBOR increase above 5.50% on a quarterly reset date, the interest rate will be reset to the initial rate minus twice the difference between 3 month LIBOR and 5.50% for the next quarter, assuming the counter-party does not exercise its call option. \$5.0 million are callable by the issuer quarterly beginning December 3, 2010 and mature December 3,

2014. The interest rate is 3.83% as long as the 3 month LIBOR remains below 5.12%. Should the 3 month LIBOR increase above 5.12% on a quarterly reset date, the interest rate will be reset to the initial rate minus twice the difference between 3 month LIBOR and 5.12% for the next quarter, assuming the counter-party does not exercise its call option.

#### Subsidiary Activities

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

Hungaria Urban Renewal, LLC is a Delaware limited-liability corporation established in 2002 as a qualified intermediary operating for the purpose of acquiring and developing Magyar Bank's new main office. On January 24, 2006, Magyar Bank exercised a purchase option within its lease from Hungaria Urban Renewal, LLC allowing Magyar Bank to purchase the land and building from this entity. Magyar Bank acquired a 100% interest in Hungaria Urban Renewal, LLC,

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which will have no other business other than owning Magyar Bank's main office site. As part of a tax abatement agreement with the City of New Brunswick, Magyar Bank's new office will remain in Hungaria Urban Renewal, LLC's name.

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

## Personnel

At September 30, 2010, we employed 87 full-time employees and 11 part-time employees. Our employees are not represented by any collective bargaining group. Management believes that we have good relations with our employees.

## FEDERAL AND STATE TAXATION

### Federal Taxation

**General.** Magyar Bancorp, Inc. and Magyar Bank are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. Magyar Bank's federal tax returns are not currently under audit, and Magyar Bank has not been audited during the past five years. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to Magyar Bancorp, Inc. or Magyar Bank.

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

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

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

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

At September 30, 2010, our total federal pre-base year reserve was approximately \$1.3 million. However, under current law, pre-base year reserves remain subject to recapture if Magyar Bank makes certain non-dividend distributions, repurchases any of its stock, pays dividends in excess of tax earnings and profits, or ceases to maintain a bank charter.

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

Net Operating Loss Carryovers. At September 30, 2010, a financial institution was able to carry back net operating losses to the preceding five taxable years and forward to the succeeding 20 taxable years. At September 30, 2010, the Company had approximately \$4.4 million of federal and \$9.1 million of state net operating loss carry forwards available to offset future taxable income for tax reporting purposes. The federal net operating loss carry forwards will begin to expire in 2028, while the state net operating losses will begin to expire by 2015, if not used. Based on projections of future taxable income, the company expects to be able to utilize all net operating loss carry forwards.

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On November 6, 2009, President Obama signed into law a bill that expanded the net operating loss carry back tax rules, allowing companies to carry back 2008 or 2009 losses to reduce taxable income for the past five years and obtain a refund of taxes already paid. A refund for the fifth year was subject to a 50 percent cap.

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

## State Taxation

**New Jersey State Taxation.** The income of savings institutions in New Jersey, which is calculated based on federal taxable income, subject to certain adjustments, is subject to New Jersey tax. Magyar Bank, Magyar Service Corporation, and MagBank Investment Company file New Jersey corporate income tax returns. Magyar Bank, Magyar Service Corporation, and MagBank Investment Company are not currently under audit with respect to their New Jersey income tax returns nor have their respective state tax returns been audited for the past five years.

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

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

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

## SUPERVISION AND REGULATION

### General

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

structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes.

On April 22, 2010, Magyar Bank entered into agreements with the Federal Deposit Insurance Corporation and the New Jersey Department of Banking and Insurance which required the Bank to take certain measures to improve its safety and soundness. In connection with these agreements, the Bank stipulated to the issuance by the Federal Deposit Insurance Corporation and the New Jersey Department of Banking and Insurance of consent orders (the "Consent Orders") against the Bank relating to certain findings from an examination of the Bank that occurred in 2009. Copies of the Consent Orders were attached as exhibits to a Current Report on Form 8-K, which was filed with the SEC on April 23, 2010 and which is incorporated by reference into this Annual Report on Form 10-K. In entering into the stipulation and consenting to entry of

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the Consent Orders, the Bank did not concede the findings or admit to any of the assertions therein. The Consent Orders impose no fines or penalties upon the Bank.

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

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

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

New Federal Legislation

The recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) will significantly change the current bank regulatory structure and affect the lending, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act provides that the Office of Thrift Supervision, which is the current primary federal regulator for federal thrifts, will cease to exist one year from the date of the new law’s enactment. The Office of the Comptroller of the Currency, which is currently the primary federal regulator for national banks, will become the primary federal regulator for federal thrifts. In addition, the Board of Governors of the Federal Reserve System will supervise and regulate all savings and loan holding companies that were formerly regulated by the Office of Thrift Supervision.

The Dodd-Frank Act also requires the Federal Reserve Board to set minimum capital levels for bank holding companies that are as stringent as those required for the insured depository subsidiaries, and the components of Tier 1 capital would be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions. Bank holding companies with assets of less than \$500 million are exempt from these capital requirements. Under the Dodd-Frank Act, the proceeds of trust preferred securities are excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by bank or savings and loan holding companies with less than \$15 billion of assets. The legislation also establishes a floor for capital of insured depository institutions that cannot be lower than the standards in effect today, and directs the federal banking regulators to implement new leverage and capital requirements within 18 months that take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives.

The Dodd-Frank Act also creates a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions such as Magyar Bank, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Banks and savings institutions with \$10 billion or less in assets will be examined by their applicable bank regulators. The new legislation also weakens the federal preemption available for national banks and federal savings



associations, and gives state attorneys general the ability to enforce applicable federal consumer protection laws.

The legislation also broadens the base for Federal Deposit Insurance Corporation insurance assessments. Assessments will now be based on the average consolidated total assets less tangible equity capital of a financial institution. The Dodd-Frank Act also permanently increases the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per depositor, retroactive to January 1, 2008, and non-interest bearing transaction accounts have unlimited deposit insurance through December 31, 2013. Lastly, the Dodd-Frank Act will increase stockholder influence over boards of directors by requiring companies to give stockholders a non-binding vote on executive compensation and so-called “golden parachute” payments, and authorizing the Securities and Exchange Commission to promulgate rules that would allow stockholders to nominate and solicit votes for their own candidates using a company’s proxy materials. The legislation also directs the Federal Reserve Board to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded or not.

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New Jersey Banking Regulation

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

- real estate mortgages;
- consumer and commercial loans;
- specific types of debt securities, including certain corporate debt securities and obligations of federal, state and local governments and agencies;
- certain types of corporate equity securities; and
- certain other assets.

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

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

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

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

Examination and Enforcement. The New Jersey Department of Banking and Insurance may examine Magyar Bank whenever it deems an examination advisable. The New Jersey Department of Banking and Insurance examines Magyar Bank at least every two years. The Commissioner may order any savings bank to discontinue any violation of law or unsafe or unsound business practice and may direct any director, officer, attorney or employee of a savings bank engaged in an objectionable activity, after the Commissioner has ordered the activity to be terminated, to show

cause at a hearing before the Commissioner why such person should not be removed.

#### Federal Banking Regulation

Capital Requirements. The Federal Deposit Insurance Corporation regulations establish a minimum leverage capital requirement for banks in the strongest financial and managerial condition, with a rating of 1 (the highest

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examination rating of the Federal Deposit Insurance Corporation for banks) under the Uniform Financial Institutions Rating System, of not less than a ratio of 3.0% of Tier 1 capital to total assets. For all other banks, the minimum leverage capital requirement is 4.0%, unless a higher leverage capital ratio is warranted by the particular circumstances or risk profile of the depository institution.

The Federal Deposit Insurance Corporation regulations also require that banks meet a risk-based capital standard. The risk-based capital standard requires the maintenance of a ratio of total capital, which is defined as the sum of Tier 1 capital and Tier 2 capital, to risk-weighted assets of at least 8% and a ratio of Tier 1 capital to risk-weighted assets of at least 4%. In determining the amount of risk-weighted assets, all assets, plus certain off balance sheet items, are multiplied by a risk-weight of 0% to 200%, based on the risks the Federal Deposit Insurance Corporation believes are inherent in the type of asset or item.

The federal banking agencies, including the Federal Deposit Insurance Corporation, have also adopted regulations to require an assessment of an institution's exposure to declines in the economic value of a bank's capital due to changes in interest rates when assessing the bank's capital adequacy. Institutions with significant interest rate risk may be required to hold additional capital.

Among the corrective actions required in the Consent Orders were for the Bank to develop, within 30 days of the April 22, 2010 effective date of the Consent Orders, a written capital plan that details the manner in which the Bank will achieve a Tier 1 capital as a percentage of the Bank's total assets of at least 8%, and total qualifying capital as a percentage of risk-weighted assets of at least 12%. For purposes of the Consent Orders, Tier 1 capital, qualifying total capital, total assets, and risk-weighted assets shall be calculated in accordance with Part 325 of the FDIC Rules and Regulations, 12 C.F.R Part 325.

A capital plan was submitted on a timely basis to the Federal Deposit Insurance Corporation and New Jersey Department of Banking of Insurance detailing the manner and timing in which the Bank will achieve the capital ratios. As of September 30, 2010, Magyar Bank's Tier 1 capital as a percentage of the Bank's total assets was 7.80% and the total qualifying capital as a percentage of risk-weighted assets was 12.59%. Both capital ratios exceeded the ratios in the submitted capital plan at September 30, 2010.

Prompt Corrective Action. The Federal Deposit Improvement Act also established a system of prompt corrective action to resolve the problems of undercapitalized institutions. The Federal Deposit Insurance Corporation, as well as the other federal banking regulators, adopted regulations governing the supervisory actions that may be taken against undercapitalized institutions. The regulations establish five categories, consisting of "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." The Federal Deposit Insurance Corporation's regulations define the five capital categories as follows:

An institution will be treated as "well-capitalized" if:

- its ratio of total capital to risk-weighted assets is at least 10%;
- its ratio of Tier 1 capital to risk-weighted assets is at least 6%; and
- its ratio of Tier 1 capital to total assets is at least 5%, and it is not subject to any order or directive by the Federal Deposit Insurance Corporation to meet a specific capital level; and is not subject to any written agreement, order, or capital directive issued by the Federal Deposit Insurance Corporation to meet and maintain a specific capital level.

An institution will be treated as "adequately capitalized" if:

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- its ratio of total capital to risk-weighted assets is at least 8%; or
- its ratio of Tier 1 capital to risk-weighted assets is at least 4%; and
- its ratio of Tier 1 capital to total assets is at least 4% (3% if the bank receives the highest rating under the Uniform Financial Institutions Rating System) and it is not a well-capitalized institution.

An institution will be treated as “undercapitalized” if:

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- its total risk-based capital is less than 8%; or
- its Tier 1 risk-based-capital is less than 4%; and
- its leverage ratio is less than 4% (or less than 3% if the institution receives the highest rating under the Uniform Financial Institutions Rating System).

An institution will be treated as “significantly undercapitalized” if:

- its total risk-based capital is less than 6%;
- its Tier 1 capital is less than 3%; or
- its leverage ratio is less than 3%.

An institution that has a tangible capital to total assets ratio equal to or less than 2% would be deemed to be “critically undercapitalized.”

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

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

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

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

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

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conditions necessary to establish and engage in permitted activities through financial subsidiaries, it has not yet determined whether or the extent to which it will seek to engage in such activities.

Federal Home Loan Bank System. Magyar Bank is a member of the Federal Home Loan Bank system, which consists of twelve regional federal home loan banks, each subject to supervision and regulation by the Federal Housing Finance Board (“FHFB”). The federal home loan banks provide a central credit facility primarily for member thrift institutions as well as other entities involved in home mortgage lending. Magyar Bank, as a member of the Federal Home Loan Bank of New York, is required to purchase and hold shares of capital stock in the Federal Home Loan Bank of New York in an amount at least equal to the sum of:

- (i) 0.2% of its mortgage related assets, calculated annually, which include one-to-four family residential mortgage loans, multifamily and non-residential real estate loans, home equity loans, and mortgage-backed investment securities;
- (ii) 4.5% (or such greater fraction as established by the Federal Home Loan Bank of New York) of its advances from the Federal Home Loan Bank of New York, calculated daily.

As of September 30, 2010, Magyar Bank was in compliance with these requirements.

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

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

The Federal Deposit Insurance Corporation has adopted a temporary Transaction Account Guarantee (TAG) Program that provides unlimited insurance coverage for all non-interest bearing transaction accounts, including NOW accounts and IOLTA accounts. This temporary Transaction Account Guarantee Program is schedule to expire on December 31, 2010. In connection with the passage of the Dodd-Frank Act, the Federal Deposit Insurance Corporation has adopted a new rule that provides full insurance coverage for all non-interest bearing transaction accounts, except NOW accounts and IOLTA accounts. The new rule becomes effective December 31, 2010 for a two-year period. As a result of this new rule, the Federal Deposit Insurance Corporation has decided not to extend the coverage its Transaction Account Guarantee Program.

The deposit insurance assessment rates are in addition to the assessments for payments on the bonds issued in the late 1980s by the Financing Corporation, or FICO, to recapitalize the now defunct Federal Savings and Loan Insurance Corporation. The FICO payments will continue until the FICO bonds mature in 2017 through 2019. Our expense for the assessment of deposit insurance and the FICO payments was \$1.3 million for the year ended September 30, 2010 and \$1.1 million for the year ended September 30, 2009.

The Federal Deposit Insurance Corporation regulations assess insurance premiums based on an institution’s risk. Under this assessment system, the Federal Deposit Insurance Corporation evaluates the risk of each financial institution based on its supervisory rating, financial ratios, and long-term debt issuer rating. The assessment rates can range between seven and 77.5 basis points for every \$100 of assessable deposits. Additionally, Federal law requires the Federal Deposit Insurance Corporation to establish a deposit reserve ratio for the deposit insurance fund of between 1.15% and 1.50% of estimated deposits.



In November 2010, the FDIC Board issued a proposed rule that would change the assessment base, beginning with the second quarter of 2011, from adjusted domestic deposits to a bank's average consolidated total assets minus average Tier 1 capital, as required by the Dodd-Frank Act. The FDIC proposal also would lower assessment rates to between 2.5 and 9 basis points on the broader base for banks in the lowest risk category, and 30 to 45 basis points for banks in the highest risk category. The proposal would eliminate the adjustment to the rate paid for secured liabilities, including Federal Home Loan Bank advances, since these will be part of the new assessment base. The proposal also would create a new depository institution debt adjustment (DIDA) that increases the assessment rate of an institution that holds long-term unsecured debt issued by another insured depository institution. The proposal also would change the amount of, and cap on, the unsecured debt adjustment to the assessment base; eliminate Tier 1 capital from the definition of unsecured debt; and tweak the formula for the current brokered deposits adjustment.

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

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

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

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

An institution's failure to comply with the provisions of the Community Reinvestment Act could, at a minimum, result in regulatory restrictions on its activities. We received an "outstanding" Community Reinvestment Act rating in our most recently completed federal examination, which was conducted by the Federal Deposit Insurance Corporation in 2010.

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

Loans to a Bank's Insiders

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

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unimpaired capital and surplus. Generally, such loans must be made on substantially the same terms as, and follow credit underwriting procedures that are not less stringent than, those that are prevailing at the time for comparable transactions with other persons.

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

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

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

### Federal Reserve System

Federal Reserve Board regulations require all depository institutions to maintain non-interest-earning reserves at specified levels against their transaction accounts (primarily NOW and regular checking accounts). At September 30, 2010, Magyar Bank was in compliance with the Federal Reserve Board's reserve requirements. Savings associations, such as Magyar Bank, are authorized to borrow from the Federal Reserve Bank "discount window." Magyar Bank is deemed by the Federal Reserve Board to be generally sound and thus is eligible to obtain primary credit from its Federal Reserve Bank. Generally, primary credit is extended on a very short-term basis to meet the liquidity needs of the institution. Loans must be secured by acceptable collateral and carry a rate of interest above the Federal Open Market Committee's federal funds target rate.

### The USA PATRIOT Act

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

### Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 ("SOX") is a law that addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. As directed by

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

Section 404(b) requires independent auditors to report on management's assessment of internal controls over financial reporting. The 2010 Dodd-Frank Act provided an exemption on compliance with Sarbanes-Oxley Act (SOX) Section 404(b) for companies with less than \$75 million in market capitalization. The inclusion of the exemption in the

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final reform legislation permanently exempted the auditor attestation requirement and significantly reduced the anticipated compliance burdens of smaller reporting companies. Disclosure of management attestations on internal control over financial reporting will continue to be required for smaller reporting companies.

Holding Company Regulation

**Federal Regulation.** Magyar Bancorp, Inc. is regulated as a bank holding company. Bank holding companies are subject to examination, regulation and periodic reporting under the Bank Holding Company Act, as administered by the Federal Reserve Board. The Federal Reserve Board has adopted capital adequacy guidelines for bank holding companies on a consolidated basis substantially similar to those of the Federal Deposit Insurance Corporation for Magyar Bank. As of September 30, 2010, Magyar Bancorp, Inc.'s total capital and Tier 1 capital ratios exceeded these minimum capital requirements.

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

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

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

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

- making or servicing loans;

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

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

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

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

It has been the policy of many mutual holding companies to waive the receipt of dividends declared by its subsidiary. In connection with its approval of the reorganization, however, the Federal Reserve Board will require Magyar Bancorp, MHC to obtain prior Federal Reserve Board approval before it may waive any dividends. As of the date hereof, Federal Reserve Board policy is to prohibit a mutual holding company from waiving the receipt of dividends from its holding company or bank subsidiary, and management is not aware of any instance in which the Federal Reserve Board has given its approval for a mutual holding company to waive dividends. Additionally, under Federal Deposit Insurance Corporation policy, the cumulative amount of waived dividends, if any, must not be available for distribution to public stockholders. See “Supervision and Regulation-Holding Company Regulation.” It is not currently intended that Magyar Bancorp, MHC will waive dividends declared by Magyar Bancorp, Inc. as long as Magyar Bancorp, MHC is regulated by the Federal Reserve Board.

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

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



Magyar Bank.

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

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

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

The registration under the Securities Act of 1933 of shares of the common stock sold in the stock offering did not cover the resale of the shares. Shares of the common stock purchased by persons who are not affiliates of Magyar Bancorp, Inc. may be resold without registration. Shares purchased by an affiliate of Magyar Bancorp, Inc. will be subject to the resale restrictions of Rule 144 under the Securities Act of 1933. If Magyar Bancorp, Inc. meets the current public information requirements of Rule 144 under the Securities Act of 1933, each affiliate of Magyar Bancorp, Inc. who complies with the other conditions of Rule 144, including those that require the affiliate's sale to be aggregated with those of other persons, would be able to sell in the public market, without registration, a number of shares not to exceed, in any three month period, the greater of 1% of the outstanding shares of Magyar Bancorp, Inc., or the average weekly volume of trading in the shares during the preceding four calendar weeks. Provision may be made in the future by Magyar Bancorp, Inc. to permit affiliates to have their shares registered for sale under the Securities Act of 1933.

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ITEM 1A. Risk Factors

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

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

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

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

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

Changes in interest rates also affect the current market value of our interest-earning securities portfolio. Generally, the value of securities moves inversely with changes in interest rates. At September 30, 2010, the fair value of our total securities portfolio was \$59.6 million. The unrealized net gain on securities totaled \$731,000 on a pre-tax basis at September 30, 2010.

We evaluate interest rate sensitivity using models that estimate the change in Magyar Bank’s net interest income over a range of interest rate scenarios. At September 30, 2010, in the event of an immediate 200 basis point increase in interest rates, the model projects that we would experience an \$301,000, or 1.9%, decrease in net interest income in the first year following the change in interest rates, and a \$201,000, or 1.3%, decrease in net interest income in the second year following the change in interest rates. At September 30, 2010, in the event of an immediate 100 basis point decrease in interest rates, the model projects that we would experience a \$256,000, or 1.7%, decrease in net interest income in the first year following the change in interest rates, and a \$412,000, or 2.7%, decrease in net interest income in the second year following the change in interest rates.

At September 30, 2010, our available-for-sale securities portfolio totaled \$14.2 million, which included \$13.2 million of mortgage-backed securities. To the extent interest rates increase and the value of our available-for-sale portfolio decreases, our stockholders’ equity will be adversely affected.

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

At September 30, 2010, our portfolio of commercial business and commercial real estate loans totaled \$149.9 million, or 36.7% of our total loans, compared to \$143.1 million or 32.2% of our total loans at September 30, 2009 and \$128.8

million or 31.4% of our total loans at September 30, 2008. It is our intent to continue to emphasize the origination of commercial business and commercial real estate loans. Commercial business and commercial real estate loans generally have more risk than one-to four-family residential mortgage loans. At September 30, 2010, our non-performing loans decreased to \$27.4 million from \$33.5 million at September 30, 2009, but have increased from \$20.1 million at September 30, 2008. Because the repayment of these loans depends on the successful management and operation of the borrower's properties or related businesses, repayment of these loans has been and may continue to be affected by adverse conditions in the real estate market or the local economy. Further, these loans typically have larger loan balances, and several of our borrowers have more than one commercial business and commercial real estate loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan. Finally, if we foreclose on a commercial business or commercial real estate loan, our holding period for the collateral, if any, typically is longer than for one- to four-family residential mortgage loans because there are fewer potential purchasers of the collateral.

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Because we plan to continue to emphasize the origination of these loans, it may be necessary to increase our allowance for loan losses because of the increased credit risk associated with these types of loans. Any increase to our allowance for loan losses would adversely affect our earnings.

The Financial Sector Is Experiencing An Economic Downturn. A Deterioration of Our Current Non-performing Loans or An Increase In The Number of Non-performing Loans Will Have An Adverse Effect On Our Operations.

Virtually all of our real estate loans are secured by real estate in New Jersey. At September 30, 2010, loans secured by real estate, including home equity loans and lines of credit, represented 88.5% of our total loans. Both nationally and in the State of New Jersey we are experiencing an economic downturn that is having a significant impact on the prices of real estate and related assets. The residential and commercial real estate sectors have been adversely affected by weakening economic conditions, which may negatively impact our loan portfolio. Total troubled debt restructuring and total non-performing assets increased from \$39.5 million at September 30, 2009 to \$43.7 million at September 30, 2010. Troubled debt restructuring and total non-performing assets as a percentage of total assets increased to 8.12% at September 30, 2010 as compared to 6.99% at September 30, 2009. If loans that are currently non-performing further deteriorate or loans that are currently performing become non-performing loans, we may need to increase our allowance for loan losses, which would have an adverse impact on our financial condition and results of operations.

Our FDIC Premium Could Be Substantially Higher In The Future, Which Would Have An Adverse Effect On Our Future Earnings.

Our FDIC insurance assessment was \$1.3 million for fiscal year 2010 compared to \$1.1 million for fiscal year 2009. Our FDIC assessment could be substantially higher in future periods depending on the premium rates set by the FDIC for such periods and the composite rating assigned to the Bank by the FDIC. Any increases in our FDIC premium rates will reduce future earnings.

Our Profits Have Declined over the Past Three Years, and May Not Improve in the Foreseeable Future.

Over the past three years, in addition to losses related to higher non-performing loans, our earnings have declined as a direct result of our branch expansion, the relocation of our headquarters office, and the addition of experienced senior lending and administrative personnel. We plan to add additional new branches. It is possible that our business plan will not succeed, or that our new branches, when added, will not become profitable or will take longer than expected to achieve profitability. Accordingly, we may not experience any improvement in our net income in the near future as a result of these efforts.

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

Our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, requiring additions to our allowance, which could materially decrease our net income. Our allowance for loan losses was 1.2% of total loans and 17.4% of total non-performing loans at September 30, 2010. We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review our loans and our loss and delinquency experience, and we evaluate economic conditions. Based on this review, we believe our allowance for loan losses is adequate to absorb losses in our loan portfolio as of September 30, 2010.

Bank regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory authorities will have a material adverse effect on our financial condition and results of

operations.

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

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

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offered by some of our competitors may limit our ability to increase our interest-earning assets. For additional information see “Business of Magyar Bank-Competition.”

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

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

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

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

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

Magyar Bank is subject to extensive regulation, supervision and examination by the New Jersey Department of Banking and Insurance, its chartering authority, and by the Federal Deposit Insurance Corporation, which insures Magyar Bank’s deposits. As a bank holding company, Magyar Bancorp, Inc. is subject to regulation and supervision by the Federal Reserve Board. Such regulation and supervision govern the activities in which financial institutions and their holding companies may engage and are intended primarily for the protection of the federal deposit insurance fund and depositors. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operations of financial institutions, the classification of assets by financial institutions and the adequacy of financial institutions’ allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, or legislation, could have a material impact on Magyar Bank and Magyar Bancorp, Inc.

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

We are Subject to Consent Orders, which Place Limits on our Operations, Increase our Compliance Expense and Could Result in Penalties or Further Restrictions if We Fail to Comply with Their Terms.

On April 22, 2010, Magyar Bank entered into agreements with the Federal Deposit Insurance Corporation and the New Jersey Department of Banking and Insurance that require Magyar Bank to take certain measures to improve its safety and soundness. In connection with these agreements, Magyar Bank stipulated to the issuance by the Federal Deposit Insurance Corporation and the New Jersey Department of Banking and Insurance of Consent Orders against Magyar Bank relating to findings from an examination of Magyar Bank that occurred in 2009. While the Consent Orders imposed no fines or penalties upon Magyar Bank, the Consent Orders require corrective actions, including that Magyar Bank develop a written capital plan to achieve Tier 1 capital as a percentage of total assets of at least 8%, and total qualifying capital as a percentage of risk-weighted assets of at least 12%, levels of capital greater than those required for a New Jersey savings bank to be classified as well-capitalized. Under the Consent Orders, Magyar Bank also agreed, among other things; to



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develop and implement a plan to reduce the bank's delinquent and non-accrual loans and risk exposure in certain classified assets; to develop and implement a plan to reduce commercial real estate loan concentrations and the bank's concentration of bank-owned life insurance; to make certain revisions to the bank's loan policies and procedures and methodology for determining the allowance for loan and lease losses; to develop and implement a strategic plan, a profit plan and a liquidity and funds management plan that conform to specified requirements in the Consent Orders; and to correct and prevent all unsafe or unsound banking practices, violations of law and regulations and policies discussed in the examination report. The Consent Orders restrict Magyar Bank from declaring or paying cash dividends, soliciting, accepting or renewing brokered deposits, and extending additional credit to certain types of borrowers.

Because the Consent Orders place limitations and restrictions on our operations, including our lending and borrowing operations, the Consent Orders could adversely affect our ability to implement our business plans, including potential profitable growth strategies that we might otherwise pursue, which may adversely affect our financial performance. For example, our capital plan required by the Consent Orders states that the higher capital ratios will be achieved by September 30, 2011. The higher capital ratios may reduce our origination of loans, including attractive loans that we would otherwise make. Further, the Consent Orders require us to reduce our concentrations of commercial real estate loans, even potentially profitable ones. In addition, the Consent Orders require us to reduce classified, delinquent and nonaccrual loans within specified time frames. These time frames could result in our inability to maximize the price that we might otherwise receive for the sale of the underlying collateral. Finally, the Consent Orders' restriction on brokered deposits may affect our ability to have sufficient liquid assets for our operations or require us to pay higher rates on retail deposits to replace our use of brokered deposits.

To comply with the Consent Orders, Magyar Bank has incurred and expects to continue to incur significant consulting and legal fees. Notwithstanding these fees, there can be no assurance that we will achieve full compliance with the requirements of the Consent Orders, nor can we estimate when the Consent Orders will be lifted. If we fail to comply with the provisions of the Consent Orders, we could be subject to additional restrictions or penalties, including civil money penalties on us and our directors and officers, and the removal of directors and officers from their positions with Magyar Bancorp, Inc. and Magyar Bank.

Government Responses to Economic Conditions May Adversely Affect Our Operations, Financial Condition and Earnings.

New financial reform legislation has been enacted by Congress that will change the bank regulatory framework, create an independent consumer protection bureau that will assume the consumer protection responsibilities of the various federal banking agencies, and establish more stringent capital standards for banks and bank holding companies. The legislation will also result in new regulations affecting the lending, funding, trading and investment activities of banks and bank holding companies. Bank regulatory agencies also have been responding aggressively to concerns and adverse trends identified in examinations. Ongoing uncertainty and adverse developments in the financial services industry and the domestic and international credit markets, and the effect of new legislation and regulatory actions in response to these conditions, may adversely affect our operations by restricting our business activities, including our ability to originate or sell loans, modify loan terms, or foreclose on property securing loans. These measures are likely to increase our costs of doing business and may have a significant adverse effect on our lending activities, financial performance and operating flexibility. In addition, these risks could affect the performance and value of our loan and investment securities portfolios, which also would negatively affect our financial performance.

Furthermore, the Board of Governors of the Federal Reserve System, in an attempt to help stabilize the economy, has, among other things, kept interest rates low through its targeted federal funds rate and the purchase of mortgage-backed securities. If the Federal Reserve increases the federal funds rate, overall interest rates will likely rise, which may negatively impact the housing markets and the U.S. economic recovery. In addition, deflationary pressures, while

possibly lowering our operating costs, could have a significant negative effect on our borrowers, especially our business borrowers, and the values of underlying collateral securing loans, which could negatively affect our financial performance.

It is difficult to predict at this time what impact the new legislation and implementing regulations will have on community banks, including the lending and credit practices of such banks. Moreover, many of the provisions of the Dodd-Frank Act will not take effect for at least a year, and the legislation requires various federal agencies to promulgate numerous and extensive implementing regulations over the next several years. Although the substance and scope of these regulations cannot be determined at this time, it is expected that the legislation and implementing regulations, particularly those provisions relating to the new Consumer Financial Protection Bureau, will increase our operating and compliance costs.

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## ITEM 1B. Unresolved Staff Comments

Not required for smaller reporting companies.

## ITEM 2. Properties

The following table provides certain information with respect to our five banking offices as of September 30, 2010:

| Location   | Leased or Owned | Original Year Leased or Acquired | Year of Lease Expiration |
|--|-----------------|----------------------------------|--------------------------|
| Main Office:                                       |                 |                                  |                          |
| 400 Somerset Street<br>New Brunswick, New Jersey   | Owned           | 2005                             | -                        |
| Full - Service Branches:                           |                 |                                  |                          |
| 582 Milltown Road<br>North Brunswick, New Jersey   | Leased          | 2002                             | 2012                     |
| 3050 Highway No. 27<br>South Brunswick, New Jersey | Owned           | 1969                             | -                        |
| 1000 Route 202 South<br>Branchburg, New Jersey     | Leased          | 2006                             | 2031                     |
| 89 French Street<br>New Brunswick, New Jersey      | Leased          | 2006                             | 2011                     |
| 475 North Bridge Street<br>Bridgewater, New Jersey | Leased          | 2010                             | 2025                     |

The net book value of our premises, land and equipment was approximately \$20.1 million at September 30, 2010.

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

## ITEM 3. Legal Proceedings

From time to time, we are involved as plaintiff or defendant in various legal proceedings arising in the ordinary course of business. At September 30, 2010, we were not involved in any legal proceedings, the outcome of which would be material to our financial condition or results of operations.

## ITEM 4. [Removed and Reserved]

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## PART II

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

(a) Our shares of common stock are traded on the NASDAQ Global Market under the symbol "MGYR." At September 30, 2010, Magyar Bancorp, MHC owned 3,200,450 shares, or 54.03% of the issued shares of our common stock. The approximate number of holders of record of Magyar Bancorp, Inc.'s common stock as of September 30, 2010 was 588. Certain shares of Magyar Bancorp, Inc. are held in "nominee" or "street" name and accordingly, the number of beneficial owners of such shares is not known or included in the foregoing number. The following table presents quarterly market information for Magyar Bancorp, Inc. common stock for each quarter of the previous two fiscal years. Magyar Bancorp, Inc. began trading on the NASDAQ Global Market on January 24, 2006. The following information was provided by the NASDAQ Stock Market.

| Fiscal Year Ended<br>September 30, 2010 | High    | Low     | Closing<br>Price | Dividends<br>Declared |
|---|---------|---------|------------------|-----------------------|
| Quarter ended September 30, 2010        | \$ 5.36 | \$ 3.01 | \$ 3.55          | \$ -                  |
| Quarter ended June 30, 2010             | 5.29    | 3.09    | 3.74             | -                     |
| Quarter ended March 31, 2010            | 4.50    | 3.08    | 4.01             | -                     |
| Quarter ended December 31, 2009         | 4.75    | 2.91    | 4.00             | -                     |

| Fiscal Year Ended<br>September 30, 2009 | High    | Low     | Closing<br>Price | Dividends<br>Declared |
|---|---------|---------|------------------|-----------------------|
| Quarter ended September 30, 2009        | \$ 6.01 | \$ 3.75 | \$ 4.10          | \$ -                  |
| Quarter ended June 30, 2009             | 7.50    | 4.50    | 5.18             | -                     |
| Quarter ended March 31, 2009            | 7.05    | 2.65    | 4.50             | -                     |
| Quarter ended December 31, 2008         | 10.80   | 4.25    | 5.94             | -                     |

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

Other than its employee stock ownership plan, Magyar Bancorp, Inc. does not have any equity compensation plans that were not approved by stockholders. The following table sets forth information with respect to the Magyar Bancorp's equity compensation plans.

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|                            | Number of securities to be issued upon exercise of outstanding options and rights | Weighted average exercise price(1) | Number of securities remaining available for issuance under plan |
|----------------------------|---|------------------------------------|--|
| Stock options              | 188,276   | \$ 14.61                           | 84,053   |
| Shares of restricted stock | -   | -                                  | 6,252  |
| Total                      | 188,276   | \$ 14.61                           | 90,305   |

(1) Reflects weighted average exercise price of stock options only.

(b) Not applicable.

(c) Share repurchases.

The Company completed its first stock repurchase program of 130,927 shares in November 2007 and announced in November 2007 a second repurchase program of up to 5% of its publicly-held outstanding shares of common stock, or 129,924 shares, under which 66,970 shares had been repurchased as of September 30, 2010 at an average price of \$9.39.

There were no repurchases of our common stock during the year ended September 30, 2010.

#### ITEM 6. Selected Financial Data

Not required for smaller reporting companies.

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

##### Overview

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

operations are general and local economic and competitive conditions, government policies and actions of regulatory authorities.

On April 22, 2010, the Bank entered into agreements with the Federal Deposit Insurance Corporation and the New Jersey Department of Banking and Insurance which require the Bank to take certain measures to improve its safety and soundness. In connection with these agreements, the Bank stipulated to the issuance of consent orders against the Bank (the "Consent Orders") relating to certain findings from a recent examination of the Bank. In entering into the stipulation and consenting to entry of the Consent Orders, the Bank did not concede the findings or admit to any of the assertions therein. The Consent Orders impose no fines or penalties upon the Bank.

Among the corrective actions required were for the Bank to develop, within 30 days of the April 22, 2010 effective date of the Consent Orders, a written capital plan that details the manner in which the Bank will achieve a Tier 1 capital as a percentage of the Bank's total assets of at least 8%, and total qualifying capital as a percentage of risk-weighted assets of at least 12%. For purposes of the Consent Orders, Tier 1 capital, qualifying total capital, total assets, and risk-weighted assets shall be calculated in accordance with Part 325 of the FDIC Rules and Regulations, 12 C.F.R Part 325. The Bank developed and filed a capital plan on a timely basis with the Federal Deposit Insurance Corporation and the New Jersey Department of

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Banking and Insurance. At September 30, 2010, the Bank's Tier 1 capital as a percentage of the Bank's total assets was 7.80%, and total qualifying capital as a percentage of risk-weighted assets was 12.59%.

During the year ended September 30, 2010, we decreased net loans \$35.1 million, or 8.0%, primarily due to a \$36.1 million, or 38.8%, decrease in construction loans. The contraction in the construction loan portfolio was due to the decision to cease originations of new construction loans in 2008 based on the adverse economic environment and its impact on this type of lending. Existing commitments to fund construction projects declined during fiscal year 2009, leading to significant repayments during fiscal year 2010. Due to the difficult economic environment and the need to increase capital ratios, the repayments of these loans were used to shrink the Bank's balance sheet by reducing higher-cost borrowings and deposits.

Borrowing decreased \$9.4 million, or 13.3%, and deposits decreased \$20.6 million, or 4.6%, during the year ended September 30, 2010. Balances of certificates of deposit (including individual retirement accounts) declined \$32.4 million, or 14.7%, reflecting the Bank's continued strategy of shifting funding sources from higher cost certificates of deposit and borrowings to lower cost checking and savings accounts, which increased \$4.1 million, or 4.8%, and \$4.0 million, or 6.9%, respectively, during the year. The shift in funding helped contribute to a 38 basis point increase in the Company's net interest margin from 2.82% for the year ended September 30, 2009 to 3.20% for the year ended September 30, 2010. We attribute this growth to the expansion of our commercial relationships, which tend to hold larger deposit balances, successful business development efforts by our retail branch managers, and the continued growth of the Bank's two newest branch facilities.

We reported net income of \$3.9 million for the year ended September 30, 2010. Net income increased \$10.1 million for the year ended September 30, 2010 compared with the year ended September 30, 2009, attributable to a \$1.7 million increase in net interest and dividend income, a \$5.5 million decrease in provisions for loan losses and a \$3.7 million income tax benefit recorded during the current year period.

Loan loss provisions were decreased to \$2.7 million during the year ended September 30, 2010 compared with \$8.2 million for the year ended September 30, 2009 due to lower levels of loan charge-offs and non-performing loans during the current period.

Throughout 2011, we expect to continue with our strategy of diversifying our balance sheet with higher concentrations in commercial real estate and commercial business loans.

## Critical Accounting Policies

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

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

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

Management performs a quarterly evaluation of the adequacy of the allowance for loan losses. We consider a variety of factors in establishing this estimate including, but not limited to, current economic conditions, delinquency statistics, geographic and industry concentrations, the adequacy of the underlying collateral, the financial strength of the



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borrower, results of internal loan reviews and other relevant factors. This evaluation is inherently subjective as it requires material estimates by management that may be susceptible to significant change based on changes in economic and real estate market conditions.

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

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

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

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

**Comparison of Financial Condition at September 30, 2010 and September 30, 2009**

**Total Assets.** Total assets decreased \$27.3 million, or 4.8%, to \$537.9 million at September 30, 2010 from \$565.2 million at September 30, 2009, due to reductions of loans receivable and investment securities, partially offset by an increase in cash and cash equivalents.

**Loans Receivable.** Net loans receivable decreased \$35.1 million, or 8.0%, to \$403.9 million at September 30, 2010 from \$439.0 million at September 30, 2009. During the year ended September 30, 2010, construction loans decreased \$36.1 million, or 38.8%, to \$57.1 million at September 30, 2010 from \$93.2 million at September 30, 2009. In addition, one-to-four-family residential mortgage loans and commercial business loans decreased \$7.0 million, or 4.0%, and \$3.7 million, or 9.9%, to \$165.5 million and \$33.7 million, respectively. Commercial real estate loans increased \$10.5 million, or 9.9%, to \$116.2 million at September 30, 2010 from \$105.8 million at September 30, 2009.

At September 30, 2010, the significant loan categories in terms of the percent of total loans were 40.5% in one-to-four-family residential mortgage loans, 28.4% in commercial real estate loans and 14.0% in construction loans. The remaining total loans were comprised of 8.2% of commercial business, 5.6% of home equity lines of credit and 3.3% of other loans, which consisted primarily of stock-secured consumer loans.

Total non-performing loans and troubled debt restructurings decreased by \$2.9 million to \$31.0 million at September 30, 2010 from \$33.9 million at September 30, 2009. Non-performing loans consisted of 33 non-accrual loans totaling \$27.4 million and troubled debt restructurings consisted of seven loans totaling \$3.6 million. Non-accrual loans consisted of fourteen construction loan relationships totaling \$14.0 million, seven commercial real estate loans totaling \$8.2 million, four mortgage loans secured by one-to-four family residential properties totaling \$2.4 million, five commercial business loan totaling \$1.5 million and three home equity lines of credit totaling \$1.3 million. Troubled debt restructuring loans consisted of three commercial real estate loans totaling \$2.8 million, three mortgage loans secured by one-to-four family residential properties totaling \$705,000, and one commercial business loan totaling \$74,000. The troubled debt restructuring loans were performing in accordance with their restructured terms at September 30, 2010.

Adverse economic conditions have led to high levels of non-performing loans, particularly in the Company's construction loan portfolio. The repayment of construction loans is typically dependent upon the sale of the collateral

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securing the loan, which has been negatively impacted by significant deterioration in the housing market and decreased buyer demand. As a result, construction projects have slowed and reached their maturity dates. In order for the Company to extend the loans beyond the original maturity date, the value of the collateral securing the loan must be assessed, which is typically done by obtaining an updated third-party appraisal. Given the deterioration in the economy and, specifically, the housing market, updated valuations of the collateral reflect depreciation from earlier assessments. To the extent that the current appraised value of collateral is insufficient to cover a collateral-dependent loan, the Company reduces the balance of the loan via a charge to the allowance for loan loss.

Non-performing construction loans decreased \$5.5 million to \$14.0 million at September 30, 2010 from \$19.5 million at September 30, 2009. The real estate securing these loans ranged from vacant and partially completed residential lots to a substantially completed condominium projects in various locations in the State of New Jersey. Magyar Bank is determining the proper course of action to collect the principal outstanding on these loans including foreclosure of collateral and pursuit of personal guarantors on the loans. During the year ended September 30, 2010, Magyar Bank charged off \$3.1 million in non-performing construction loan balances through a reduction of its allowance for loan loss.

Construction loans may contain interest reserves on which the interest is capitalized. At September 30, 2010, there were four performing construction loans with interest reserves representing outstanding balances of \$13.7 million, original interest reserves of \$1.1 million, advanced interest reserves of \$644,000, and remaining interest reserve balances of \$411,000. At September 30, 2009, there were six performing construction loans with interest reserves representing outstanding balances of \$17.3 million, original interest reserves of \$1.6 million, advanced interest reserves of \$454,000, and remaining interest reserve balances of \$1.1 million.

Underwriting for construction loans with and without interest reserves has followed a uniform process. Construction loan progress is monitored by loan on a monthly basis by management of the Bank as well as by the Board of Directors. Each time an advance is requested, an inspection is made of the project by an outside engineer or appraiser, depending on the size and complexity of the project, to determine the amount of work completed and if the costs to date are supported adequately. The Bank's construction loan operations personnel compare the advance request with the original budget and remaining loan funds available to ensure the project is in balance and that at all times the amount remaining on the loan is sufficient to complete the project.

A number of the Bank's construction loans have been extended due to slower sales as a result of worsening economic conditions. In cases where updated appraisals reflect collateral values insufficient to cover the loan, additional collateral and/or a principal reduction is required to extend the loan. Some of the Bank's loans that originally had interest reserves are non-performing. The Bank does not currently have any non-performing loans with active interest reserves. Once a loan is deemed impaired, any interest reserve is frozen and the loan is placed on non-accrual so that no future interest income is recorded on these loans. The Bank ceased originating new non-owner occupied construction loans in October 2008.

Non-performing commercial real estate loans increased \$789,000 to \$8.2 million at September 30, 2010 from \$7.4 million at September 30, 2009. Magyar Bank had begun foreclosure proceedings on the properties securing these loans at September 30, 2010. During the year ended September 30, 2010, Magyar Bank had charged off \$321,000 in non-performing commercial real estate loan balances through a reduction of its allowance for loan loss. There were restructurings of three troubled commercial real estate loans totaling \$2.8 million during the year ended September 30, 2010 that were performing at their restructured terms at September 30, 2010. Two of the three restructurings totaling \$2.4 million were non-performing loans at September 30, 2009.

Non-performing loans secured by one-to four-family residential properties including home equity lines of credit decreased \$1.9 million to \$3.8 million at September 30, 2010 from \$5.7 million at September 30, 2009. Magyar Bank

had begun foreclosure proceedings on the majority of the properties as of September 30, 2010. During the year ended September 30, 2010, Magyar Bank had charged off \$154,000 in non-performing loans secured by one-to four-family residential properties including home equity line of credit loans through a reduction of its allowance for loan loss. There was a restructuring of one troubled loan secured by a one-to four-family residential property totaling \$247,000 during the year ended September 30, 2010 that was performing at its restructured terms at September 30, 2010. Troubled debt restructurings increased from two loans totaling \$458,000 at September 30, 2009 to three loans totaling \$705,000 at September 30, 2010.

Non-performing commercial business loans increased \$586,000 to \$1.5 million at September 30, 2010 from \$879,000 at September 30, 2009. Of the five non-performing loans, two loans totaling \$1.1 million were secured by real estate collateral as an abundance of caution while three loans totaling \$292,000 were not secured by real estate. Magyar Bank is determining the proper course of action to collect the principal outstanding on these loans which will include

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foreclosure proceedings for those loans secured by real estate. During the year ended September 30, 2010, Magyar Bank had charged off \$196,000 in non-performing commercial business loans through a reduction of its allowance for loan loss. There was a restructuring of one troubled commercial business loan totaling \$74,000 during the year ended September 30, 2010 that was performing at its restructured terms at September 30, 2010.

The ratio of non-performing loans and troubled debt restructurings to total loans receivable was unchanged at 7.6% at September 30, 2010 and September 30, 2009. However, the ratio of non-accrual loans to total loans receivable decreased to 6.7% at September 30, 2010 from 7.5% at September 30, 2009. The allowance for loan losses decreased \$1.0 million to \$4.8 million or 15.4% of non-performing loans at September 30, 2010 compared with \$5.8 million or 17.3% of non-performing loans at September 30, 2009. Provisions for loan loss during the year ended September 30, 2010 were \$2.7 million while net charge-offs were \$3.8 million. The allowance for loan losses was 1.2% of gross loans outstanding at September 30, 2010 and 1.3% of gross loans outstanding at September 30, 2009.

Investment Securities. Investment securities decreased \$15.3 million, or 20.8%, to \$58.7 million at September 30, 2010 from \$74.0 million at September 30, 2009.

Securities available-for-sale decreased \$3.9 million, or 21.5%, to \$14.2 million at September 30, 2010 from \$18.1 million at September 30, 2009. The decrease was the result of \$14.8 million in security sales and \$2.2 million in principal amortization, partially offset by \$13.0 million in purchases of mortgage-backed securities and U.S. government-sponsored enterprise obligations. In addition, the unrealized loss on the available-for-sale portfolio increased \$103,000 to \$187,000 at September 30, 2010 compared with the prior year period.

Securities held-to-maturity decreased \$11.5 million, or 20.5%, to \$44.5 million at September 30, 2010 from \$56.0 million at September 30, 2009, resulting from \$21.7 million in principal amortization and \$4.0 million in sales, partially offset by \$14.4 million in purchases of mortgage-backed securities and U.S. government-sponsored enterprise obligations. The Company sold its only corporate security, a \$4.0 million bond, from the held-to-maturity portfolio. The issuer of the bond was downgraded by a major credit rating agency, which was considered evidence of a significant deterioration in the issuer's creditworthiness. The bond was sold for a gain of \$270,000. Management does not believe the sale of the bond affects its intent or ability to hold the remaining investment securities in the held to maturity portfolio until their maturity.

Bank-Owned Life Insurance. The cash surrender value of life insurance held for directors and executive officers of Magyar Bank decreased \$1.7 million, or 15.4%, to \$9.3 million at September 30, 2010 from \$11.0 million at September 30, 2009. The decrease in bank-owned life insurance was due to the surrender of one \$2.1 million policy, partially offset by an increase in the cash surrender value of policies totaling \$421,000.

Other Real Estate Owned. Other real estate owned increased \$7.1 million to \$12.7 million at September 30, 2010 from \$5.6 million at September 30, 2009.

The Company was able to successfully dispose of four properties with an aggregate carrying value of \$3.5 million at September 30, 2009 during the year ended September 30, 2010 for a net profit of \$61,000 and the Company was able to secure the title for 26 other properties totaling \$10.0 million which will help to facilitate the sales process. Other real estate owned at September 30, 2010 consisted of five residential properties, two substantially completed condominium projects, four partially completed residential properties, and eighteen real estate lots approved for residential homes. The Bank is determining the proper course of action for its other real estate owned, which may include holding the properties until the real estate market improves, selling the properties to a developer and completing partially completed homes for either rental or sale.

Other Assets. Other assets increased \$5.8 million, or 342%, to \$7.5 million at September 30, 2010 from \$1.7 million at September 30, 2009. The increase was due to a \$3.5 million increase in the Company's deferred tax asset and the prepayment of three years' FDIC insurance assessments during the year ended September 30, 2010. The FDIC opted to collect future payments from all insured institutions in order to replenish the Deposit Insurance Fund. The Company's prepayment totaled \$3.6 million of which \$2.6 million was recorded as a prepaid asset at September 30, 2010.

Deposits. Total deposits decreased \$20.6 million, or 4.6%, to \$427.9 million at September 30, 2010 from \$448.5 million at September 30, 2009.

The Company's deposit strategy during the year ended September 30, 2010 was focused on increasing and expanding customer relationships with Magyar Bank, including higher balance commercial deposit accounts. As a result of this strategy, the Bank was able to replace higher-cost, single service time deposit account holders with lower-cost, higher checking account balances.

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The contraction in deposits during the twelve months ended September 30, 2010 occurred in certificates of deposit (including individual retirement accounts), which decreased \$32.4 million, or 14.7%. Partially offsetting the decrease were a \$4.1 million, or 4.8%, increase in checking accounts, a \$4.0 million, or 6.9%, increase in savings accounts, and a \$3.7 million, or 4.4%, increase in money market accounts. Deposits accounted for 79.5% of assets and 106.0% of net loans at September 30, 2010.

At September 30, 2010, the Company held \$2.9 million in Certificate of Deposit Account Registry Service (CDARS) Reciprocal certificates of deposit and \$14.7 million in brokered certificates of deposit. At September 30, 2009, the Company held \$12.0 million in CDARS Reciprocal certificates of deposit and \$15.9 million in brokered certificates of deposit.

**Borrowed Funds.** Borrowings from the FHLB decreased \$9.3 million, or 17.0% to \$45.8 million at September 30, 2010 from \$55.1 million at September 30, 2009. Securities sold under agreements to repurchase remained unchanged at \$15.0 million. Proceeds from loan repayments were used to repay Federal Home Loan Bank of New York advances.

Borrowings and securities sold under agreements to repurchase decreased to 11.3% of assets at September 30, 2010 from 12.4% at September 30, 2009.

**Stockholders' Equity.** Stockholders' equity increased \$4.2 million, or 10.4%, to \$44.2 million at September 30, 2010 from \$40.0 million at September 30, 2009.

The increase in stockholders' equity was attributable to net income totaling \$3.9 million from operations and an increase in stockholders' equity of \$407,000 related to the accounting of the Company's equity incentive plan and Employee Stock Ownership Plan for the year ended September 30, 2010. Accumulated other comprehensive loss increased \$199,000 during the period to \$532,000 at September 30, 2010.

The Company completed its first stock repurchase program of 130,927 shares in November 2007 and announced a second repurchase program of up to 5% of its publicly-held outstanding shares of common stock, or 129,924 shares. During the year ended September 30, 2010, the Company did not repurchase shares of its common stock. Under the current stock repurchase program, 62,954 shares of the 129,924 shares authorized remained available for repurchase at September 30, 2010.

**Comparison of Operating Results for the Years Ended September 30, 2010 and 2009**

**Net Income (Loss).** The Company's net income increased \$10.0 million to \$3.9 million for the year ended September 30, 2010 from a net loss of \$6.1 million for the year ended September 30, 2009.

**Net Interest and Dividend Income.** Net interest and dividend income increased \$1.7 million, or 11.8%, to \$15.8 million during the year ended September 30, 2010 from \$14.1 million during the year ended September 30, 2009. Interest and dividend income decreased \$1.2 million, or 4.6%, to \$25.1 million for the year ended September 30, 2010 from \$26.3 million for the year ended September 30, 2009 while interest expense decreased \$2.9 million, or 23.6%, to \$9.3 million for the year ended September 30, 2010 from \$12.2 million for the year ended September 30, 2009

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Average Balance Sheet. The following table presents certain information regarding our financial condition and net interest income for the years ended September 30, 2010 and 2009. The table presents the annualized average yield on interest-earning assets and the annualized average cost of interest-bearing liabilities. We derived the yields and costs by dividing annualized income or expense by the average balance of interest-earning assets and interest-bearing liabilities, respectively, for the periods shown. We derived average balances from daily balances over the periods indicated. Interest income includes fees that we consider adjustments to yields.

**MAGYAR BANCORP, INC. AND SUBSIDIARY**  
**Comparative Average Balance Sheets**  
(Dollars In Thousands)

|   | For the Year Ended September 30, |                       |                 |                         |                       |                 |                         |                       |               |
|---|----------------------------------|-----------------------|-----------------|-------------------------|-----------------------|-----------------|-------------------------|-----------------------|---------------|
|   | 2010                             |                       |                 | 2009                    |                       |                 | 2008                    |                       |               |
| Average Balance                           | Interest Income/Expense          | Yield/Annualized Cost | Average Balance | Interest Income/Expense | Yield/Annualized Cost | Average Balance | Interest Income/Expense | Yield/Annualized Cost |               |
| <b>Interest-earning assets:</b>           |                                  |                       |                 |                         |                       |                 |                         |                       |               |
| Interest-earning deposits                 | \$ 2,598                         | \$ 8                  | 0.30 %          | \$ 3,398                | \$ 3                  | 0.09 %          | \$ 403                  | \$ 9                  | 2.12 %        |
| Loans receivable, net                     | 424,554                          | 22,521                | 5.30 %          | 428,428                 | 23,145                | 5.40 %          | 396,343                 | 25,890                | 6.51 %        |
| <b>Securities</b>                         |                                  |                       |                 |                         |                       |                 |                         |                       |               |
| Taxable                                   | 64,439                           | 2,431                 | 3.77 %          | 65,962                  | 3,037                 | 4.60 %          | 50,979                  | 2,534                 | 4.96 %        |
| Tax-exempt (1)                            | 105                              | 6                     | 5.94 %          | 1,174                   | 48                    | 4.09 %          | 3,362                   | 198                   | 5.87 %        |
| FHLB of NY stock                          | 3,083                            | 159                   | 5.16 %          | 3,702                   | 105                   | 2.84 %          | 3,550                   | 256                   | 7.19 %        |
| <b>Total interest-earning assets</b>      | <b>494,779</b>                   | <b>25,125</b>         | <b>5.08 %</b>   | <b>502,664</b>          | <b>26,338</b>         | <b>5.24 %</b>   | <b>454,637</b>          | <b>28,887</b>         | <b>6.34 %</b> |
| Noninterest-earning assets                | 54,192                           |                       |                 | 44,721                  |                       |                 | 45,423                  |                       |               |
| <b>Total assets</b>                       | <b>\$ 548,971</b>                |                       |                 | <b>\$ 547,385</b>       |                       |                 | <b>\$ 500,060</b>       |                       |               |
| <b>Interest-bearing liabilities:</b>      |                                  |                       |                 |                         |                       |                 |                         |                       |               |
| <b>Savings accounts</b>                   |                                  |                       |                 |                         |                       |                 |                         |                       |               |
| (2)                                       | \$ 61,639                        | \$ 599                | 0.97 %          | \$ 47,682               | \$ 532                | 1.11 %          | \$ 34,440               | \$ 272                | 0.79 %        |
| NOW accounts (3)                          | 134,667                          | 1,384                 | 1.03 %          | 114,541                 | 1,583                 | 1.38 %          | 113,124                 | 2,757                 | 2.43 %        |
| Time deposits (4)                         | 201,124                          | 4,600                 | 2.29 %          | 224,038                 | 7,045                 | 3.14 %          | 192,928                 | 8,085                 | 4.18 %        |
| <b>Total interest-bearing deposits</b>    | <b>397,430</b>                   | <b>6,583</b>          | <b>1.66 %</b>   | <b>386,261</b>          | <b>9,160</b>          | <b>2.37 %</b>   | <b>340,492</b>          | <b>11,114</b>         | <b>3.26 %</b> |
| Borrowings                                | 67,800                           | 2,728                 | 4.02 %          | 83,201                  | 3,028                 | 3.64 %          | 80,617                  | 3,178                 | 3.93 %        |
| <b>Total interest-bearing liabilities</b> | <b>465,230</b>                   | <b>9,311</b>          | <b>2.00 %</b>   | <b>469,462</b>          | <b>12,188</b>         | <b>2.60 %</b>   | <b>421,109</b>          | <b>14,292</b>         | <b>3.38 %</b> |
| Noninterest-bearing liabilities           | 39,768                           |                       |                 | 37,836                  |                       |                 | 32,737                  |                       |               |



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|   |            |            |            |
|---|------------|------------|------------|
| Total liabilities   | 504,998    | 507,298    | 453,846    |
| Retained earnings   | 43,973     | 40,087     | 46,214     |
| Total liabilities and retained earnings                                 | \$ 548,971 | \$ 547,385 | \$ 500,060 |
| Tax-equivalent basis adjustment   | -          | -          | (67 )      |
| Net interest income   | \$ 15,814  | \$ 14,150  | \$ 14,528  |
| Interest rate spread  | 3.08 %     | 2.64 %     | 2.96 %     |
| Net interest-earning assets   | \$ 29,549  | \$ 33,202  | \$ 33,528  |
| Net interest margin (5)   | 3.20 %     | 2.82 %     | 3.19 %     |
| Average interest-earning assets to average interest-bearing liabilities | 106.35 %   | 107.07 %   | 107.96 %   |

- 
- (1) Calculated using 34% tax rate for all periods.
- (2) Includes passbook savings, money market passbook and club accounts.
- (3) Includes interest-bearing checking and money market accounts.
- (4) Includes certificates of deposits and individual retirement accounts.
- (5) Calculated as net interest income divided by average total interest-earning assets.

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

|  | 2010 vs. 2009          |          | September 30, |         |               |          |
|--|------------------------|----------|---------------|---------|---------------|----------|
|  | Increase (decrease)    |          |               |         | 2009 vs. 2008 |          |
|  | due to                 |          |               |         | due to        |          |
|  | Volume                 | Rate     | Net           | Volume  | Rate          | Net      |
|  | (Dollars in thousands) |          |               |         |               |          |
| <b>Interest-earning assets:</b>                                  |                        |          |               |         |               |          |
| Interest-earning deposits  | (1 )                   | \$6      | \$5           | \$9     | \$(15 )       | \$(6 )   |
| Loans  | (205 )                 | (419 )   | (624 )        | 1,949   | (4,694 )      | (2,745 ) |
| <b>Securities</b>  |                        |          |               |         |               |          |
| Taxable  | (69 )                  | (537 )   | (606 )        | 698     | (195 )        | 503      |
| Tax-exempt (1)   | (57 )                  | 15       | (42 )         | (103 )  | (47 )         | (150 )   |
| FHLB of NY stock   | (20 )                  | 74       | 54            | 10      | (161 )        | (151 )   |
| Total interest-earning assets                                    | (351 )                 | \$(862 ) | (1,213 )      | 2,563   | (5,112 )      | (2,549 ) |
| <b>Interest-bearing liabilities:</b>                             |                        |          |               |         |               |          |
| Savings accounts (2)   | 140                    | (73 )    | 67            | 34      | (1,208 )      | (1,174 ) |
| NOW accounts (3)   | 247                    | (446 )   | (199 )        | 127     | 133           | 260      |
| Time deposits (4)  | (670 )                 | (1,775 ) | (2,445 )      | 1,169   | (2,209 )      | (1,040 ) |
| Total interest-bearing deposits                                  | (284 )                 | (2,293 ) | (2,577 )      | 1,330   | (3,284 )      | (1,954 ) |
| Borrowings   | (596 )                 | 296      | (300 )        | 96      | (246 )        | (150 )   |
| Total interest-bearing liabilities                               | (880 )                 | (1,997 ) | (2,877 )      | 1,426   | (3,530 )      | (2,104 ) |
| <b>Increase (decrease) in tax equivalent net interest income</b> |                        |          |               |         |               |          |
| net interest income  | 528                    | \$1,136  | 1,664         | \$1,137 | \$(1,582 )    | (445 )   |
| Change in tax-equivalent basis adjustment                        |                        |          | -             |         |               | 67       |
| <b>Increase (decrease) in net interest income</b>                |                        |          |               |         |               |          |
|  |                        |          | \$1,664       |         |               | \$(378 ) |

- (1) Calculated using 34% tax rate for periods.  
(2) Includes passbook savings, money market passbook and club accounts.  
(3) Includes interest-bearing checking and money market accounts.  
(4) Includes certificates of deposits and individual retirement accounts.

Interest and Dividend Income. Interest and dividend income decreased \$1.2 million, or 4.6%, to \$25.1 million for the year ended September 30, 2010 from \$26.3 million for the year ended September 30, 2009. The decrease was attributable to lower yields on interest-bearing assets, which decreased 16 basis points to 5.08%, and lower balances of such assets, which decreased \$7.9 million, or 1.6%, to \$494.8 million for the year ended September 30, 2010.

Interest income on loans decreased \$624,000, or 2.7%, to \$22.5 million for the year ended September 30, 2010 from \$23.1 million for the prior year. The decrease was attributable to a decrease of \$3.9 million, or 0.9%, in the average balance of loans as well as a 10 basis point decrease in the average yield on such loans to 5.30% from 5.40%. The decline in yield on loans reflected the lower interest rate environment for loans during the year ended September 30, 2010 compared with the year ended September 30, 2009.

Interest earned on investment securities, excluding Federal Home Loan Bank of New York stock, decreased \$648,000, or 21.0%, to \$2.4 million for the year ended September 30, 2010 from \$3.1 million for the prior year. The decrease was due to a \$2.6 million, or 3.9%, decrease in the average balance of such securities to \$64.5 million from \$67.1 million for the prior year as well as an 82 basis point decrease in the average yield on securities to 3.77% from 4.59% for

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the prior year period. The decline in yield on investment securities reflected the lower interest rate environment during the year ended September 30, 2010 compared with the year ended September 30, 2009.

**Interest Expense.** Interest expense decreased \$2.9 million, or 23.6%, to \$9.3 million for the year ended September 30, 2010 from \$12.2 million for the year ended September 30, 2009. The average balance of interest-bearing liabilities decreased \$4.2 million between the two periods while the cost of such liabilities fell 60 basis points to 2.00% for the year ended September 30, 2010.

The average balance of interest-bearing deposits increased \$11.1 million to \$397.4 million for the year ended September 30, 2010 from \$386.3 million for the prior year while the average cost of such deposits decreased 71 basis points to 1.66% from 2.37%. This resulted in a \$2.6 million, or 28.1%, decrease in interest paid on deposits to \$6.6 million for the year ended September 30, 2010 from \$9.2 million for the year ended September 30, 2009.

Interest paid on advances and securities sold under agreements to repurchase decreased \$300,000 to \$2.7 million for the year ended September 30, 2010 from \$3.0 million for the year ended September 30, 2009. An increase in the average cost of borrowings of 38 basis points to 4.02% for the year ended September 30, 2010 from 3.64% for the year ended September 30, 2009 was more than offset by a decrease in the average balance of advances and securities sold under agreements to repurchase of \$15.4 million to \$67.8 million for the year ended September 30, 2010 from \$83.2 million for the year ended September 30, 2009.

**Provision for Loan Losses.** We establish provisions for loan losses, which are charged to earnings, at a level necessary to absorb known and inherent losses that are both probable and reasonably estimable at the date of the financial statements. In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, peer group information and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events occur. After an evaluation of these factors, management made a provision of \$2.7 million for the year ended September 30, 2010 compared with an \$8.2 million provision for the prior year.

Provisions for loan loss decreased \$5.5 million due to lower levels of loan charge-offs during the twelve months ended September 30, 2010 compared to the twelve months ended September 30, 2009, lower levels of construction loans and lower levels of non-performing loans.

There were net charge-offs of \$3.8 million for the year ended September 30, 2010 compared to net charge-offs of \$6.9 million for the year ended September 30, 2009. The lower level of loan charge-offs resulted from fewer impaired loans at September 30, 2010, in comparison with September 30, 2009, and lower charge-offs of previously impaired loans in comparison to the prior year period.

Non-performing and restructured loans decreased \$2.9 million, or 8.6%, to \$31.0 million at September 30, 2010 from \$33.9 million at September 30, 2009. Excluding troubled debt restructurings, non-accrual loans decreased \$6.1 million, or 18.1%. The allowance for loan losses decreased \$1.0 million to \$4.8 million, or 1.2% of gross loans outstanding at September 30, 2010, from \$5.8 million, or 1.3% of gross loans outstanding at September 30, 2009. The decline in the allowance for loan loss was primarily due to a \$36.1 million, or 38.8%, decrease in the construction loan portfolio during the year ended September 30, 2010.

**Other Income.** Non-interest income decreased \$789,000, or 25.6%, to \$2.3 million during the year ended September 30, 2010 compared to \$3.1 million for the year ended September 30, 2009. The decrease in non-interest income for the year was attributable to lower gains on the sales of assets, which were \$828,000 for the year ended September 30,

2010 compared with \$1.7 million for the year ended September 30, 2009.

The Company's gains from the sales of investment securities decreased \$1.0 million to \$501,000 for the year ended September 30, 2010 from \$1.5 million for the year ended September 30, 2009. The gains resulted from sales of mortgage-backed securities, callable bonds and a corporate bond in the current lower interest rate environment. The Company's gains on the sales of mortgage loans increased \$130,000 to \$266,000 for the year ended September 30, 2010 from \$136,000 for the year ended September 30, 2009. The Company sold fourteen residential mortgage loans, servicing retained, totaling \$2.8 million to Freddie Mac during the year ended September 30, 2010. In addition, there were \$61,000 in net gains on the sales of real estate owned for the year ended September 30, 2010.

Other Expenses. Other expense increased \$92,000, or 0.6%, to \$15.2 million for the year ended September 30, 2010 compared to \$15.1 million for the year ended September 30, 2009. A decrease in compensation and benefit expenses

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of \$582,000 was partially offset by increases in professional services of \$266,000 and FDIC insurance premiums of \$200,000.

Employee and benefit expenses decreased \$582,000, or 7.2%, to \$7.5 million for the year ended September 30, 2010 from \$8.1 million for the year ended September 30, 2009. The decrease was the result of reductions in the number of Bank staff, benefits, such as 401(k) matches and Employee Stock Ownership Plan contributions, incentive expenses, and conference and convention expenses. The Company's former President and Chief Executive Officer resigned in December 2009 and was replaced by the former Chief Operating Officer, which resulted in lower salary and benefit expenses for the remaining nine months of the Company's fiscal year. The Company entered into a separation agreement with former President and Chief Executive Officer in December 2009 and recorded a severance expense of \$852,000. The accrued payment was subsequently reversed during the year ended September 30, 2010 due to regulatory prohibitions of such payments by Banks under a Consent Order.

The FDIC substantially has increased its assessment rate for all insured banks in an effort to increase its Deposit Insurance Fund, (together with a higher assessment rate for the Bank due to the imposition of the Consent Orders) resulting in an increased expense for the Company of \$200,000, or 18.8%, to \$1.3 million for the twelve months ended September 30, 2010 compared with \$1.1 million for the year ended September 30, 2009.

Occupancy expense increased \$145,000 or 5.7% to \$2.7 million for the year ended September 30, 2010 from \$2.5 million for the prior year period. The increase reflected the lease and operation of the Bank's sixth retail branch location in Bridgewater, New Jersey in June 2010.

Professional fees increased \$266,000, or 31.1%, to \$1.1 million during the year ended September 30, 2010 from the prior year period. The increase in professional fees was primarily due to higher expenses related to the collection of non-performing loans and the foreclosure of collateral securing non-performing loans.

Other expenses increased \$138,000, or 7.8%, to \$1.9 million for the year ended September 30, 2010 from \$1.8 million for the prior year period. The increase was the result of higher expenses associated with other real estate owned, such as real estate taxes, insurance, and utilities.

Income Tax Expense (Benefit). The Company recorded a tax benefit of \$3.7 million for the year ended September 30, 2010 compared with tax expense of \$55,000 for the year ended September 30, 2009.

The \$3.7 million tax benefit for the year ended September 30, 2010 resulted primarily from a partial reduction in the valuation allowance previously recorded against its deferred tax asset. In assessing the realizability of deferred tax assets, the Company considers the likelihood that part or all of the deferred tax assets will not be realized. This assessment requires significant judgment and estimates. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during the period in which those temporary differences become deductible. The Company considers our history of losses, scheduled reversal of tax assets and liabilities, deferred tax planning strategies, if any, and projected future taxable income over the periods in which the deferred tax asset items are deductible. Based on these considerations, the Company reached a "more likely than not" conclusion required under the applicable literature to recognize certain deferred tax assets in our Consolidated Balance Sheet.

Management of Market Risk

General. The majority of our assets and liabilities are monetary in nature. Consequently, our most significant form of market risk is interest rate risk. Our assets, consisting primarily of mortgage loans, have longer maturities than our liabilities, consisting primarily of deposits. As a result, a principal part of our business strategy is to manage interest

rate risk and reduce the exposure of our net interest income to changes in market interest rates. Accordingly, our Board of Directors has established an Asset and Liability Management Committee which is responsible for evaluating the interest rate risk inherent in our assets and liabilities, for determining the level of risk that is appropriate, given our business strategy, operating environment, capital, liquidity and performance objectives, and for managing this risk consistent with the guidelines approved by the Board of Directors. Senior management monitors the level of interest rate risk on a regular basis and the Asset and Liability Committee meets at least on a quarterly basis to review our asset/liability policies and interest rate risk position.

We have sought to manage our interest rate risk in order to minimize the exposure of our earnings and capital to changes in interest rates. As part of our ongoing asset-liability management, we seek to manage our exposure to interest rate risk by retaining in our loan portfolio fewer fixed rate residential loans, by originating and retaining adjustable-rate loans in

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the residential, construction and commercial real estate loan portfolios, by using alternative funding sources, such as advances from the Federal Home Loan Bank of New York, to “match fund” longer-term residential and commercial mortgage loans, and by originating and retaining variable rate home equity and short-term and medium-term fixed-rate commercial business loans. We have also increased money market account deposits as a percentage of our total deposits. Money market accounts offer a variable rate based on market indications. Finally, we have purchased interest rate floors and sold securities under agreements to repurchase with embedded derivatives to mitigate the impact of interest rates on our prime-based loans. At September 30, 2010 we held interest rate floors with a notional amount of \$5.0 million and securities sold under agreements to repurchase with embedded derivatives in the amount of \$15.0 million. By following these strategies, we believe that we are well-positioned to react to changes in market interest rates.

Net Interest Income Analysis. The table below sets forth, as of September 30, 2010, the estimated changes in our net interest income for each of the next two years that would result from the designated instantaneous changes in interest rates. These estimates require making certain assumptions including loan and mortgage-related investment prepayment speeds, reinvestment rates, and deposit maturities and decay rates. These assumptions are inherently uncertain and, as a result, we cannot precisely predict the impact of changes in interest rates on net interest income. Actual results may differ significantly due to timing, magnitude and frequency of interest rate changes and changes in market conditions. Further, certain shortcomings are inherent in the methodology used in the interest rate risk measurement. Modeling changes in net interest income require making certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates.

| Change in Interest rates (Basis Points)(1) | Estimated Net Interest Income            |   |         | Estimated Net Interest Income            |   |         |
|--|--|---|---------|--|---|---------|
|  | Estimated Net Interest Income NII Year 1 | Estimated Increase (Decrease) in NII Year 1 |         | Estimated Net Interest Income NII Year 2 | Estimated Increase (Decrease) in NII Year 2 |         |
|  | Amount                                   | Percentage                                  |         | Amount                                   | Percentage                                  |         |
| (Dollars in thousands)                     |  |   |         |  |   |         |
| +200                                       | \$15,218                                 | \$(301 )                                    | -1.94 % | \$15,352                                 | \$(201 )                                    | -1.29 % |
| Unchanged                                  | 15,519                                   | -   | -       | 15,553                                   | -   | -       |
| -100                                       | 15,263                                   | (256 )                                      | -1.65 % | 15,141                                   | (412 )                                      | -2.65 % |

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

### Liquidity and Capital Resources

Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan repayments and maturities and sales of securities. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. Our Asset/Liability Management Committee is responsible for establishing and monitoring our liquidity targets and strategies in order to ensure that sufficient liquidity exists for meeting the borrowing needs of our customers as well as unanticipated contingencies. We seek to maintain a liquidity ratio of 5.0% of assets or greater. The liquidity ratio is calculated by determining the sum of the difference between liquid assets (cash and unpledged investment securities) and short-term liabilities (estimated 30-day deposit outflows), borrowing capacity from the FHLB NY, and brokered deposit capacity and dividing the sum by total assets. At September 30, 2010, our liquidity ratio was 11.1% of assets.



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

Our most liquid assets are cash and cash equivalents. The levels of these assets are dependent on our operating, financing, lending and investing activities during any given period. At September 30, 2010, cash and cash equivalents totaled \$21.1 million. Securities classified as available-for-sale, which provide additional sources of liquidity from sales, totaled \$14.2 million at September 30, 2010. At September 30, 2010, we also had the ability to borrow \$94.5 million from the Federal Home Loan Bank of New York. On that date, we had an aggregate of \$45.8 million in advances outstanding.

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

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At September 30, 2010, we had \$3.8 million in loan origination commitments outstanding. In addition to commitments to originate loans, we had \$42.9 million in unused lines of credit to borrowers. Certificates of deposit due within one year of September 30, 2010 totaled \$97.5 million, or 22.8% of total deposits. If these deposits do not remain with us, we will be required to seek other sources of funds, including other deposits and Federal Home Loan Bank advances. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before September 30, 2011. We believe, however, that based on past experience a significant portion of our certificates of deposit will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

Our primary investing activities are the origination of loans and the purchase of securities. For the year ended September 30, 2010, we originated \$42.5 million of loans and purchased \$27.4 million of securities.

Financing activities consist primarily of activity in deposit accounts and Federal Home Loan Bank advances. We experienced a net decrease in total deposits of \$20.6 million for the year ended September 30, 2010 and a net increase in total deposits of \$73.0 million for the year ended September 30, 2009. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors and other factors.

Liquidity management is both a daily and long-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the Federal Home Loan Bank of New York, which provide an additional source of funds. Federal Home Loan Bank advances totaled \$45.8 million and \$55.1 million at September 30, 2010 and September 30, 2009, respectively. Federal Home Loan Bank advances have primarily been used to fund loan demand.

Magyar Bank is subject to various regulatory capital requirements, including a risk-based capital measure as well as Consent Orders that require Magyar Bank to develop a written capital plan that details the manner in which the Bank will achieve Tier 1 capital as a percentage of the Bank's total assets of at least 8%, and total qualifying capital as a percentage of risk-weighted assets of at least 12% (which exceed the required regulatory capital ratios). A capital plan was submitted on a timely basis to the Federal Deposit Insurance Corporation and New Jersey Department of Banking of Insurance and calls for the Bank to achieve these higher capital ratios by September 30, 2011. As of September 30, 2010, Magyar Bank's Tier 1 capital as a percentage of the Bank's total assets was 7.80% and the total qualifying capital as a percentage of risk-weighted assets was 12.59%. These capital ratios exceeded all required regulatory capital ratios as well as those projected in the submitted capital plan at September 30, 2010. See "Supervision and Regulation-Federal Banking Regulation-Capital Requirements."

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

## Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

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

Note Q “Financial Instruments with Off-Balance Sheet Risk” to our Financial Statements.

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

The following table summarizes our significant fixed and determinable contractual obligations and other funding needs by payment date at September 30, 2010. The payment amounts represent those amounts due to the recipient and do not include any unamortized premiums or discounts or other similar carrying amount adjustments.

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|                       | Payments Due by Period |                       |                        |                         | Total     |
|-----------------------|------------------------|-----------------------|------------------------|-------------------------|-----------|
|                       | Less Than<br>One Year  | One to<br>Three Years | Three to<br>Five Years | More Than<br>Five Years |           |
|                       | (Dollars in thousands) |                       |                        |                         |           |
| Federal Home Loan     |                        |                       |                        |                         |           |
| Bank advances         | \$ 10,853              | \$ 11,956             | \$ 13,700              | \$ 9,260                | \$ 45,769 |
| Repurchase agreements | -                      | 10,000                | 5,000                  | -                       | 15,000    |
| Operating leases      | 477                    | 676                   | 686                    | 4,819                   | 6,658     |
| Total                 | \$ 11,330              | \$ 22,632             | \$ 19,386              | \$ 14,079               | \$ 67,427 |

## ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk

Not required for smaller reporting companies.

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ITEM 8. Financial Statements and Supplementary Data

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Consolidated Financial Statements:

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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders  
Magyar Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of Magyar Bancorp, Inc. (the “Company”) and subsidiary as of September 30, 2010 and 2009, and the related consolidated statements of operations, changes in stockholders’ equity and cash flows for the years then ended. The Company’s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Magyar Bancorp, Inc. and subsidiary as of September 30, 2010 and 2009, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ ParenteBeard LLC

ParenteBeard LLC  
Clark, New Jersey  
December 21, 2010

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MAGYAR BANCORP, INC. AND SUBSIDIARY  
Consolidated Balance Sheets  
(In Thousands, Except Share Data)

|   | September 30,    |                  |
|---|------------------|------------------|
|   | 2010             | 2009             |
| <b>Assets</b>   |                  |                  |
| Cash  | \$1,126          | \$3,529          |
| Interest earning deposits with banks  | 19,960           | 4,392            |
| Total cash and cash equivalents   | 21,086           | 7,921            |
| Investment securities - available for sale, at fair value   | 14,187           | 18,083           |
| Investment securities - held to maturity, at amortized cost (fair value of \$45,398 and \$55,997 at September 30, 2010 and 2009, respectively)                          | 44,479           | 55,951           |
| Federal Home Loan Bank of New York stock, at cost   | 2,775            | 3,178            |
| Loans receivable, net of allowance for loan losses of \$4,766 and \$5,807 at September 30, 2010 and 2009, respectively  | 403,886          | 438,997          |
| Bank owned life insurance   | 9,306            | 10,996           |
| Accrued interest receivable   | 1,950            | 2,207            |
| Premises and equipment, net   | 20,142           | 20,622           |
| Other real estate owned   | 12,655           | 5,562            |
| Other assets  | 7,483            | 1,690            |
| <b>Total assets</b>   | <b>\$537,949</b> | <b>\$565,207</b> |
| <b>Liabilities and Stockholders' Equity</b>   |                  |                  |
| <b>Liabilities</b>  |                  |                  |
| Deposits  | \$427,932        | \$448,517        |
| Escrowed funds  | 1,555            | 1,246            |
| Federal Home Loan Bank of New York advances   | 45,769           | 55,127           |
| Securities sold under agreements to repurchase  | 15,000           | 15,000           |
| Loans payable   | -                | -                |
| Accrued interest payable  | 418              | 675              |
| Accounts payable and other liabilities  | 3,098            | 4,615            |
| <b>Total liabilities</b>  | <b>493,772</b>   | <b>525,180</b>   |
| <b>Stockholders' equity</b>   |                  |                  |
| 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; 5,783,131 and 5,767,434 outstanding at September 30, 2010 and 2009, respectively, at cost | 59               | 59               |
| Additional paid-in capital  | 26,396           | 26,329           |
| Treasury stock: 140,611 and 156,308 shares at September 30, 2010 and 2009, respectively, at cost  | (1,704 )         | (1,897 )         |
| Unearned Employee Stock Ownership Plan shares   | (1,342 )         | (1,454 )         |
| Retained earnings   | 21,300           | 17,323           |

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|  |           |           |
|--|-----------|-----------|
| Accumulated other comprehensive loss       | (532 )    | (333 )    |
| Total stockholders' equity                 | 44,177    | 40,027    |
| Total liabilities and stockholders' equity | \$537,949 | \$565,207 |

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 Year<br>Ended September 30, |               |
|---|-------------------------------------|---------------|
|   | 2010                                | 2009          |
| Interest and dividend income  |                                     |               |
| Loans, including fees   | \$22,521                            | \$23,145      |
| Investment securities   |                                     |               |
| Taxable   | 2,439                               | 3,040         |
| Tax-exempt  | 6                                   | 48            |
| Federal Home Loan Bank of New York stock                                    | 159                                 | 105           |
| <b>Total interest and dividend income</b>                                   | <b>25,125</b>                       | <b>26,338</b> |
| Interest expense  |                                     |               |
| Deposits  | 6,583                               | 9,160         |
| Borrowings  | 2,728                               | 3,028         |
| <b>Total interest expense</b>   | <b>9,311</b>                        | <b>12,188</b> |
| <b>Net interest and dividend income</b>                                     | <b>15,814</b>                       | <b>14,150</b> |
| <b>Provision for loan losses</b>  | <b>2,729</b>                        | <b>8,212</b>  |
| <b>Net interest and dividend income after<br/>provision for loan losses</b> | <b>13,085</b>                       | <b>5,938</b>  |
| Other income  |                                     |               |
| Service charges   | 979                                 | 923           |
| Other operating income  | 483                                 | 490           |
| Gains on sales of loans   | 266                                 | 136           |
| Gains on sales of investment securities                                     | 501                                 | 1,530         |
| Gains on the sales of other real estate owned                               | 61                                  | -             |
| <b>Total other income</b>   | <b>2,290</b>                        | <b>3,079</b>  |
| Other expenses  |                                     |               |
| Compensation and employee benefits  | 7,473                               | 8,055         |
| Occupancy expenses  | 2,671                               | 2,526         |
| Advertising   | 157                                 | 226           |
| Professional fees   | 1,120                               | 854           |
| Service fees  | 570                                 | 576           |
| FDIC deposit insurance premiums   | 1,266                               | 1,066         |
| Other expenses  | 1,917                               | 1,779         |
| <b>Total other expenses</b>   | <b>15,174</b>                       | <b>15,082</b> |

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|   |          |            |
|---|----------|------------|
| Income (loss) before income tax expense (benefit) | 201      | (6,065 )   |
| Income tax expense (benefit)                      | (3,741 ) | 55         |
| Net income (loss)                                 | \$3,942  | \$(6,120 ) |
| Net income (loss) per share-basic and diluted     | \$0.68   | \$(1.06 )  |

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  
Years Ended September 30, 2010 and 2009  
(In Thousands, Except for Share Amounts)

|   | Common Stock<br>Shares<br>Outstanding | Par<br>Value | Additional<br>Paid-In<br>Capital | Treasury<br>Stock | Unearned<br>ESOP<br>Shares | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Total     |
|---|---------------------------------------|--------------|----------------------------------|-------------------|----------------------------|----------------------|---|-----------|
| Balance, September 30, 2008   | 5,756,141                             | \$ 59        | \$ 26,209                        | \$ (2,093)        | \$ (1,551)                 | \$ 23,398            | \$ (196)                                      | \$ 45,826 |
| Comprehensive loss:   | -                                     | -            | -                                | -                 | -                          | -                    | -   | -         |
| Net loss  | -                                     | -            | -                                | -                 | -                          | (6,120)              | -   | (6,120)   |
| Change in funded status of retirement obligations, net of tax benefit of \$288          | -                                     | -            | -                                | -                 | -                          | -                    | (433)   | (433)     |
| Unrealized loss on securities available-for-sale, net of tax benefit of \$836           | -                                     | -            | -                                | -                 | -                          | -                    | 1,298   | 1,298     |
| Reclassification adjustment for gains included in net loss, net of tax expense of \$611 | -                                     | -            | -                                | -                 | -                          | -                    | (919)   | (919)     |
| Unrealized loss on derivatives, net of tax benefit of \$56                              | -                                     | -            | -                                | -                 | -                          | -                    | (83)  | (83)      |
| Total comprehensive loss  | -                                     | -            | -                                | -                 | -                          | -                    | -   | (6,257)   |
| Purchase of treasury stock  | (9,600)                               | -            | -                                | (62)              | -                          | -                    | -   | (62)      |
| Treasury stock used for restricted stock plan   | 20,893                                | -            | (303)                            | 258               | -                          | 45                   | -   | -         |
| ESOP shares allocated   | -                                     | -            | (42)                             | -                 | 97                         | -                    | -   | 55        |
| Stock-based compensation expense  | -                                     | -            | 465                              | -                 | -                          | -                    | -   | 465       |
| Balance, September 30, 2009   | 5,767,434                             | \$ 59        | \$ 26,329                        | \$ (1,897)        | \$ (1,454)                 | \$ 17,323            | \$ (333)                                      | \$ 40,027 |
| Comprehensive income:   |                                       |              |                                  |                   |                            |                      |   |           |
| Net income  | -                                     | -            | -                                | -                 | -                          | 3,942                | -   | 3,942     |

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|  |           |    |        |         |         |        |        |           |
|--|-----------|----|--------|---------|---------|--------|--------|-----------|
| Change in funded status of retirement obligations, net of tax expense of \$33          | -         | -  | -      | -       | -       | -      | 50     | 50        |
| Unrealized gain on securities available-for-sale, net of tax of \$57                   | -         | -  | -      | -       | -       | -      | 70     | 70        |
| Reclassification adjustment for gains included in net loss, net of tax benefit of \$93 | -         | -  | -      | -       | -       | -      | (138 ) | (138 )    |
| Unrealized loss on derivatives, net of tax benefit of \$120                            | -         | -  | -      | -       | -       | -      | (181 ) | (181 )    |
| Total comprehensive income   | -         | -  | -      | -       | -       | -      | -      | 3,743     |
| Purchase of treasury stock   | -         | -  | -      | -       | -       | -      | -      | -         |
| Treasury stock used for restricted stock plan  | 15,697    | -  | (228 ) | 193     | -       | 35     | -      | -         |
| ESOP shares allocated  | -         | -  | (57 )  | -       | 112     | -      | -      | 55        |
| Stock-based compensation expense   | -         | -  | 352    | -       | -       | -      | -      | 352       |
| Balance, September 30, 2010  | 5,783,131 | 59 | 26,396 | (1,704) | (1,342) | 21,300 | (532 ) | \$ 44,177 |

The accompanying notes are an integral part of this statement.

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MAGYAR BANCORP, INC. AND SUBSIDIARY  
Consolidated Statements of Cash Flows  
(In Thousands)

|   | For the Year Ended<br>September 30, |            |
|---|-------------------------------------|------------|
|   | 2010                                | 2009       |
| Operating activities  |                                     |            |
| Net income (loss)   | \$3,942                             | \$(6,120 ) |
| Adjustment to reconcile net income (loss) to net cash provided<br>by operating activities |                                     |            |
| Depreciation expense  | 1,137                               | 1,117      |
| Premium amortization on investment securities, net  | 163                                 | 98         |
| Proceeds from the sales of loans  | 7,830                               | 5,742      |
| Provision for loan losses   | 2,729                               | 8,212      |
| Gains on sale of loans  | (266 )                              | (136 )     |
| Gains on sales of investment securities   | (501 )                              | (1,530 )   |
| Gains on the sales of other real estate owned   | (61 )                               | -          |
| Gains on the sale of premises and equipment   | -                                   | -          |
| ESOP compensation expense   | 55                                  | 55         |
| Stock-based compensation expense  | 352                                 | 465        |
| Deferred income tax provision (benefit)   | (3,468 )                            | -          |
| Decrease (increase) in accrued interest receivable  | 257                                 | (30 )      |
| Increase in surrender value bank owned life insurance                                     | (421 )                              | (449 )     |
| Increase in other assets  | (2,504 )                            | (415 )     |
| Increase (decrease) in accrued interest payable   | (257 )                              | 15         |
| Increase (decrease) in accounts payable and other liabilities                             | (1,434 )                            | 887        |
| Net cash provided by operating activities   | 7,553                               | 7,911      |
| Investing activities  |                                     |            |
| Net decrease (increase) in loans receivable   | 14,814                              | (48,992 )  |
| Purchases of investment securities held to maturity                                       | (14,368 )                           | (50,071 )  |
| Purchases of investment securities available for sale                                     | (13,007 )                           | (23,965 )  |
| Sales of investment securities held to maturity   | 4,270                               | -          |
| Sales of investment securities available for sale   | 14,796                              | 50,825     |
| Proceeds from calls of investment securities held to maturity                             | -                                   | -          |
| Proceeds from maturities of investment securities available for sale                      | -                                   | -          |
| Principal repayments on investment securities held to maturity                            | 21,716                              | 3,691      |
| Principal repayments on investment securities available for sale                          | 2,196                               | 6,467      |
| Redemptions of bank owned life insurance  | 2,111                               | -          |
| Purchases of premises and equipment   | (657 )                              | (126 )     |
| Proceeds from the sale of premises and equipment  | -                                   | -          |
| Investment in other real estate owned   | (899 )                              | (302 )     |
| Proceeds from the sale of other real estate owned   | 3,871                               | 1,732      |
| Redemption of Federal Home Loan Bank stock  | 403                                 | 689        |
| Net cash provided (used) by investing activities  | 35,246                              | (60,052 )  |
| Financing activities  |                                     |            |

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|   |           |           |
|---|-----------|-----------|
| Net increase (decrease) in deposits                               | (20,585 ) | 72,957    |
| Net increase (decrease) in escrowed funds                         | 309       | (39 )     |
| Proceeds from long-term advances                                  | 1,500     | 7,500     |
| Repayments of long-term advances                                  | (10,858 ) | (7,757 )  |
| Net change in short-term advances                                 | -         | (17,550 ) |
| Purchase of treasury stock  | -         | (62 )     |
| Net cash (used) provided by financing activities                  | (29,634 ) | 55,049    |
| Net increase in cash and cash equivalents                         | 13,165    | 2,908     |
| Cash and cash equivalents, beginning of period                    | 7,921     | 5,013     |
| Cash and cash equivalents, end of period                          | \$21,086  | \$7,921   |
| Supplemental disclosures of cash flow information                 |           |           |
| Cash paid for   |           |           |
| Interest  | \$9,568   | \$12,173  |
| Income taxes  | \$4       | \$52      |
| Non-cash investing activities                                     |           |           |
| Real estate acquired in full satisfaction of loans in foreclosure | \$10,004  | \$2,326   |

The accompanying notes are an integral part of these statements.

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MAGYAR BANCORP, INC. AND SUBSIDIARY  
Notes to Consolidated Financial Statements – Continued  
September 30, 2010 and 2009

NOTE A - ORGANIZATION

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

Magyar Bancorp, MHC, owns 54.0%, or 3,200,450, of the issued shares of common stock of Magyar Bancorp, Inc. Of the remaining shares, 2,582,681, or 43.6%, are held by public stockholders and 140,611, or 2.4%, are held by Magyar Bancorp, Inc. in treasury stock. So long as Magyar Bancorp, MHC exists, it will be required to own a majority of the voting stock of Magyar Bancorp, Inc. Magyar Bancorp, MHC is subject to comprehensive regulation and examination by the Board of Governors of the Federal Reserve System and the New Jersey Department of Banking and Insurance.

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

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

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

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

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

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

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Basis of Financial Statement Presentation

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



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MAGYAR BANCORP, INC. AND SUBSIDIARY  
Notes to Consolidated Financial Statements – Continued  
September 30, 2010 and 2009

The Company has evaluated subsequent events and transactions occurring subsequent to the consolidated balance sheet date of September 30, 2010, 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.

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

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

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

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

## 2. Cash and Cash Equivalents

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

## 3. Investment Securities

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

If the fair value of a security is less than its amortized cost, the security is deemed to be impaired. Management evaluates all securities with unrealized losses quarterly to determine if such impairments are “temporary” or

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

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MAGYAR BANCORP, INC. AND SUBSIDIARY  
Notes to Consolidated Financial Statements – Continued  
September 30, 2010 and 2009

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

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

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

#### 4. Loans and Allowance for Loan Losses

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

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

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

transferred to other real estate owned or other determination of a confirmed loss. Recoveries on loans previously charged off are also recorded through the allowance.

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

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MAGYAR BANCORP, INC. AND SUBSIDIARY  
Notes to Consolidated Financial Statements – Continued  
September 30, 2010 and 2009

collectively evaluated for impairment which for the Company includes one- to four-family first mortgage loans and consumer loans, other than those modified in a troubled debt restructuring (TDR).

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

5. Premises and Equipment

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

The Company accounts for the impairment of long-lived assets in accordance with US GAAP, which requires recognition and measurement for the impairment of long-lived assets to be held and used or to be disposed of by sale. The Company had no impaired long-lived assets at September 30, 2010 and 2009.

6. Derivative Contracts

Derivative contracts are carried at fair value with unrealized gains and losses excluded from earnings and reported in a separate component of stockholders' equity, net of related income tax effects. Gains and losses on derivative contracts are recognized upon realization utilizing the specific identification method.

As required by US GAAP, the Company recognizes all derivatives as either assets or liabilities in the statement of financial condition and measures those instruments at fair value.

7. Other Real Estate Owned

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

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

8. Income Taxes

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

The Company records income taxes on the basis of reported income using the asset and liability method. Accordingly, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. To the extent that current available evidence about the future raises doubt about the realization of a deferred tax asset, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

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MAGYAR BANCORP, INC. AND SUBSIDIARY  
Notes to Consolidated Financial Statements – Continued  
September 30, 2010 and 2009

The Company follows the provisions of FASB ASC Topic 740, which provides clarification on accounting for uncertainty in income taxes recognized in an enterprise's financial statements. The guidance prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. At September 30, 2010 and 2009, no significant income tax uncertainties have been included in the Company's Consolidated Balance Sheets. The Company's policy is to recognize interest and penalties on unrecognized tax benefits in income tax expense in the Consolidated Statements of Operations. No interest and penalties were recorded during the years ended September 30, 2010 and 2009. The tax years subject to examination by the taxing authorities are the years ended September 30, 2006 and forward.

#### 9. Advertising Costs

The Company expenses advertising costs as incurred.

#### 10. Earnings Per Share

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

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

The following tables illustrate the reconciliation of the numerators and denominators of the basic and diluted earnings per share (EPS) calculations.

|  | For the Years Ended September 30, |                                       |                        |             |                                       |                        |
|--|-----------------------------------|---------------------------------------|------------------------|-------------|---------------------------------------|------------------------|
|  | Income                            | 2010<br>Weighted<br>average<br>shares | Per<br>share<br>Amount | Income      | 2009<br>Weighted<br>average<br>shares | Per<br>share<br>Amount |
| (In thousands, except share and per share data)    |                                   |                                       |                        |             |                                       |                        |
| <b>Basic EPS</b>                                   |                                   |                                       |                        |             |                                       |                        |
| Net income (loss) available to common shareholders | \$ 3,942                          | 5,784,976                             | \$ 0.68                | \$ (6,120 ) | 5,769,839                             | \$ (1.06 )             |
| Effect of dilutive securities                      |                                   |                                       |                        |             |                                       |                        |

|   |          |           |         |             |           |            |
|---|----------|-----------|---------|-------------|-----------|------------|
| Options and grants  | -        | -         | -       | -           | -         | -          |
| Diluted EPS   |          |           |         |             |           |            |
| Net income (loss)<br>available to<br>common<br>shareholders plus<br>assumed<br>conversion | \$ 3,942 | 5,784,976 | \$ 0.68 | \$ (6,120 ) | 5,769,839 | \$ (1.06 ) |

All options were anti-dilutive at September 30, 2010 and 2009.

#### 11. Comprehensive Income (Loss)



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MAGYAR BANCORP, INC. AND SUBSIDIARY  
Notes to Consolidated Financial Statements – Continued  
September 30, 2010 and 2009

Comprehensive income (loss) includes net income (loss) as well as certain other items which result in a change to equity during the period.

The other items allocated to comprehensive income (loss), as well as the related income tax effects, for the year ended September 30, 2010 and 2009 were as follows:

|   | 2010                    |                             | September 30,                                     |                         | 2009                        |                         |
|---|-------------------------|-----------------------------|---|-------------------------|-----------------------------|-------------------------|
|   | Before<br>Tax<br>Amount | Tax<br>(Benefit)<br>Expense | Net of<br>Tax<br>Amount<br>(Dollars in thousands) | Before<br>Tax<br>Amount | Tax<br>(Benefit)<br>Expense | Net of<br>Tax<br>Amount |
| Unrealized holding gains (losses) arising during period on:                               |                         |                             |   |                         |                             |                         |
| Available-for-sale investments  | \$ 127                  | \$ (57 )                    | \$ 70   | \$ 2,134                | \$ (836 )                   | \$ 1,298                |
| Less reclassification adjustment for net gains realized on available-for-sale investments | (231 )                  | 93                          | (138 )  | (1,530 )                | 611                         | (919 )                  |
| Minimum pension liability   | 83                      | (33 )                       | 50  | (721 )                  | 288                         | (433 )                  |
| Interest rate derivatives   | (301 )                  | 120                         | (181 )  | (139 )                  | 56                          | (83 )                   |
| Other comprehensive loss, net   | \$ (322 )               | \$ 123                      | \$ (199 )   | \$ (256 )               | \$ 119                      | \$ (137 )               |

In April 2008, the Company unwound a \$10 million interest rate collar with Lehman Brothers Special Financing Inc. and received an \$817,000 termination fee. The termination fee was netted against the book value of \$112,000, resulting in an unrealized gain of \$705,000. In accordance with US GAAP, the unrealized gain remained in other comprehensive income, net of deferred tax expense, and will be accreted to income over the previously contracted life of the interest rate collar, which was scheduled to mature June 24, 2013. At September 30, 2010, the book value of the unwound derivative was \$251,000, recorded as \$151,000 in other comprehensive loss, net of deferred tax of \$100,000. At September 30, 2009, the book value of the unwound derivative was \$400,000, recorded as \$240,000 in other comprehensive loss, net of deferred tax of \$160,000.

## 12. Bank-Owned Life Insurance

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

### 13. New Accounting Pronouncements

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

In June 2008, the Emerging Issues Task Force (“EITF”) issued guidance, codified within Accounting Standards Codification (“ASC”) 260, Earnings Per Share, that addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share. The guidance is effective for financial statements issued for fiscal years beginning after

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December 15, 2008. The implementation of this guidance, effective October 1, 2009, did not have a material impact on the Company's consolidated financial statements.

In December 2008, the Financial Accounting Standards Board ("FASB") issued guidance, codified within ASC 715, Compensation - Retirement Benefits, that provides guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. The disclosures about plan assets required by the guidance must be provided for fiscal years ending after December 15, 2009. The implementation of this guidance, effective for the fiscal year ending September 30, 2010, did not have a material impact on the Company's consolidated financial statements.

In October 2009, the FASB issued Accounting Standards Update ("ASU") 2009-16, Transfers and Servicing (Topic 860) - Accounting for Transfers of Financial Assets. This Update amends the Codification for the issuance of FASB Statement No. 166, Accounting for Transfers of Financial Assets-an amendment of FASB Statement No. 140. The amendments in this Update improve financial reporting by eliminating the exceptions for qualifying special-purpose entities from the consolidation guidance and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets. In addition, the amendments require enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. Comparability and consistency in accounting for transferred financial assets will also be improved through clarifications of the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting. This Update is effective at the start of a reporting entity's first fiscal year beginning after November 15, 2009. Early application is not permitted. The Company is currently reviewing the effect this new guidance will have on its consolidated financial statements.

In October 2009, the FASB issued ASU 2009-17, Consolidations (Topic 810) - Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities. This Update amends the Codification for the issuance of FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R). The amendments in this Update replace the quantitative-based risks and rewards calculation for determining which reporting entity, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which reporting entity has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. An approach that is expected to be primarily qualitative will be more effective for identifying which reporting entity has a controlling financial interest in a variable interest entity. The amendments in this Update also require additional disclosures about a reporting entity's involvement in variable interest entities, which will enhance the information provided to users of financial statements. This Update is effective at the start of a reporting entity's first fiscal year beginning after November 15, 2009. Early application is not permitted. The Company is currently reviewing the effect this new guidance will have on its consolidated financial statements.

The FASB has issued ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. This ASU requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Codification Subtopic 820-10. The FASB's objective is to improve these disclosures and, thus, increase the transparency in financial reporting. Specifically, ASU 2010-06 amends Codification Subtopic 820-10 to now require: (1) a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and (2) in the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity should present separately information about purchases, sales, issuances, and settlements. In addition, ASU

2010-06 clarifies the requirements of the following existing disclosures: (1) for purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and (2) a reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Early adoption is permitted. The Company is currently reviewing the effect this new guidance will have on its consolidated financial statements.

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The FASB has issued ASU 2010-09, Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements. The amendments in the ASU remove the requirement for an SEC filer to disclose a date through which subsequent events have been evaluated in both issued and revised financial statements. Revised financial statements include financial statements revised as a result of either correction of an error or retrospective application of U.S. GAAP. The FASB also clarified that if the financial statements have been revised, then an entity that is not an SEC filer should disclose both the date that the financial statements were issued or available to be issued and the date the revised financial statements were issued or available to be issued. The FASB believes these amendments remove potential conflicts with the SEC’s literature. All of the amendments in the ASU were effective upon issuance (February 24, 2010) except for the use of the issued date for conduit debt obligors. That amendment is effective for interim or annual periods ending after June 15, 2010. The amendments did not have a material impact on the Company’s consolidated financial statements.

The FASB issued ASU 2010-11, Derivatives and Hedging (Topic 815): Scope Exception Related to Embedded Credit Derivatives. The FASB believes this ASU clarifies the type of embedded credit derivative that is exempt from embedded derivative bifurcation requirements. Specifically, only one form of embedded credit derivative qualifies for the exemption - one that is related only to the subordination of one financial instrument to another. As a result, entities that have contracts containing an embedded credit derivative feature in a form other than such subordination may need to separately account for the embedded credit derivative feature. The amendments in the ASU are effective for each reporting entity at the beginning of its first fiscal quarter beginning after June 15, 2010. Early adoption is permitted at the beginning of each entity’s first fiscal quarter beginning after March 5, 2010. The ASU did not have a material impact on the Company’s consolidated financial statements.

The FASB issued ASU 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, in an effort to help investors assess the credit risk of a company’s receivables portfolio and the adequacy of its allowance for credit losses held against the portfolios by expanding credit risk disclosures. This ASU requires more information about the credit quality of financing receivables in the disclosures to financial statements, such as aging information and credit quality indicators. The amendments in this Update apply to all public and nonpublic entities with financing receivables. Financing receivables include loans and trade accounts receivable. Short-term trade accounts receivable, receivables measured at fair value or lower of cost or fair value, and debt securities are exempt from these disclosure amendments. The amendments require disclosures as of the end of a reporting period effective for periods ending on or after December 15, 2010. The amendments that require disclosures about activity that occurs during a reporting period are effective for periods beginning on or after December 15, 2010. The Company is currently reviewing the effect this new guidance will have on its consolidated financial statements.

NOTE C – STOCK-BASED COMPENSATION

The Company follows Statement of Financial Accounting Standards (“SFAS”) No. 123R, “Share-Based Payments”, now codified as ASC 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.

At the annual meeting held on February 12, 2007, stockholders of the Company approved the Magyar Bancorp, Inc. 2006 Equity Incentive Plan. On March 1, 2007, directors, senior officers and certain employees of the Company were granted in aggregate 217,826 stock options and 103,479 shares of restricted stock.

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

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option grants were estimated using the Black-Scholes option-pricing model. Since there is 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 provides 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.

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 two-year period ended September 30, 2010:

|  | Number of<br>Stock Options | Weighted<br>Average<br>Exercise Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Aggregate<br>Intrinsic<br>Value |
|--|----------------------------|---------------------------------------|---|---------------------------------|
| Balance at September 30, 2008 and 2009 | 217,826                    | \$ 14.61                              |   |                                 |
| Granted                                | -                          | -                                     |   |                                 |
| Exercised                              | -                          | -                                     |   |                                 |
| Forfeited                              | (29,550 )                  | 14.61                                 |   |                                 |
| Balance at September 30, 2010          | 188,276                    | \$ 14.61                              | 6.4 years   | \$ -                            |
| Exercisable at September 30, 2010      | 120,846                    | \$ 14.61                              | 6.4 years   | \$ -                            |

No stock options were granted or exercised during the years ended September 30, 2010 and 2009.

The following is a summary of the status of the Company's non-vested restricted shares as of September 30, 2010 and 2009, and changes during the year ended September 30, 2010:

|                               | Number of<br>Stock<br>Awards | Weighted<br>Average<br>Grant Date<br>Fair Value |
|-------------------------------|------------------------------|---|
| Balance at September 30, 2008 | 83,783                       | \$ 14.51  |
| Granted                       | -                            | -   |
| Vested                        | (20,893)                     | 14.51   |

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|                               |          |          |
|-------------------------------|----------|----------|
| Forfeited                     | -        | -        |
| Balance at September 30, 2009 | 62,890   | 14.51    |
| Granted                       | 15,000   | 4.50     |
| Vested                        | (15,700) | 14.51    |
| Forfeited                     | (16,800) | 13.77    |
| Balance at September 30, 2010 | 45,390   | \$ 11.45 |



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Stock option and stock award expenses included with compensation expense were \$162,000 and \$190,000, respectively, for the year ended September 30, 2010, and \$162,000 and \$303,000, respectively, for the year ended September 30, 2009. The Company had no other stock-based compensation plans as of September 30, 2010, except as disclosed below.

On April 27, 2007 the Company announced its first stock repurchase program and authorized the repurchase of up to 5% of its publicly-held outstanding shares of common stock, or approximately 130,927 shares. The Company completed its first stock repurchase program of 130,927 shares in November 2007 and announced a second repurchase program of up to 5% of its publicly-held outstanding shares of common stock, or 129,924 shares in November 2007. Pursuant to the second repurchase program, the Company had repurchased 66,970 shares of its common stock at an average cost of \$9.39 per share through September 30, 2009 (no shares were repurchased in the current year). Under the second stock repurchase program, 62,954 shares of the 129,924 shares authorized remained available for repurchase. One of the Company's intended uses of the repurchased shares is to satisfy awards granted under the 2006 Equity Incentive Plan.

The Company has an Employee Stock Ownership Plan ("ESOP") for the benefit of employees who meet the eligibility requirements as defined in the plan. The ESOP trust purchased 217,863 shares of common stock in the open market using proceeds of a loan from the Company. The total cost of shares purchased by the ESOP trust was \$2.3 million, reflecting an average cost per share of \$10.58. The Bank will make cash contributions to the ESOP on an annual basis sufficient to enable the ESOP to make the required loan payments to the Company. The loan bears a variable interest rate that adjusts annually to Prime (3.25% at September 30, 2010) with principal and interest payable annually in equal installments over thirty years. The loan is secured by shares of the Company's stock.

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. The Company accounts for its ESOP in accordance with SOP 93-6, "Employer's Accounting for Employee Stock Ownership Plans", issued by the Accounting Standards Division of the American Institute of Certified Public Accountants ("AICPA"). As shares are released from collateral, the Company reports compensation expense equal to the current market price of the shares, and the shares become outstanding for earnings per share computations. The Company's contribution expense for the ESOP was \$55,000 for both years ended September 30, 2010 and 2009.

The following table presents the components of the ESOP shares as of September 30, 2010:

|   |         |
|---|---------|
| Unreleased shares at September 30, 2009                                 | 153,219 |
| Shares released for allocation during the year ended September 30, 2010 | 12,946  |
| Unreleased shares at September 30, 2010                                 | 140,273 |
| Total released shares   | 77,590  |
| Total ESOP shares   | 217,863 |

The aggregate fair value of the unreleased shares at September 30, 2010 was approximately \$498,000.

## NOTE D - INVESTMENT SECURITIES

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

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|  | Amortized<br>Cost | At September 30, 2010<br>Gross Unrealized Gains      Gross Unrealized Losses |          | Fair<br>Value |
|--|-------------------|--|----------|---------------|
|  |                   | (Dollars in thousands)   |          |               |
| Securities available for sale:                         |                   |  |          |               |
| Obligations of U.S. government agencies:               |                   |  |          |               |
| Mortgage backed securities - residential               | \$3,904           | \$-  | \$(26 )  | \$3,878       |
| Obligations of U.S. government-sponsored enterprises:  |                   |  |          |               |
| Mortgage-backed securities - residential               | 2,833             | 107  | -        | 2,940         |
| Mortgage backed securities - commercial                | 4,274             | -  | (4 )     | 4,270         |
| Debt securities  | 1,001             | 1  | -        | 1,002         |
| Private label mortgage-backed securities - residential | 2,362             | -  | (265 )   | 2,097         |
| Total securities available for sale                    | \$14,374          | \$108  | \$(295 ) | \$14,187      |
| Securities held to maturity:                           |                   |  |          |               |
| Obligations of U.S. government agencies:               |                   |  |          |               |
| Mortgage-backed securities - residential               | \$18,407          | \$401  | \$-      | \$18,808      |
| Mortgage-backed securities - commercial                | 1,725             | 22   | -        | 1,747         |
| Obligations of U.S. government-sponsored enterprises:  |                   |  |          |               |
| Mortgage backed securities - residential               | 17,880            | 425  | -        | 18,305        |
| Debt securities  | 4,499             | 35   | -        | 4,534         |
| Private label mortgage-backed securities - residential | 1,871             | 101  | (70 )    | 1,902         |
| Obligations of state and political subdivisions        | 97                | 5  | -        | 102           |
| Total securities held to maturity                      | \$44,479          | \$989  | \$(70 )  | \$45,398      |
|  |                   |  |          |               |
|  | Amortized<br>Cost | At September 30, 2009<br>Gross Unrealized Gains      Gross Unrealized Losses |          | Fair<br>Value |
|  |                   | (Dollars in thousands)   |          |               |
| Securities available for sale:                         |                   |  |          |               |
| Obligations of U.S. government-sponsored enterprises:  |                   |  |          |               |
| Mortgage-backed securities - residential               | \$10,703          | \$216  | \$(1 )   | \$10,918      |
| Debt securities  | 2,237             | 6  | -        | 2,243         |
| Private label mortgage-backed securities - residential | 5,227             | -  | (305 )   | 4,922         |
| Total securities available for sale                    | \$18,167          | \$222  | \$(306 ) | \$18,083      |
| Securities held to maturity:                           |                   |  |          |               |
| Obligations of U.S. government agencies:               |                   |  |          |               |
| Mortgage-backed securities - residential               | \$16,258          | \$12   | \$(378 ) | \$15,892      |
| Mortgage-backed securities - commercial                | 1,981             | 1  | (1 )     | 1,981         |
| Obligations of U.S. government-sponsored enterprises:  |                   |  |          |               |
| Mortgage backed securities - residential               | 22,757            | 215  | (50 )    | 22,922        |

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|  |          |       |          |          |
|--|----------|-------|----------|----------|
| Debt securities  | 8,020    | 43    | -        | 8,063    |
| Private label mortgage-backed securities - residential | 2,813    | 79    | -        | 2,892    |
| Obligations of state and political subdivisions        | 122      | 9     | -        | 131      |
| Corporate securities                                   | 4,000    | 116   | -        | 4,116    |
| Total securities held to maturity                      | \$55,951 | \$475 | \$(429 ) | \$55,997 |

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The contractual maturities of mortgage-backed securities generally exceed 20 years; however, the effective lives are expected to be shorter due to anticipated prepayments. The amortized cost and fair value of the Company's securities available-for-sale at September 30, 2010 are summarized in the following table:

|                                    | At September 30, 2010  |                  |
|------------------------------------|------------------------|------------------|
|                                    | Amortized              |                  |
|                                    | Cost                   | Fair Value       |
|                                    | (Dollars in thousands) |                  |
| Due within 1 year                  | \$ -                   | \$ -             |
| Due after 1 but within 5 years     | 1,001                  | 1,002            |
| Due after 5 but within 10 years    | -                      | -                |
| Due after 10 years                 | -                      | -                |
| <b>Total debt securities</b>       | <b>1,001</b>           | <b>1,002</b>     |
| <b>Mortgage-backed securities:</b> |                        |                  |
| Residential(1)                     | 9,099                  | 8,915            |
| Commercial(2)                      | 4,274                  | 4,270            |
| <b>Total</b>                       | <b>\$ 14,374</b>       | <b>\$ 14,187</b> |

(1) Mortgage-backed securities – residential include an amortized cost of \$3.9 million and a fair value of \$3.9 million for obligations of U.S. government agencies issued by the Government National Mortgage Association and obligations of U.S. government-sponsored enterprises issued by Federal National Mortgage Association and Federal Home Loan Mortgage Corporation which had an amortized cost of \$2.8 million and a fair value of \$2.9 million. Also included are residential mortgage backed securities issued by non-U.S. government agencies and government-sponsored enterprises with an amortized cost of \$2.4 million and fair value of \$2.1 million.

(2) Mortgage-backed securities – commercial include an amortized cost of \$4.3 million and a fair value of \$4.3 million for obligations of U.S. government-sponsored enterprises issued by the Federal National Mortgage Association.

The maturities of the debt securities and the mortgage-backed securities held to maturity at September 30, 2010 are summarized in the following table:

|                                    | At September 30, 2010  |              |
|------------------------------------|------------------------|--------------|
|                                    | Amortized              |              |
|                                    | Cost                   | Fair Value   |
|                                    | (Dollars in thousands) |              |
| Due within 1 year                  | \$ -                   | \$ -         |
| Due after 1 but within 5 years     | 97                     | 102          |
| Due after 5 but within 10 years    | 1,999                  | 2,008        |
| Due after 10 years                 | 2,500                  | 2,526        |
| <b>Total debt securities</b>       | <b>4,596</b>           | <b>4,636</b> |
| <b>Mortgage-backed securities:</b> |                        |              |
| Residential(1)                     | 38,158                 | 39,015       |

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|               |           |           |
|---------------|-----------|-----------|
| Commercial(2) | 1,725     | 1,747     |
| Total         | \$ 44,479 | \$ 45,398 |

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(1) Mortgage-backed securities – residential include an amortized cost of \$18.4 million and a fair value of \$18.8 million for obligations of U.S. government agencies issued by the Government National Mortgage Association and

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obligations of U.S. government-sponsored enterprises issued by Federal National Mortgage Association and Federal Home Loan Mortgage Corporation which had an amortized cost of \$17.9 million and a fair value of \$18.3 million. Also included are mortgage backed securities issued by non-U.S. government agencies and government-sponsored enterprises with an amortized cost of \$1.9 million and a fair value of \$1.9 million.

- (2) Mortgage-backed securities – commercial include an amortized cost of \$1.7 million and a fair value of \$1.7 million for obligations of U.S. government agencies issued by the Small Business Administration.

There were \$14.8 million and \$50.8 million in sales of securities from the available-for-sale portfolios during the years ended September 30, 2010 and 2009, respectively. The gross gains on sales of the available-for-sale securities totaled \$231,000 and \$1.5 million, respectively.

During the year ended September 30, 2010, the Company sold its only corporate security from the held-to-maturity portfolio. The issuer of the \$4.0 million bond was downgraded by a rating agency, which was considered evidence of a significant deterioration in the issuer's creditworthiness. The bond was sold for a gain of \$270,000. Management does not believe the sale of the bond affects its intent or ability to hold the remaining investment securities in the held to maturity portfolio until their maturity. There were no sales from the held-to-maturity portfolio during the year ended September 30, 2009.

As of September 30, 2010 and 2009, securities having an estimated fair value of approximately \$4,876,000 and \$5,685,000, respectively, were pledged to secure public deposits.

Details of securities with unrealized losses for the years ended September 30, 2010 and 2009 are as follows:

|   | Number<br>of<br>Securities | Less Than 12 Months |                      | September 30, 2010<br>12 Months Or Greater |                      | Total            |                      |
|---|----------------------------|---------------------|----------------------|--|----------------------|------------------|----------------------|
|   |                            | Fair<br>Value       | Unrealized<br>Losses | Fair<br>Value                              | Unrealized<br>Losses | Fair<br>Value    | Unrealized<br>Losses |
| (Dollars in thousands)                                      |                            |                     |                      |  |                      |                  |                      |
| Obligations of U.S.<br>government agencies:                 |                            |                     |                      |  |                      |                  |                      |
| Mortgage backed securities -<br>residential                 | 2                          | \$ 3,878            | \$ (26 )             | \$ -                                       | \$ -                 | \$ 3,878         | \$ (26 )             |
| Obligations of U.S.<br>government-sponsored<br>enterprises: |                            |                     |                      |  |                      |                  |                      |
| Mortgage backed<br>securities-commercial                    | 1                          | 4,270               | (4 )                 | -  | -                    | 4,270            | (4 )                 |
| Private label<br>mortgage-backed<br>securities-residential  | 3                          | -                   | -                    | 2,964                                      | (335 )               | 2,964            | (335 )               |
| <b>Total</b>  | <b>6</b>                   | <b>\$ 8,148</b>     | <b>\$ (30 )</b>      | <b>\$ 2,964</b>                            | <b>\$ (335 )</b>     | <b>\$ 11,112</b> | <b>\$ (365 )</b>     |

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|   | Number<br>of<br>Securities | Less Than 12 Months |                      | September 30, 2009<br>12 Months Or Greater |                      | Total         |                      |
|---|----------------------------|---------------------|----------------------|--|----------------------|---------------|----------------------|
|   |                            | Fair<br>Value       | Unrealized<br>Losses | Fair<br>Value                              | Unrealized<br>Losses | Fair<br>Value | Unrealized<br>Losses |
| (Dollars in thousands)                                      |                            |                     |                      |  |                      |               |                      |
| Obligations of U.S.<br>government agencies:                 |                            |                     |                      |  |                      |               |                      |
| Mortgage-backed securities                                  |                            |                     |                      |  |                      |               |                      |
| - residential   | 5                          | \$ 8,967            | \$ (379 )            | \$ -                                       | \$ -                 | \$ 8,967      | \$ (379 )            |
| Mortgage-backed securities                                  |                            |                     |                      |  |                      |               |                      |
| - commercial  | 2                          | -                   | -                    | 90   | (1 )                 | 90            | (1 )                 |
| Obligations of U.S.<br>government-sponsored<br>enterprises: |                            |                     |                      |  |                      |               |                      |
| Mortgage backed securities                                  |                            |                     |                      |  |                      |               |                      |
| - residential   | 5                          | 10,497              | (50 )                | -  | -                    | 10,497        | (50 )                |
| Private label<br>mortgage-backed securities                 |                            |                     |                      |  |                      |               |                      |
| - residential   | 3                          | 2,244               | (29 )                | 2,678                                      | (276 )               | 4,922         | (305 )               |
| Total   | 15                         | \$ 21,708           | \$ (458 )            | \$ 2,768                                   | \$ (277 )            | \$ 24,476     | \$ (735 )            |



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The investment securities listed above currently have fair values less than amortized cost and therefore contain unrealized losses. The Company evaluated these securities and determined that the decline in value was primarily related to fluctuations in the interest rate environment and were not related to any company or industry specific event. At September 30, 2010 and September 30, 2009, there were seven and fifteen investment securities with unrealized losses. The Company anticipates full recovery of amortized costs with respect to these securities. The Company does not intend to sell these securities and has determined that it is not more likely than not that the Company would be required to sell these securities prior to maturity or market price recovery. Management has considered factors regarding other than temporarily impaired securities and determined that there are no securities with impairment that is other than temporary as of September 30, 2010 and 2009.

## NOTE E - LOANS RECEIVABLE, NET

Loans receivable are comprised of the following:

|                                | September 30,          |                   |
|--------------------------------|------------------------|-------------------|
|                                | 2010                   | 2009              |
|                                | (Dollars in thousands) |                   |
| One-to four-family residential | \$ 165,462             | \$ 172,415        |
| Commercial real estate         | 116,222                | 105,764           |
| Construction                   | 57,086                 | 93,217            |
| Home equity lines of credit    | 22,823                 | 22,528            |
| Commercial business            | 33,676                 | 37,372            |
| Other                          | 13,277                 | 13,484            |
| <b>Total loans receivable</b>  | <b>408,546</b>         | <b>444,780</b>    |
| Net deferred loan costs        | 106                    | 24                |
| Allowance for loan losses      | (4,766 )               | (5,807 )          |
| <b>Loans receivable, net</b>   | <b>\$ 403,886</b>      | <b>\$ 438,997</b> |

Certain directors and executive officers of the Bank have loans with the Company. Such loans were made in the ordinary course of business at the Company's normal credit terms, including interest rate and collateralization, and do not represent more than a normal risk of collection. Total loans receivable from directors and executive officers, and affiliates thereof, were approximately \$6,437,000 and \$5,197,000 at September 30, 2010 and 2009, respectively. Total principal additions were approximately \$1,608,000 and total principal repayments were approximately \$368,000 for the year ended September 30, 2010.

At September 30, 2010 and 2009, the Company was servicing loans for others amounting to approximately \$14,900,000 and \$7,800,000, respectively. The Company held mortgage servicing rights in the amount of \$136,000 and \$103,000 at September 30, 2010 and 2009, respectively. Servicing loans for others generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors, and foreclosure processing. Loan servicing income is recorded on the cash basis and includes servicing fees from investors and certain charges collected

from borrowers, such as late payment fees. In connection with loans serviced for others, the Company held borrowers' escrow balances of approximately \$99,000 and \$66,000 at September 30, 2010 and 2009, respectively.

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The following summarizes the activity in the allowance for loan losses for the years ended September 30, 2010 and 2009:

|   | September 30,          |          |
|---|------------------------|----------|
|   | 2010                   | 2009     |
|   | (Dollars in thousands) |          |
| Balance, beginning of year                | \$ 5,807               | \$ 4,502 |
| Provision for loan loss charged to income | 2,729                  | 8,212    |
| Recoveries                                | 3                      | 3        |
| Charge-offs                               | (3,773 )               | (6,910 ) |
| Balance, end of year                      | \$ 4,766               | \$ 5,807 |

At September 30, 2010 and 2009, non-accrual loans had a total principal balance of approximately \$27,417,000 and \$33,484,000, respectively. The amount of interest income not recognized on non-accrual loans was approximately \$2.6 million and \$2.5 million for the years ended September 30, 2010 and 2009, respectively. At September 30, 2010 and September 30, 2009, there were no commitments to lend additional funds to borrowers whose loans are classified as non-accrual. At September 30, 2010 and 2009, loans ninety days or more delinquent and still accruing interest totaled \$583,000 and \$0, respectively.

The following is a summary of impaired loans:

|   | September 30,          |           |
|---|------------------------|-----------|
|   | 2010                   | 2009      |
|   | (Dollars in thousands) |           |
| Impaired loans for which an allowance for credit losses has been provided | \$ -                   | \$ -      |
| Impaired loans for which no allowance for credit losses has been provided | 28,002                 | 32,694    |
| Total impaired loans  | 28,002                 | 32,694    |
| Allowance on impaired loans   | -                      | -         |
| Net impaired loans  | \$ 28,002              | \$ 32,694 |

At September 30, 2010 there were no allowances for loan losses provided for the \$28.0 million in impaired loans because the Company has written these loans down to reflect the appraised value of collateral securing the loans. The average recorded investment in impaired loans was \$27,746,000 and \$25,604,000, no interest income was recognized while the loans were impaired, and no interest income was recognized using the cash basis method of accounting while these loans were impaired for the years ended September 30, 2010 and 2009, respectively.

The Company has interest-only mortgage loans with principal balances of \$16.5 million and \$19.6 million at September 30, 2010 and 2009, respectively. The average interest-only term on these loans is 10 years at which time these loans reset to fully amortize over 20 years, on average. As these loans are collateralized by residential real estate with an average original loan-to-value of 64.7%, management does not anticipate any losses on these loans as of September 30, 2010.

Total loans pledged as collateral against Federal Home Loan Bank of New York borrowings were \$116.5 million and \$130.6 million as of September 30, 2010 and 2009, respectively.

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## NOTE F - ACCRUED INTEREST RECEIVABLE

The following is a summary of accrued interest receivable:

|                             | September 30,          |          |
|-----------------------------|------------------------|----------|
|                             | 2010                   | 2009     |
|                             | (Dollars in thousands) |          |
| Loans                       | \$ 1,692               | \$ 1,783 |
| Investment securities       | 131                    | 257      |
| Mortgage-backed securities  | 127                    | 167      |
| Accrued interest receivable | \$ 1,950               | \$ 2,207 |

## NOTE G - PREMISES AND EQUIPMENT

Premises and equipment consist of the following:

|  | Estimated<br>Useful Lives | September 30,          |           |
|--|---------------------------|------------------------|-----------|
|  |                           | 2010                   | 2009      |
|  |                           | (Dollars in thousands) |           |
| Land   | Indefinite                | \$ 3,095               | \$ 3,095  |
| Buildings and improvements                     | 10-40 years               | 21,142                 | 20,656    |
| Furniture, fixtures and equipment              | 5-7 years                 | 3,373                  | 3,202     |
|  |                           | 27,610                 | 26,953    |
| Less accumulated depreciation and amortization |                           | (7,468 )               | (6,332 )  |
|  |                           | \$ 20,142              | \$ 20,622 |

For the years ended September 30, 2010 and 2009, depreciation expense included in occupancy expense amounted to approximately \$1,137,000 and \$1,117,000, respectively.

Hungaria Urban Renewal, LLC was formed in 2002 and its sole purpose was to purchase the land and construct the office building for which the Company is the primary tenant. During the period of construction, the Company had leased the land and building from the entity. The lease payments were structured to equal the debt service on the loans plus a nominal fee. The lease agreement contained an irrevocable purchase option allowing the Company to purchase the land and building from this entity for the aggregated outstanding indebtedness. The Company owns a 100% interest in Hungaria Urban Renewal, LLC, which has no other business other than owning the Bank's main office site. At September 30, 2010, Hungaria Urban Renewal, LLC accounted for approximately \$3,095,000, \$12,063,000, and \$527,000 of land, building, and furniture, fixtures and equipment, net of depreciation, respectively. At September 30, 2009, Hungaria Urban Renewal, LLC accounted for approximately \$3,095,000, \$12,407,000, and \$644,000 of land, building, and furniture, fixtures and equipment, net of depreciation, respectively.

NOTE H - OTHER REAL ESTATE OWNED

The Company held \$12.7 million of real estate owned properties at September 30, 2010 and \$5.6 million at September 30, 2009. The Company did not incur any write downs on these properties during the years ended September 30, 2010 and 2009. Further declines in real estate values may result in increased foreclosed real estate expense in the future. Routine holding costs are charged to expense as incurred and improvements to real estate owned that enhance the value of the real estate are capitalized.

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## NOTE I - DEPOSITS

A summary of deposits by type of account follows (in thousands):

|                        | September 30,          |            |
|------------------------|------------------------|------------|
|                        | 2010                   | 2009       |
|                        | (Dollars in thousands) |            |
| Demand accounts        | \$ 37,298              | \$ 35,221  |
| Savings accounts       | 61,867                 | 57,864     |
| NOW accounts           | 51,473                 | 49,456     |
| Money market accounts  | 89,279                 | 85,535     |
| Certificate of deposit | 156,528                | 187,289    |
| Retirement accounts    | 31,487                 | 33,152     |
|                        | \$ 427,932             | \$ 448,517 |

The aggregate amount of deposit accounts with a minimum denomination of \$100,000 was approximately \$227,836,000 and \$227,694,000 at September 30, 2010 and 2009, respectively. The aggregate amount of certificate deposits with balance of \$100,000 or more was \$81.8 million and \$88.9 million at September 30, 2010 and 2009, respectively.

At September 30, 2010, certificates of deposit (including retirement accounts) have contractual maturities as follows (in thousands):

| Year Ending<br>September<br>30, |            |
|---------------------------------|------------|
| 2011                            | \$ 97,517  |
| 2012                            | 41,179     |
| 2013                            | 11,582     |
| 2014                            | 27,318     |
| 2015                            | 10,419     |
|                                 | \$ 188,015 |

## NOTE J - BORROWINGS

## 1. Federal Home Loan Bank of New York Advances

Long term Federal Home Loan Bank of New York (FHLB NY) advances at September 30, 2010 and September 30, 2009 totaled approximately \$45,769,000 and \$55,127,000, respectively. The weighted average interest rate on advances outstanding at September 30, 2010 was 3.82%. The advances were collateralized by unencumbered qualified assets consisting of one-to-four family residential mortgage loans and investment securities. Advances are made

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pursuant to several different credit programs offered from time to time by the FHLB NY.

Long term FHLB NY advances as of September 30, 2010 mature as follows (in thousands):

| Year Ending<br>September<br>30, |           |
|---------------------------------|-----------|
| 2011                            | \$ 10,853 |
| 2012                            | 2,813     |
| 2013                            | 9,143     |
| 2014                            | 8,700     |
| 2015                            | 5,000     |
| Thereafter                      | 9,260     |
|                                 | \$ 45,769 |



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Additionally, the Company has established an Overnight Line of Credit arrangement with the FHLB NY. The total amount available under the line of credit is based on the amount of eligible collateral pledged to the FHLB NY. At September 30, 2010, the Company had available credit from the FHLB NY totaling \$48.7 million. Information concerning short-term arrangements with the FHLB NY is summarized as follows:

|   | September 30,          |           |
|---|------------------------|-----------|
|   | 2010                   | 2009      |
|   | (Dollars in thousands) |           |
| Balance at end of year                            | \$ -                   | \$ -      |
| Weighted average balance during the year          | 700                    | 12,541    |
| Weighted average interest rate at the end of year | n/a                    | n/a       |
| Maximum month-end balance during the year         | \$ 8,150               | \$ 42,350 |
| Average interest rate during the year             | 0.37 %                 | 0.70 %    |

## 2. Securities Sold Under Reverse Repurchase Agreements

Qualifying repurchase agreements are treated as financings and are reflected as a liability in the consolidated balance sheet. The Company had repurchase agreements of \$15,000,000 at September 30, 2010 and 2009, including \$10,000,000 at an interest rate of 4.92% maturing in July 2012 and \$5,000,000 at an interest rate of 3.83% maturing in December 2014. These agreements are collateralized by securities underlying the agreements and are held in safekeeping with the transaction's counter-party. At September 30, 2010, the fair value of the FHLB obligation and mortgage-backed investment security collateral for these agreements totaled approximately \$20,233,000.

## NOTE K – SERVICING POLICY

The Company originates and sells loans receivable secured by one-to-four family residential properties and commercial business loans guaranteed by the SBA. The Company has sold loans on a servicing retained basis and on a servicing released basis. Loans sold with servicing released and servicing retained during the year ended September 30, 2010 were \$0 and \$7.8 million, respectively. Loans sold with servicing released and servicing retained during the year ended September 30, 2009 were \$0.7 million and \$5.7 million, respectively. The Company accounts for sales in accordance with ASC 860, Transfers and Servicing. Upon sale, the receivables are removed from the balance sheet, mortgage servicing rights are recorded as an asset for servicing rights retained, and a gain on sale, if applicable, is recognized for the difference between the carrying value of the receivables and the sales proceeds, net of origination costs.

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

mortgage loans.

The Company services one-to-four family residential mortgage loans for investors in the secondary mortgage market, which are not included in the balance sheet. The Company's fee is a percentage of the principal balance and is recognized as income when received. At September 30, 2010 and 2009, we were servicing such sold loans in the amount of \$10.7 million and \$7.8 million, respectively. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent mortgagors, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans. Mortgage servicing rights are amortized in proportion to, and over the period of, estimated net servicing revenues and are included in other assets on the consolidated balance sheet. Activity in mortgage servicing rights during the years ended September 30, 2010 and 2009, are summarized as follows:

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|  | September 30,          |        |
|--|------------------------|--------|
|  | 2010                   | 2009   |
|  | (Dollars in thousands) |        |
| Beginning balance                        | \$ 103                 | \$ 14  |
| Origination of mortgage servicing rights | 59                     | 99     |
| Amortization                             | (26 )                  | (10 )  |
| Ending balance                           | \$ 136                 | \$ 103 |

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

The Company also services the SBA guaranteed portion of commercial business loans sold to investors in the secondary market, which are not included in the balance sheet. The Company's fee is a percentage of the principal balance and is recognized as income when received. At September 30, 2010, we were servicing SBA loans sold in the amount of \$4.2 million. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent mortgagors, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans.

## NOTE L - INCOME TAXES

The income tax expense is comprised of the following components for the years ended September 30, 2010 and 2009:

|                                    | September 30,          |       |
|------------------------------------|------------------------|-------|
|                                    | 2010                   | 2009  |
|                                    | (Dollars in thousands) |       |
| Current                            | \$ (273 )              | \$ 55 |
| Deferred                           | (3,468 )               | -     |
| Total income tax (benefit) expense | \$ (3,741 )            | \$ 55 |

A reconciliation of income tax at the statutory tax rate to the effective income tax expense for the years ended September 30, 2010 and 2009 is as follows:

|   | September 30,          |             |
|---|------------------------|-------------|
|   | 2010                   | 2009        |
|   | (Dollars in thousands) |             |
| Income tax expense (benefit) at statutory rate        | \$ 68                  | \$ (2,062 ) |
| Increase (decrease) resulting from:                   |                        |             |
| State income taxes, net of federal income tax benefit | 18                     | 37          |
| Tax-exempt income, net                                | (156 )                 | (189 )      |
| Nondeductible expenses                                | 2                      | 2           |
| Share based compensation                              | 34                     | 34          |

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|  |             |       |
|--|-------------|-------|
| Employee stock ownership plan              | (19 )       | (60 ) |
| Increase (decrease) in valuation allowance | (3,414 )    | 2,293 |
| Federal refunds from change in tax law     | (329 )      | -     |
| Other, net                                 | 55          | -     |
| Total income tax (benefit) expense         | \$ (3,741 ) | \$ 55 |

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The major sources of temporary differences and their deferred tax effect at September 30, 2010 and 2009 are as follows:

|   | September 30,          |          |
|---|------------------------|----------|
|   | 2010                   | 2009     |
|   | (Dollars in thousands) |          |
| Allowance for loan losses                                       | \$ 1,904               | \$ 2,332 |
| Deferred loan fees  | 840                    | 1,146    |
| Employee benefits   | 450                    | 607      |
| Charitable contributions  | 586                    | 582      |
| Net operating losses  | 2,041                  | 1,446    |
| Alternative minimum tax credit                                  | 260                    | -        |
| Capital loss disallowed   | -                      | 7        |
| Net unrealized losses, investment securities available-for-sale | 81                     | 44       |
| Unrealized loss, minimum pension liability                      | 400                    | 433      |
| Gross deferred tax asset  | 6,562                  | 6,597    |
| Depreciation  | (1,659 )               | (1,714 ) |
| Discount accretion on investments                               | (90 )                  | (67 )    |
| Unrealized gain, derivative contracts                           | (117 )                 | (237 )   |
| Gross deferred tax liability                                    | (1,866 )               | (2,018 ) |
| Net deferred tax asset  | 4,696                  | 4,579    |
| Valuation allowance   | (864 )                 | (4,339 ) |
| Net deferred tax asset, included in other assets                | \$ 3,832               | \$ 240   |

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences are deductible and carry forwards are available. Due to the uncertainty of the Company's ability to realize the benefit of certain deferred tax assets within statutory time limits, the net deferred tax assets are partially offset by a valuation allowance at September 30, 2010 and 2009.

The net change in the total valuation allowance for the year ended September 30, 2010 was a decrease of \$3,414,000. Based upon an assessment of current and projected future operations, management determined that a portion of the deferred tax valuation allowance was no longer necessary and the balance was reduced to \$864,000 at September 30, 2010. At September 30, 2010 the Company had approximately \$4.4 million of federal and \$9.1 million of state net operating loss carry forwards available to offset future taxable income for tax reporting purposes. The Federal net operating loss carry forward will begin to expire in 2028. The state net operating losses will expire in 2015, if not utilized.

Prior to 1996, savings banks that met certain definitions, tests and other conditions prescribed by the Internal Revenue Code were allowed to deduct, with limitations, a bad debt deduction computed as a percentage of taxable income before such deduction. Currently, the Company employs the direct charge-off method to account for bad debt. The company was required to switch from the reserve method because it now qualifies as a Large Bank as defined under Code Section 585, and is precluded from further using the reserve method.

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The Company is not required to provide a deferred tax liability for its tax loss reserve as of December 31, 1987 (the Base Year). The amount of this reserve on which no deferred taxes have been provided is approximately \$1,258,000. This reserve could be recognized as taxable income and create a current and/or deferred tax liability using the income tax rates then in effect if one of the following occur: (1) the Company's retained earnings represented by this reserve is used for purposes other than to absorb losses from bad debts, including dividends or distributions in liquidation, (2) the Company fails to meet the definitions, tests, or other conditions provided by the Internal Revenue Code for a qualified savings and loan association, or (3) there is a change in the Federal tax law. Deferred tax liabilities have been recorded for tax loss reserves in excess of book reserves recorded after the Base Year.

## NOTE M - PENSION PLAN

On January 26, 2006, the Company's defined-benefit pension plan was frozen and amended to eliminate future benefit accruals after February 15, 2006.

The Company had a noncontributory defined benefit pension plan covering all eligible employees. Plan assets are invested in six diversified investment funds of the Pentegra Retirement Trust (the Trust), a no load series open-ended mutual fund. The Trust has been given discretion by the Plan Sponsor to determine the appropriate strategic asset allocation versus plan liabilities, as governed by the Trust's Statement of Investment Objectives and Guidelines (the Guidelines).

The long-term investment objective is to be invested 65% in equity securities (equity mutual funds) and 35% in debt securities (bond mutual funds). If the plan is underfunded under the Guidelines, the bond fund portion will be temporarily increased to 50% in order to lessen asset value volatility. When the plan is no longer underfunded, the bond fund portion will be decreased back to 35%. Asset rebalancing is performed at least annually, with interim adjustments made when the investment mix varies more than 5% from the target (i.e., a 10% target range). Risk/volatility is further managed by the distinct investment objectives of each of the Trust funds and the diversification within each fund.

The following table sets forth the plan's funded status and amounts recognized in the Company's consolidated balance sheet at September 30, 2010 and September 30, 2009.

|  | At September 30,       |          |
|--|------------------------|----------|
|  | 2010                   | 2009     |
|  | (Dollars in thousands) |          |
| Actuarial present value of benefit obligations | \$ 3,527               | \$ 3,421 |
| Change in benefit obligations                  |                        |          |
| Projected benefit obligation, beginning        | \$ 3,421               | \$ 2,685 |
| Interest cost                                  | 184                    | 196      |
| Actuarial loss                                 | 28                     | 660      |
| Annuity payments and lump sum distributions    | (106 )                 | (120 )   |
| Projected benefit obligation, end              | \$ 3,527               | \$ 3,421 |

|   |             |             |
|---|-------------|-------------|
| Change in plan assets                         |             |             |
| Fair value of assets, beginning               | \$ 2,089    | \$ 2,119    |
| Actual return on plan assets                  | 216         | 100         |
| Administrative expense                        | (11 )       | (10 )       |
| Employer contributions                        | 133         | -           |
| Annuity payments and lump sum distributions   | (106 )      | (120 )      |
| Fair value of assets, end                     | \$ 2,321    | \$ 2,089    |
| Funded status included with other liabilities | \$ (1,206 ) | \$ (1,332 ) |



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Net pension cost for the years ended September 30, 2010 and 2009 included the following components:

|   | September 30,          |        |
|---|------------------------|--------|
|   | 2010                   | 2009   |
|   | (Dollars in thousands) |        |
| Service cost benefits earned during the year  | \$ -                   | \$ -   |
| Interest cost on projected benefit obligation | 184                    | 196    |
| Expected return on plan assets                | (156 )                 | (160 ) |
| Amortization of unrecognized net loss         | 62                     | 9      |
| Net Pension Cost                              | \$ 90                  | \$ 45  |

For 2010, the weighted average discount rate used in determining the actuarial present value of the projected benefit obligation was 5.125%. For 2009, the weighted average discount rate used in determining the actuarial present value of the projected benefit obligation was 5.50%.

The long-term rate-of-return on assets assumption was set based on historical returns earned by equities and fixed income securities, adjusted to reflect expectations of future returns as applied to the plan's target allocation of asset classes. The expected long-term rate of return on assets was determined to be 7.50% for 2010 and 2009.

#### Current Asset Allocation

The Company's pension plan weighted-average asset allocations at September 30, 2010 and 2009, by asset category are as follows:

|                                     | September 30, |   |      |   |
|-------------------------------------|---------------|---|------|---|
|                                     | 2010          |   | 2009 |   |
| Equity securities                   | 58            | % | 53   | % |
| Debt securities (Bond Mutual Funds) | 40            | % | 47   | % |
| Other (Money Market Fund)           | 2             | % | 0    | % |
| Total                               | 100           | % | 100  | % |

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

#### Expected Contributions

For the fiscal year ending September 30, 2011, the Company expects to contribute \$80,000 to the Plan.

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## Estimated Future Benefit Payments

The following benefit payments, which reflect approximate expected future service, as appropriate, are expected to be paid as follows (in thousands):

|              |         |
|--------------|---------|
| 10/01/2010 - |         |
| 09/30/2011   | \$ 148  |
| 10/01/2011 - |         |
| 09/30/2012   | 149     |
| 10/01/2012 - |         |
| 09/30/2013   | 149     |
| 10/01/2013 - |         |
| 09/30/2014   | 150     |
| 10/01/2014 - |         |
| 09/30/2015   | 153     |
| 10/01/2015 - |         |
| 09/30/2020   | 844     |
|              | \$1,593 |

Included in the funded status of the pension plan at September 30, 2010 and 2009, are actuarial losses of \$1,001,000 and \$1,084,000, respectively. These amounts are included, net of related income tax effects of \$400,000 and \$433,000, respectively, in the accumulated other comprehensive loss component of stockholders' equity. During the year ending September 30, 2011, approximately \$54,000 of the actuarial losses is expected to be amortized into net periodic pension expense.

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

|                   | September 30,<br>2010 | Fair Value Measurements at Reporting Date<br>Using:                              |   |  |
|-------------------|-----------------------|--|---|--|
|                   |                       | Quoted<br>Prices<br>in Active<br>Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| (In thousands)    |                       |  |   |  |
| Investments       |                       |  |   |  |
| Equity Securities | \$ 1,346              | \$ 1,346   | \$ -  | \$ -   |
| Debt Securities   | 928                   | -  | 928   | -  |
| Total Investments | \$ 2,274              | \$ 1,346   | \$ 928  | \$ -   |

Equity securities are reported at fair value in the table above utilizing exchange quoted prices in active markets for identical instruments (Level 1 inputs). Debt securities are reported at fair value utilizing Level 2 inputs. The prices for these instruments are derived from market quotations and matrix pricing obtained through an independent pricing service. Such fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

#### NOTE N - NONQUALIFIED COMPENSATION PLAN

The Company maintains a Supplemental Executive Retirement Plan (SERP) for the benefit of its senior officers. In addition, the Company also adopted voluntary Deferred Income and Emeritus Plans on behalf of its directors and those directors elected by the Board as "Director Emeritus." The SERP provides the Company with the opportunity to supplement the retirement income of selected officers to achieve equitable wage replacement at retirement while the Deferred Income Plan provides participating directors with an opportunity to defer all or a portion of their fees into a tax

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deferred accumulation account for future retirement. The Director Emeritus Plan enables the Company to reward its directors for longevity of service in consideration of their availability and consultation at a sum equal to a fifteen year certain annuity based on fifty-percent of last years' Board fee. The SERP is based upon achieving retirement benefits equal to two percent multiplied by the number of service years multiplied by the final salary.

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

The Company funds the plans through a modified endowment contract. Income recorded for the plans represents life insurance income as recorded based on the projected increases in cash surrender values of life insurance policies. As of September 30, 2010 and 2009, the Life Insurance Contracts had cash surrender values of approximately \$9,306,000 and \$10,996,000, respectively.

The Company is recording benefit costs so that the cost of each participant's retirement benefits is being expensed and accrued over the participant's active employment so as to result in a liability at retirement date equal to the present value of the benefits expected to be provided. As of September 30, 2010 and 2009, the Company has accrued approximately \$0 and \$521,000, respectively, for benefits under these Plans.

NOTE O - 401(K) EMPLOYEE CONTRIBUTION PLAN

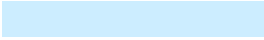
The Company has a defined contribution 401(k) plan covering all employees, as defined under the plan document. Employees may contribute to the plan, as defined under the plan document, and the Company can make discretionary contributions. The Company did not make a contribution to the plan for the year ended September 30, 2010. The Company contributed \$113,000 to the plan for the year ended September 30, 2009.

NOTE P - COMMITMENTS

1. Lease Commitments

Approximate future minimum payments under non-cancelable operating leases are due as follows for the years ending September 30 (in thousands):

|            |       |
|------------|-------|
| 2011       | \$477 |
| 2012       | 341   |
| 2013       | 335   |
| 2014       | 343   |
| 2015       | 343   |
| Thereafter | 4,819 |

  
\$6,658

Total rental expense was approximately \$513,000 and \$388,000 for the years ended September 30, 2010 and 2009, respectively.

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## 2. Contingencies

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

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

The Company uses derivative financial instruments, such as interest rate floors and collars, as part of its interest rate risk management. Interest rate caps and floors are agreements whereby one party agrees to pay or receive a floating rate of interest on a notional principal amount for a predetermined period of time if certain market interest rate thresholds are met. The Company considers the credit risk inherent in these contracts to be negligible.

As of September 30, 2010, the Company held one Prime-based interest rate floor. The counterparty in the transaction is Wachovia Bank, N.A. In accordance with cash flow hedge accounting, the amortization of the costs of the derivatives flowed through the Company's income statement as a reduction to loan interest income. In addition, all changes in fair value of the derivative contracts are recorded through other comprehensive income.

The table below shows the notional amount, strike and maturity date of each interest rate derivative contract as of September 30, 2010 and 2009.

|                        | Notional<br>Amount | Strike | Maturity<br>Date | Fair Value<br>at September 30, |        |
|------------------------|--------------------|--------|------------------|--------------------------------|--------|
|                        |                    |        |                  | 2010                           | 2009   |
| (Dollars in thousands) |                    |        |                  |                                |        |
| Interest rate floor    | \$ 5,000           | 7.25%  | 12/27/10         | \$ 51                          | \$ 234 |

In April 2008, the Company unwound a \$10 million interest rate collar with Lehman Brothers Special Financing Inc. and received an \$817,000 termination fee. The termination fee was netted against the book value of \$112,000, resulting in an unrealized gain of \$705,000. In accordance with US GAAP, the unrealized gain remained in other comprehensive income, net of deferred tax expense at September 30, 2008. The gain will be accreted to income over the previously contracted life of the interest rate collar, which is scheduled to mature June 24, 2013. At September 30, 2010, the carrying value of the unwound derivative was \$251,000, recorded as \$151,000 in accumulated other comprehensive loss, net of deferred tax of \$100,000. At September 30, 2009, the carrying value of the unwound derivative was \$400,000, recorded as \$240,000 in accumulated other comprehensive loss, net of deferred tax of \$160,000.

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments are commitments to extend credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheets.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

At September 30, 2010 and 2009, the Company had outstanding commitments (substantially all of which expire within one year) to originate residential mortgage loans, construction loans, commercial real estate and consumer loans. These commitments were comprised of fixed and variable rate loans.



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|   | September 30,          |           |
|---|------------------------|-----------|
|   | 2010                   | 2009      |
| Financial instruments whose contract amounts represent credit risk: | (Dollars in thousands) |           |
| Letters of credit   | \$ 2,048               | \$ 2,318  |
| Unused lines of credit  | 42,890                 | 35,859    |
| Fixed rate loan commitments   | 3,746                  | 3,863     |
| Variable rate loan commitments                                      | 100                    | 1,120     |
|   | \$ 48,784              | \$ 43,160 |

**NOTE R - 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, Fair Value Measurements and Disclosures, 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.

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.

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## Derivative financial instruments

The Company uses interest rate floors to manage its interest rate risk. The valuation of these instruments is based on a third party value of interest rate derivative contracts which are based on the fair market value using market prices provided from brokers trading in such instruments, less their carrying value. The carrying value is the price paid for the derivative contracts less prior amortization of the price paid.

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 at September 30, 2010 and 2009 (in thousands):

|                       | Total     | Fair Value at September 30, 2010 |           |         |
|-----------------------|-----------|----------------------------------|-----------|---------|
|                       |           | Level 1                          | Level 2   | Level 3 |
| Investment securities |           |                                  |           |         |
| available-for-sale    | \$ 14,187 | \$ -                             | \$ 14,187 | \$ -    |
| Derivatives           | 51        | -                                | 51        | -       |
|                       | \$ 14,238 | \$ -                             | \$ 14,238 | \$ -    |

|                       | Total     | Fair Value at September 30, 2009 |           |         |
|-----------------------|-----------|----------------------------------|-----------|---------|
|                       |           | Level 1                          | Level 2   | Level 3 |
| Investment securities |           |                                  |           |         |
| available-for-sale    | \$ 18,083 | \$ -                             | \$ 18,083 | \$ -    |
| Derivatives           | 234       | -                                | 234       | -       |
|                       | \$ 18,317 | \$ -                             | \$ 18,317 | \$ -    |

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

## Mortgage Servicing Rights

Mortgage Servicing Rights (MSR's) are carried at the lower of amortized cost or estimated fair value. The estimated fair value of MSRs is determined through a calculation of future cash flows, incorporating estimates of assumptions market participants would use in determining fair value including market discount rates, prepayment speeds, servicing income, servicing costs, default rates and other market driven data, including the market's perception of future interest rate movements and, as such, are classified as Level 3. No valuation write-downs were made to MSR's during the years ended September 30, 2010 and 2009.

## 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 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

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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**

Other real estate owned is carried at lower of cost or estimated fair value less disposal costs. The estimated fair value of the real estate is determined through current appraisals, and adjusted as necessary, by management, to reflect current market conditions. As such, other real estate owned is generally classified as Level 3. No valuation write-downs were made to other real estate owned during the years ended September 30, 2010 and 2009.

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 September 30, 2010 and 2009 (in thousands):

|                       | Total     | Level 1 | Level 2 | Level 3   |
|-----------------------|-----------|---------|---------|-----------|
| Impaired loans:       |           |         |         |           |
| At September 30, 2010 | \$ 16,193 | \$ -    | \$ -    | \$ 16,193 |
| At September 30, 2009 | \$ 19,051 | \$ -    | \$ -    | \$ 19,051 |

Impaired loans reported in the above table consist of 21 loans with aggregate loan balances of \$24.9 million reduced by \$8.7 million in cumulative charge-offs (\$3.8 million in the current year) and \$0 in specific loss reserves. These loans are all collateralized by real estate.

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

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

Investment securities: For investment securities, fair values are calculated individually based on level 2 prices obtained from an independent nationally recognized pricing service.

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

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

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 costs to terminate the letters of credit. Fair values of unrecognized financial instruments including commitments to extend

credit and the fair value of letter of credit are considered immaterial.

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

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

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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.

Interest rate derivatives: The third party value of interest rate derivative contracts are based on the fair market value using market prices provided from brokers trading in such instruments, less their carrying value. The carrying value is the price paid for the derivative contracts less prior amortization of the price paid.

The carrying amounts and estimated fair values of the Company's financial instruments at September 30, 2010 and 2009 are as follows:

|  | 2010                   |                   | September 30,<br>2009 |                   |
|--|------------------------|-------------------|-----------------------|-------------------|
|  | Carrying<br>Value      | Fair<br>Value     | Carrying<br>Value     | Fair<br>Value     |
|  | (Dollars in thousands) |                   |                       |                   |
| <b>Financial assets</b>                |                        |                   |                       |                   |
| Investment securities                  | \$ 58,666              | \$ 59,585         | \$ 74,034             | \$ 74,080         |
| Loan, net of allowance for loan losses | 403,886                | 408,790           | 438,997               | 445,099           |
| Bank owned insurance policies          | 9,306                  | 9,306             | 10,996                | 10,996            |
| <b>Financial liabilities</b>           |                        |                   |                       |                   |
| <b>Deposits</b>                        |                        |                   |                       |                   |
| Demand, NOW and money market savings   | 239,917                | 239,917           | 228,076               | 228,076           |
| Certificates of deposit                | 188,015                | 191,636           | 220,441               | 213,569           |
| <b>Total deposits</b>                  | <b>\$ 427,932</b>      | <b>\$ 431,553</b> | <b>\$ 448,517</b>     | <b>\$ 441,645</b> |
| <b>Borrowings</b>                      | <b>\$ 60,769</b>       | <b>\$ 64,068</b>  | <b>\$ 70,127</b>      | <b>\$ 73,868</b>  |
| Interest rate derivatives              | \$ 51                  | \$ 51             | \$ 234                | \$ 234            |

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.

**NOTE 5 - REGULATORY CAPITAL**

The Company and Bank are required to maintain minimum amounts of capital to total "risk-weighted" assets, as defined by the banking regulators. Failure to meet minimum capital requirements can initiate certain mandatory and possibly

discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and Bank must meet specific capital guidelines that involve quantitative measures of the Company's and Bank's assets, liabilities, and certain off balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and Bank to maintain minimum ratios of Leverage Capital, Tier I and Total Risk-based Capital. The following table sets forth the Company's and the Bank's actual and required capital levels under those measures:



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|  | Actual    |         | For capital adequacy purposes |         | To be well-capitalized under prompt corrective action provisions |          |
|--|-----------|---------|-------------------------------|---------|--|----------|
|  | Amount    | Ratio   | Amount                        | Ratio   | Amount   | Ratio    |
| (Dollars in thousands)                   |           |         |                               |         |  |          |
| As of September 30, 2010                 |           |         |                               |         |  |          |
| Total Capital (to risk-weighted assets)  |           |         |                               |         |  |          |
| Magyar Bancorp, Inc.                     | \$ 49,289 | 13.41 % | \$ 29,373                     | ≥ 8.00% | N/A  | N/A      |
| Magyar Bank                              | 46,243    | 12.59 % | 29,402                        | ≥ 8.00% | \$ 36,752  | ≥ 10.00% |
| Tier 1 Capital (to risk-weighted assets) |           |         |                               |         |  |          |
| Magyar Bancorp, Inc.                     | 44,695    | 12.16 % | 14,686                        | ≥ 4.00% | N/A  | N/A      |
| Magyar Bank                              | 41,649    | 11.34 % | 14,701                        | ≥ 4.00% | 22,051   | ≥ 6.00%  |
| Tier 1 Capital (to average assets)       |           |         |                               |         |  |          |
| Magyar Bancorp, Inc.                     | 44,695    | 8.37 %  | 21,356                        | ≥ 4.00% | N/A  | N/A      |
| Magyar Bank                              | 41,649    | 7.80 %  | 21,360                        | ≥ 4.00% | 26,700   | ≥ 5.00%  |
| As of September 30, 2009                 |           |         |                               |         |  |          |
| Total Capital (to risk-weighted assets)  |           |         |                               |         |  |          |
| Magyar Bancorp, Inc.                     | 45,429    | 11.18 % | 32,447                        | ≥ 8.00% | N/A  | N/A      |
| Magyar Bank                              | 44,492    | 10.97 % | 32,505                        | ≥ 8.00% | 40,631   | ≥ 10.00% |
| Tier 1 Capital (to risk-weighted assets) |           |         |                               |         |  |          |
| Magyar Bancorp, Inc.                     | 40,350    | 9.93 %  | 16,224                        | ≥ 4.00% | N/A  | N/A      |
| Magyar Bank                              | 39,413    | 9.72 %  | 16,252                        | ≥ 4.00% | 24,379   | ≥ 6.00%  |
| Tier 1 Capital (to average assets)       |           |         |                               |         |  |          |
| Magyar Bancorp, Inc.                     | 40,350    | 7.37 %  | 21,896                        | ≥ 4.00% | N/A  | N/A      |
| Magyar Bank                              | 39,413    | 7.20 %  | 21,896                        | ≥ 4.00% | 27,369   | ≥ 5.00%  |

On April 22, 2010, Magyar Bank entered into Consent Order agreements with the Federal Deposit Insurance Corporation and the New Jersey Department of Banking and Insurance which required the Bank to develop a written capital plan that details the manner in which the Bank will achieve a Tier 1 capital as a percentage of the Bank's total assets of at least 8%, and total qualifying capital as a percentage of risk-weighted assets of at least 12%.

A capital plan was submitted on a timely basis to the Federal Deposit Insurance Corporation and New Jersey Department of Banking of Insurance detailing the manner and timing in which the Bank will achieve the capital ratios. As of September 30, 2010, Magyar Bank's Tier 1 capital as a percentage of the Bank's total assets was 7.80% and the

total qualifying capital as a percentage of risk-weighted assets was 12.59%. Both capital ratios exceeded those projected in the submitted capital plan at September 30, 2010.

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

On October 1, 2009, the Company was notified that the audit practice of Beard Miller Company LLP (“Beard”) an independent registered public accounting firm, was combined with ParenteBeard, LLC (“ParenteBeard”) in a transaction pursuant to which Beard combined its operations with ParenteBeard and certain of the professional staff and partners of Beard joined ParenteBeard either as employees or partners of ParenteBeard. On October 1, 2009, Beard resigned as the auditors of the Company and, on October 2, 2009, with the approval of the Audit Committee of the Company’s Board of Directors, ParenteBeard was engaged as its independent registered public accounting firm.

ITEM 9A. Controls and Procedures

Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

There has been no change in Magyar Bancorp, Inc.'s internal control over financial reporting during Magyar Bancorp, Inc.'s fourth quarter of fiscal year 2010 that has materially affected, or is reasonably likely to materially affect, Magyar Bancorp, Inc.'s internal control over financial reporting.

Report by Management on Internal Control over Financial Reporting

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

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

Magyar Bancorp, Inc.'s management assessed the effectiveness of the Company's internal control over financial reporting as of September 30, 2010. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on our assessment, we believe that, as of September 30, 2010, the Company's internal control over financial reporting was effective based on those criteria.

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

ITEM 9B.

Other Information

None.

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PART III

ITEM 10. Directors, Executive Officers, and Corporate Governance

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

Information concerning directors and executive officers of Magyar Bancorp, Inc. is incorporated herein by reference from our definitive Proxy Statement related to our 2011 Annual Meeting of Stockholders (the "Proxy Statement"), specifically the section captioned "Proposal I—Election of Directors."

ITEM 11. Executive Compensation

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

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

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

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

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

ITEM 14. Principal Accountant Fees and Services

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

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## ITEM 15.

## Exhibits and Financial Statement Schedules

|             |  |
|-------------|--|
| 3.1         | Certificate of Incorporation of Magyar Bancorp, Inc.*  |
| 3.2         | Bylaws of Magyar Bancorp, Inc.*  |
| 4           | Form of Common Stock Certificate of Magyar Bancorp, Inc.*  |
| 10.1        | Form of Employee Stock Ownership Plan*   |
| 10.2        | Restated Executive Supplemental Retirement Income Agreement for Elizabeth E. Hance**   |
| 10.3        | Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Elizabeth E. Hance**  |
| 10.4        | Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Joseph J. Lukacs, Jr.**   |
| 10.5        | Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Salvatore J. Romano**   |
| 10.6        | Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Joseph A. Yelencsics**  |
| 10.7        | Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Edward C. Stokes, III**   |
| 10.8        | Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Martin A. Lukacs**  |
| 10.9        | Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Thomas Lankey**   |
| 10.10       | Restated Director Supplemental Retirement Income and Deferred Compensation Agreement for Andrew G. Hodulik**   |
| 10.11       | Form of Employment Agreement for Elizabeth E. Hance*   |
| 10.12       | Form of Change in Control Agreement for Executive Officers*  |
| 10.13       | Executive Supplemental Retirement Income Agreement for Jon Ansari**  |
| 10.14       | Executive Supplemental Retirement Income Agreement for John Fitzgerald**   |
| 10.15       | Separation Agreement, between Magyar Bancorp and Elizabeth E. Hance***   |
| 10.16       | Consent Order Between the Federal Deposit Insurance Corporation and Magyar Bank****  |
| 10.17       | Consent Order Between the New Jersey Department of Banking and Insurance and Magyar Bank****   |
|             | 14 Code of Ethics*****   |
| 21          | Subsidiaries of Registrant*  |
| 23          | Consent of Experts and Counsel   |
| 23.1        | Consent of Experts and Counsel   |
| <u>31.1</u> | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| <u>31.2</u> | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| <u>32</u>   | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                |

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

\*\*Incorporated by reference to the Annual Report on Form 10-KSB of Magyar Bancorp, Inc. (file no. 000-51726), originally filed with the Securities and Exchange Commission on December 29, 2006.

\*\*\*Incorporated by reference to the Quarterly Report on Form 10-Q of Magyar Bancorp, Inc. (file no. 000-51726), originally filed with the Securities and Exchange Commission on February 16, 2010.

\*\*\*\*Incorporated by reference to the Current Report on Form 8-K of Magyar Bancorp, Inc. (file no. 000-51726), originally filed with the Securities and Exchange Commission on April 23, 2010.

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Available on our website [www.magbank.com](http://www.magbank.com)

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SIGNATURES

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

MAGYAR BANCORP, INC.

December 17, 2010  
Date

By: /s/ John S. Fitzgerald  
John S. Fitzgerald  
President and Chief Executive Officer  
(Duly Authorized Representative)

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

| Signatures   | Title   | Date              |
|--|---|-------------------|
| /s/ John S. Fitzgerald<br>John S. Fitzgerald               | President and Chief Executive Officer<br>(Principal Executive Officer)                            | December 17, 2010 |
| /s/ Jon R. Ansari<br>Jon R. Ansari                         | Senior Vice President and Chief Financial Officer<br>(Principal Financial and Accounting Officer) | December 17, 2010 |
| /s/ Joseph J. Lukacs, Jr.<br>Joseph J. Lukacs, Jr., D.M.D. | Chairman of the Board   | December 17, 2010 |
| /s/ Andrew Hodulik<br>Andrew Hodulik                       | Director  | December 17, 2010 |
| /s/ Thomas Lankey<br>Thomas Lankey                         | Director  | December 17, 2010 |
| /s/ Martin A. Lukacs<br>Martin A. Lukacs, D.M.D.           | Director  | December 17, 2010 |
| /s/ Salvatore J. Romano<br>Salvatore J. Romano, Ph.D.      | Director  | December 17, 2010 |
| /s/ Joseph A. Yelencsics<br>Joseph A. Yelencsics           | Director  | December 17, 2010 |
| /s/ Edward C. Stokes<br>Edward C. Stokes                   | Director  | December 17, 2010 |

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