

Melrose Bancorp, Inc.  
Form 10-Q  
November 13, 2014  
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**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

**Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2014**

**OR**

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

**Commission File No. 001-36702**

**Melrose Bancorp, Inc.**

**(Exact name of registrant as specified in its charter)**

|   |  |
|---|--|
| <b>Maryland</b><br><b>(State or other jurisdiction of</b>   | <b>47-0967316</b><br><b>(I.R.S. Employer</b> |
| <b>incorporation or organization)</b>   | <b>Identification Number)</b>                |
| <b>638 Main Street, Melrose, Massachusetts</b><br><b>(Address of Principal Executive Offices)</b> | <b>02176</b><br><b>Zip Code</b>              |
| <b>(781) 665-2500</b>   |  |

**(Registrant's telephone number)**

N/A

**(Former name or former address, if changed since last report)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such requirements for the past 90 days. YES  NO

Indicate by check mark whether the registrant has submitted electronically 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 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)

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Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if smaller reporting company)

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

As of November 10, 2014, 2,829,579 shares of the Registrant's common stock, par value \$0.01 per share, were issued and outstanding.

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**EXPLANATORY NOTE**

Melrose Bancorp, Inc., a Maryland corporation (the **Company** or the **Registrant** ), was formed in February 2014 to serve as the stock holding company for Melrose Cooperative Bank (the **Bank** ) as part of the **Bank** 's mutual-to-stock conversion. The conversion was consummated on October 21, 2014. As of September 30, 2014, the conversion had not been completed, and, as of that date, the Registrant had no assets or liabilities, and had not conducted any business other than that of an organizational nature. Accordingly, financial and other information of the **Bank** is included in this Quarterly Report.

Table of Contents**Part I. Financial Information****Item 1. Financial Statements**MELROSE COOPERATIVE BANK AND SUBSIDIARYCONSOLIDATED BALANCE SHEETS(In Thousands)

|  | September 30,<br>2014<br>(unaudited) | December 31,<br>2013 |
|--|--------------------------------------|----------------------|
| Cash and due from banks  | \$ 24,506                            | \$ 11,957            |
| Money market funds   | 1,178                                | 876                  |
| Federal funds sold   | 6,309                                | 4,162                |
| Cash and cash equivalents  | 31,993                               | 16,995               |
| Investments in available-for-sale securities (at fair value)   | 39,283                               | 39,694               |
| Federal Home Loan Bank stock, at cost  | 437                                  | 409                  |
| Loans, net of allowance for loan losses of \$520 as of September 30, 2014 (unaudited), and \$510 as of December 31, 2013 | 132,284                              | 131,995              |
| Premises and equipment, net  | 1,276                                | 1,247                |
| Co-operative Central Bank deposit  | 881                                  | 881                  |
| Bank-owned life insurance  | 4,952                                | 4,847                |
| Accrued interest receivable  | 380                                  | 408                  |
| Other assets   | 1,212                                | 199                  |
| <b>Total assets</b>  | <b>\$ 212,698</b>                    | <b>\$ 196,675</b>    |
| <b><u>LIABILITIES AND EQUITY</u></b>   |                                      |                      |
| <b>Deposits:</b>   |                                      |                      |
| Noninterest-bearing  | \$ 11,225                            | \$ 9,574             |
| Interest-bearing   | 178,740                              | 165,936              |
| Total deposits   | 189,965                              | 175,510              |
| Deferred tax liability, net  | 634                                  | 332                  |
| Other liabilities  | 471                                  | 256                  |
| <b>Total liabilities</b>   | <b>191,070</b>                       | <b>176,098</b>       |
| <b>Equity:</b>   |                                      |                      |
| Retained earnings  | 20,525                               | 20,004               |
| Accumulated other comprehensive income   | 1,103                                | 573                  |

|                              |            |            |
|------------------------------|------------|------------|
| Total equity                 | 21,628     | 20,577     |
| Total liabilities and equity | \$ 212,698 | \$ 196,675 |

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

Table of ContentsMELROSE COOPERATIVE BANK AND SUBSIDIARYCONSOLIDATED STATEMENTS OF INCOME(In Thousands)

|   | Three Months Ended September 30, |              | Nine Months Ended September 30, |              |
|---|----------------------------------|--------------|---------------------------------|--------------|
|   | 2014                             | 2013         | 2014                            | 2013         |
|   | (unaudited)                      |              |                                 |              |
| <b>Interest and dividend income:</b>                                    |                                  |              |                                 |              |
| Interest and fees on loans  | \$ 1,153                         | \$ 1,166     | \$ 3,444                        | \$ 3,542     |
| <b>Interest and dividends on securities</b>                             |                                  |              |                                 |              |
| Taxable   | 173                              | 194          | 538                             | 544          |
| Other interest  | 4                                | 7            | 12                              | 19           |
| <b>Total interest and dividend income</b>                               | <b>1,330</b>                     | <b>1,367</b> | <b>3,994</b>                    | <b>4,105</b> |
| <b>Interest expense:</b>  |                                  |              |                                 |              |
| Interest on deposits  | 317                              | 396          | 958                             | 1,172        |
| <b>Total interest expense</b>   | <b>317</b>                       | <b>396</b>   | <b>958</b>                      | <b>1,172</b> |
| <b>Net interest and dividend income</b>                                 | <b>1,013</b>                     | <b>971</b>   | <b>3,036</b>                    | <b>2,933</b> |
| Provision for loan losses   |                                  | 5            | 10                              | 36           |
| <b>Net interest and dividend income after provision for loan losses</b> | <b>1,013</b>                     | <b>966</b>   | <b>3,026</b>                    | <b>2,897</b> |
| <b>Noninterest income:</b>  |                                  |              |                                 |              |
| Fees and service charges  | 30                               | 26           | 87                              | 68           |
| Gain on sales of loans  |                                  | 25           | 19                              | 88           |
| Income on bank-owned life insurance                                     | 22                               | 19           | 65                              | 58           |
| Other income  | 2                                | 4            | 11                              | 30           |
| <b>Total noninterest income</b>   | <b>54</b>                        | <b>74</b>    | <b>182</b>                      | <b>244</b>   |
| <b>Noninterest expense:</b>   |                                  |              |                                 |              |
| Salaries and employee benefits  | 522                              | 529          | 1,516                           | 1,508        |
| Occupancy expense   | 69                               | 73           | 212                             | 219          |
| Equipment expense   | 19                               | 12           | 44                              | 37           |
| Data processing expense   | 70                               | 94           | 223                             | 230          |
| Advertising expense   | 30                               | 28           | 89                              | 87           |
| Printing and supplies   | 5                                | 7            | 24                              | 22           |
| FDIC assessment   | 30                               | 27           | 84                              | 76           |
| Audits and examinations   | 42                               | 27           | 99                              | 85           |
| Other professional services   | 16                               | 16           | 53                              | 38           |



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|                                  |        |        |        |        |
|----------------------------------|--------|--------|--------|--------|
| Other expense                    | 35     | 28     | 106    | 101    |
| Total noninterest expense        | 838    | 841    | 2,450  | 2,403  |
| Income before income tax expense | 229    | 199    | 758    | 738    |
| Income tax expense               | 69     | 63     | 237    | 234    |
| Net income                       | \$ 160 | \$ 136 | \$ 521 | \$ 504 |

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

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MELROSE COOPERATIVE BANK AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In Thousands)

|  | Three Months Ended September 30, |        | Nine Months Ended September 30, |        |
|--|----------------------------------|--------|---------------------------------|--------|
|  | 2014                             | 2013   | 2014                            | 2013   |
|  |                                  |        | (unaudited)                     |        |
| Net income   | \$ 160                           | \$ 136 | \$ 521                          | \$ 504 |
| Other comprehensive (loss) income, net of tax:                         |                                  |        |                                 |        |
| Net change in unrealized holding gain on available-for-sale securities | (50)                             | 12     | 530                             | (109)  |
| Comprehensive income   | \$ 110                           | \$ 148 | \$ 1,051                        | \$ 395 |

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

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(Unaudited)

|  | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Total     |
|--|----------------------|---|-----------|
| Balance, December 31, 2012             | \$ 19,275            | \$ 565  | \$ 19,840 |
| Net income                             | 504                  |   | 504       |
| Other comprehensive loss net of tax    |                      | (109)   | (109)     |
| Balance, September 30, 2013            | \$ 19,779            | \$ 456  | \$ 20,235 |
| Balance, December 31, 2013             | \$ 20,004            | \$ 573  | \$ 20,577 |
| Net income                             | 521                  |   | 521       |
| Other comprehensive income, net of tax |                      | 530   | 530       |
| Balance, September 30, 2014            | \$ 20,525            | \$ 1,103  | \$ 21,628 |

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

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|  | Nine Months Ended September 30, |          |
|--|---------------------------------|----------|
|  | 2014                            | 2013     |
|  | (unaudited)                     |          |
| <b>Cash flows from operating activities:</b>   |                                 |          |
| Net income   | \$ 521                          | \$ 504   |
| <b>Adjustments to reconcile net income to net cash (used in) provided by operating activities:</b> |                                 |          |
| Amortization of securities, net of accretion   | 3                               | 12       |
| Provision for loan losses  | 10                              | 36       |
| Change in net deferred loan costs/fees   | 19                              | 5        |
| Loans originated for sale  | (1,519)                         | (3,670)  |
| Proceeds from sales of loans   | 1,538                           | 3,977    |
| Gain on sales of loans   | (19)                            | (88)     |
| Gain on sale of other real estate owned  |                                 | (12)     |
| Depreciation and amortization  | 74                              | 62       |
| Decrease in accrued interest receivable  | 28                              | 28       |
| (Increase) decrease in other assets  | (949)                           | 222      |
| Increase in accrued expenses and other liabilities   | 215                             | 376      |
| Increase in income tax receivable  | (64)                            | (101)    |
| Deferred tax benefit   | (10)                            | (23)     |
| Income on bank-owned life insurance  | (65)                            | (58)     |
| <br>   |                                 |          |
| Net cash (used in) provided by operating activities  | (218)                           | 1,270    |
| <br>   |                                 |          |
| <b>Cash flows from investing activities:</b>   |                                 |          |
| Purchases of available-for-sale securities   | (1,250)                         | (9,695)  |
| Proceeds from maturities and calls of available-for-sale securities                                | 2,500                           | 2,000    |
| Purchase of Federal Home Loan Bank stock   | (28)                            | (19)     |
| Loan originations and principal collections, net   | (318)                           | (5,646)  |
| Recoveries on loans previously charged off   |                                 | 1        |
| Capital expenditures   | (103)                           | (48)     |
| Proceeds from sale of other real estate owned  |                                 | 217      |
| Premiums paid on bank-owned life insurance   | (40)                            | (41)     |
| <br>   |                                 |          |
| Net cash provided by (used in) investing activities  | 761                             | (13,231) |
| <br>   |                                 |          |
| <b>Cash flows from financing activities:</b>   |                                 |          |
| Net increase in demand deposits, NOW and savings accounts  | 22,123                          | 2,128    |

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|  |           |           |
|--|-----------|-----------|
| Net (decrease) increase in time deposits             | (7,668)   | 9,324     |
| Net cash provided by financing activities            | 14,455    | 11,452    |
| Net increase (decrease) in cash and cash equivalents | 14,998    | (509)     |
| Cash and cash equivalents at beginning of period     | 16,995    | 23,052    |
| Cash and cash equivalents at end of period           | \$ 31,993 | \$ 22,543 |

Supplemental disclosures:

|                   |        |          |
|-------------------|--------|----------|
| Interest paid     | \$ 960 | \$ 1,172 |
| Income taxes paid | 311    | 360      |

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

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**Melrose Cooperative Bank and Subsidiary**

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Notes to Consolidated Financial Statements (unaudited)

**NOTE 1 - NATURE OF OPERATIONS**

Melrose Cooperative Bank (the Bank) is a state chartered co-operative bank which was incorporated in 1890 and is headquartered in Melrose, Massachusetts. The Bank operates its business from one banking office located in Melrose, Massachusetts. The Bank is engaged principally in the business of attracting deposits from the general public and investing those deposits in residential real estate loans, and in consumer and small business loans.

**NOTE 2 - ACCOUNTING POLICIES**

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and Rule 10-01 of Regulation S-X. Information included herein as of September 30, 2014 and for the interim periods ended September 30, 2014 and 2013 is unaudited; however, in the opinion of management, all adjustments considered necessary for a fair presentation have been included and were of a normal recurring nature. The results of operations for the three and nine months ended September 30, 2014 and 2013 are not necessarily indicative of the results that may be expected for the entire year or any other interim period.

The accounting and reporting policies of the Bank and its subsidiary conform to accounting principles generally accepted in the United States of America and predominant practices within the banking industry. The consolidated financial statements were prepared using the accrual basis of accounting. The significant accounting policies are summarized below to assist the reader in better understanding the consolidated financial statements and other data contained herein.

**USE OF ESTIMATES:**

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, impairment of securities and deferred income taxes.

**BASIS OF PRESENTATION:**

The consolidated financial statements include the accounts of the Bank and its wholly-owned subsidiary, MCBSC, Inc., which is used to hold investment securities. All significant intercompany accounts and transactions have been eliminated in the consolidation.

**CASH AND CASH EQUIVALENTS:**

For purposes of reporting cash flows, cash and cash equivalents include cash, amounts due from banks, money market funds and federal funds sold.

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As of September 30, 2014 (unaudited), the Bank has total cash and cash equivalents in the following banks:

|                   |   |
|-------------------|---|
| Eastern Bank      | \$10,161,000 which represents approximately 47.0% of total equity |
| State Street Bank | \$2,993,000 which represents approximately 13.8% of total equity  |

As of December 31, 2013, the Bank has total cash and cash equivalents in the following banks:

|                   |  |
|-------------------|--|
| Eastern Bank      | \$7,258,000 which represents approximately 35.3% of total equity |
| State Street Bank | \$2,994,000 which represents approximately 14.6% of total equity |

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SECURITIES:

Investments in debt securities are adjusted for amortization of premiums and accretion of discounts computed so as to approximate the interest method. Gains or losses on sales of investment securities are computed on a specific identification basis.

The Bank classifies debt and equity securities into one of three categories: held-to-maturity, available-for-sale, or trading. These security classifications may be modified after acquisition only under certain specified conditions. In general, securities may be classified as held-to-maturity only if the Bank has the positive intent and ability to hold them to maturity. Trading securities are defined as those bought and held principally for the purpose of selling them in the near term. All other securities must be classified as available-for-sale.

Held-to-maturity securities are measured at amortized cost in the consolidated balance sheets. Unrealized holding gains and losses are not included in earnings or in a separate component of equity; they are merely disclosed in the notes to the consolidated financial statements.

Available-for-sale securities are carried at fair value on the consolidated balance sheets. Unrealized holding gains and losses are not included in earnings, but are reported as a net amount (less expected tax) in a separate component of equity until realized.

Trading securities are carried at fair value on the consolidated balance sheets. Unrealized holding gains and losses for trading securities are included in earnings.

For any debt security with a fair value less than its amortized cost basis, the Bank will determine whether it has the intent to sell the debt security or whether it is more likely than not it will be required to sell the debt security before the recovery of its amortized cost basis. If either condition is met, the Bank will recognize a full impairment charge to earnings. For all other debt securities that are considered other-than-temporarily impaired and do not meet either condition, the credit loss portion of impairment will be recognized in earnings as realized losses. The other-than-temporary impairment related to all other factors will be recorded in other comprehensive income.

Declines in marketable equity securities below their cost that are deemed other-than-temporary are reflected in earnings as realized losses.

As a member of the Federal Home Loan Bank of Boston (FHLB), the Bank is required to invest in \$100 par value stock of the FHLB. The FHLB capital structure mandates that members must own stock as determined by their Total Stock Investment Requirement which is the sum of a member's Membership Stock Investment Requirement and Activity-Based Stock Investment Requirement. The Membership Stock Investment Requirement is calculated as 0.35% of a member's Stock Investment Base, subject to a minimum investment of \$10,000 and a maximum investment of \$25,000,000. The Stock Investment Base is an amount calculated based on certain assets held by a member that are reflected on call reports submitted to applicable regulatory authorities. The Activity-Based Stock Investment Requirement is calculated as 3.0% for overnight advances, 4.0% for FHLB advances with original terms to maturity of two days to three months and 4.5% for other advances plus a percentage of advance commitments, 0.5% of standby letters of credit issued by the FHLB and 4.5% of the value of intermediated derivative contracts. Management evaluates the Bank's investment in FHLB stock for other-than-temporary impairment at least on a quarterly basis and more frequently when economic or market conditions warrant such evaluation. Based on its most recent analysis of



the FHLB as of September 30, 2014 (unaudited) and December 31, 2013, management deems its investment in FHLB stock to be not other-than-temporarily impaired.

**LOANS HELD-FOR-SALE:**

Loans held-for-sale are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to income.

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### **LOANS:**

Loans receivable that management has the intent and ability to hold until maturity or payoff are reported at their outstanding principal balances adjusted for amounts due to borrowers on unadvanced loans, any charge-offs, the allowance for loan losses and any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans.

Loan origination and commitment fees and certain direct origination costs are deferred, and the net amount amortized as an adjustment of the related loan's yield. The Bank is amortizing these amounts over the contractual lives of the related loans.

Residential real estate loans are generally placed on nonaccrual when reaching 90 days past due or in process of foreclosure. All closed-end consumer loans 90 days or more past due and any equity line in the process of foreclosure are placed on nonaccrual status. Secured consumer loans are written down to realizable value and unsecured consumer loans are charged off upon reaching 120 or 180 days past due depending on the type of loan. Commercial real estate loans and commercial business loans and leases which are 90 days or more past due are generally placed on nonaccrual status, unless secured by sufficient cash or other assets immediately convertible to cash. When a loan has been placed on nonaccrual status, previously accrued and uncollected interest is reversed against interest on loans. A loan can be returned to accrual status when collectibility of principal is reasonably assured and the loan has performed for a period of time, generally six months.

Cash receipts of interest income on impaired loans are credited to principal to the extent necessary to eliminate doubt as to the collectibility of the net carrying amount of the loan. Some or all of the cash receipts of interest income on impaired loans is recognized as interest income if the remaining net carrying amount of the loan is deemed to be fully collectible. When recognition of interest income on an impaired loan on a cash basis is appropriate, the amount of income that is recognized is limited to that which would have been accrued on the net carrying amount of the loan at the contractual interest rate. Any cash interest payments received in excess of the limit and not applied to reduce the net carrying amount of the loan are recorded as recoveries of charge-offs until the charge-offs are fully recovered.

### **ALLOWANCE FOR LOAN LOSSES:**

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

#### *General Component:*

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following loan segments: residential real estate, commercial real estate, construction, commercial and consumer. Management uses a rolling average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and

underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and local economic trends and conditions. There were no changes in the Bank's policies or methodology pertaining to the general component of the allowance for loan losses during the nine months ended September 30, 2014 (unaudited) and the year ended December 31, 2013.

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The qualitative factors are determined based on the various risk characteristics of each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

**Residential real estate:** The Bank generally does not originate loans with a loan-to-value ratio greater than 80 percent and does not grant subprime loans. Loans with loan-to-value greater than 80% require private mortgage insurance. All loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. Loans in this segment also include construction loans and home equity loans and lines of credit. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment.

**Commercial real estate:** Loans in this segment are primarily income-producing properties throughout Massachusetts. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on the credit quality in this segment. Loans in this segment also include loans secured by multifamily dwellings. Management periodically obtains rent rolls and continually monitors the cash flows of these loans.

**Construction loans:** Loans in this segment primarily include speculative real estate development loans for which payment is derived from sale of the property. Credit risk is affected by cost overruns, time to sell at an adequate price, and market conditions.

**Consumer loans:** Loans in this segment are generally secured and repayment is dependent on the credit quality of the individual borrower. Loans in this segment include auto loans and other consumer loans.

### *Allocated Component:*

The allocated component relates to loans that are classified as impaired. Impairment is measured on a loan by loan basis for commercial, commercial real estate and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows (or collateral value) of the impaired loan is lower than the carrying value of that loan. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential real estate loans for impairment disclosures, unless such loans are subject to a troubled debt restructuring agreement.

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

The Bank periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring (TDR). All TDRs are initially classified as impaired.

### *Unallocated Component:*

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

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**PREMISES AND EQUIPMENT:**

Land is carried at cost. Buildings and equipment are stated at cost, less accumulated depreciation and amortization. Cost and related allowances for depreciation and amortization of premises and equipment retired or otherwise disposed of are removed from the respective accounts with any gain or loss included in income or expense. Depreciation and amortization are calculated principally on the straight-line method over the estimated useful lives of the assets. Estimated lives are 15 to 40 years for buildings and 3 to 10 years for furniture and equipment.

**OTHER REAL ESTATE OWNED AND IN-SUBSTANCE FORECLOSURES:**

Other real estate owned includes properties acquired through foreclosure and properties classified as in-substance foreclosures in accordance with ASC 310-40, *Receivables - Troubled Debt Restructuring by Creditors*. These properties are carried at the lower of cost or estimated fair value less estimated costs to sell. Any writedown from cost to estimated fair value required at the time of foreclosure or classification as in-substance foreclosure is charged to the allowance for loan losses. Expenses incurred in connection with maintaining these assets, subsequent writedowns and gains or losses recognized upon sale are included in other expense.

In accordance with ASC 310-10-35, *Receivables - Overall - Subsequent Measurement*, the Bank classifies loans as in-substance repossessed or foreclosed if the Bank receives physical possession of the debtor's assets regardless of whether formal foreclosure proceedings take place.

**BANK-OWNED LIFE INSURANCE:**

The Bank has purchased insurance policies on the lives of certain directors, executive officers and employees. Bank-owned life insurance policies are reflected on the consolidated balance sheets at cash surrender value. Changes in net cash surrender value of the policies, as well as insurance proceeds received, are reflected in non-interest income on the consolidated statements of income and are not subject to income taxes.

**ADVERTISING:**

The Bank directly expenses costs associated with advertising as they are incurred.

**INCOME TAXES:**

The Bank recognizes income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are established for the temporary differences between the accounting basis and the tax basis of the Bank's assets and liabilities at enacted tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled.

**FAIR VALUES OF FINANCIAL INSTRUMENTS:**

Accounting Standards Codification (ASC) 825, *Financial Instruments*, requires that the Bank disclose the estimated fair value for its financial instruments. Fair value methods and assumptions used by the Bank in estimating its fair value disclosures are as follows:

Cash and cash equivalents: The carrying amounts reported in the balance sheet for cash and cash equivalents approximate those assets' fair values.

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Securities: Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Loans held-for-sale: Fair values of loans held-for-sale are based on commitments on hand from investors or prevailing market prices.

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Loans receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Accrued interest receivable: The carrying amount of accrued interest receivable approximates its fair value.

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

Off-balance sheet instruments: The fair value of commitments to originate loans is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments and the unadvanced portion of loans, fair value also considers the difference between current levels of interest rates and the committed rates.

**RECENT ACCOUNTING PRONOUNCEMENTS:**

In February 2013, the Financial Accounting Standards Board (FASB) issued ASU 2013-04, Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date. The objective of the amendments in this ASU is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, except for obligations addressed within existing guidance in GAAP. Examples of obligations within the scope of this ASU include debt arrangements, other contractual obligations, and settled litigation and judicial rulings. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The guidance should be applied retrospectively to all prior periods presented for those obligations resulting from joint and several liability arrangements within the ASU scope that exist at the beginning of an entity's fiscal year of adoption. The adoption of this guidance did not have a material impact on the Bank's consolidated financial statements.

In April 2013, the FASB issued ASU 2013-07, Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting. The amendments in this ASU are being issued to clarify when an entity should apply the liquidation basis of accounting. The guidance provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. Additionally, the amendments require disclosures about an entity's plan for liquidation, the methods and significant assumptions used to measure assets and liabilities, the type and amount of costs and income accrued, and the expected duration of the liquidation process. The amendments are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted. The adoption of this guidance did not have an impact on the Bank's consolidated financial statements.

In July 2013, the FASB issued ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The amendments in this ASU provide guidance for the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendments in this ASU are expected to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits and will better reflect the manner in which an entity would settle at the reporting date any additional income



taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The amendments apply to all entities that have unrecognized tax benefits when a net

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operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this guidance did not have a material impact on the Bank's results of operations or financial position.

In January 2014, the FASB issued ASU 2014-01, *Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects*. The amendments in this ASU apply to all reporting entities that invest in qualified affordable housing projects through limited liability entities that are flow-through entities for tax purposes as follows:

1. For reporting entities that meet the conditions for and that elect to use the proportional amortization method to account for investments in qualified affordable housing projects, all amendments in this ASU apply.
2. For reporting entities that do not meet the conditions for or that do not elect the proportional amortization method, only the amendments in this ASU that are related to disclosures apply.

The amendments in this ASU permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). For those investments in qualified affordable housing projects not accounted for using the proportional amortization method, the investment should be accounted for as an equity method investment or a cost method investment in accordance with Subtopic 970-323. The amendments in this ASU should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this ASU are effective for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The Bank does not expect that the adoption of this ASU will have an impact on its consolidated financial statements.

In January 2014, the FASB issued ASU 2014-04, *Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. The objective of the amendments in this ASU is to reduce diversity by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this ASU using either a modified retrospective transition method or a prospective transition method. The Bank does

not expect that the adoption of this ASU will have a material impact on its consolidated financial statements.

In March, 2014, the FASB issued ASU No. 2014-07, Consolidation (Topic 810): Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements. Under the ASU, a private company lessee (the reporting entity) could elect, when certain conditions exist, not to apply the variable interest entity (VIE) guidance to a lessor entity under common control. The guidance in this ASU is effective for annual reporting periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. Early application would be permitted. Entities that elect the alternative to not apply VIE guidance would use a full retrospective approach to apply it. The Bank does not expect that the adoption of this ASU will have an impact on its consolidated financial statements.

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In April 2014, the FASB issued ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. This ASU changes the criteria for reporting discontinued operations and modifies related disclosure requirements. The new guidance is effective on a prospective basis for fiscal years beginning on or after December 15, 2014, and interim periods within those years. The adoption of this guidance is not expected to have a material impact on the Bank's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The objective of this ASU is to clarify principles for recognizing revenue and to develop a common revenue standard for GAAP and International Financial Reporting Standards. The guidance in this ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in this update are effective for annual reporting periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Early application is permitted, but no earlier than an annual reporting period beginning after December 15, 2016, including interim periods within that reporting period. The Bank is currently reviewing this ASU to determine if it will have an impact on its consolidated financial statements.

In June 2014, the FASB issued ASU 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. The amendments in this ASU require two accounting changes. First, the amendments in this ASU change the accounting for repurchase-to-maturity transactions to secured borrowing accounting. Second, for repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. This ASU also includes new disclosure requirements. The accounting changes in this Update are effective for the first interim or annual period beginning after December 15, 2014. An entity is required to present changes in accounting for transactions outstanding on the effective date as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. Earlier application for a public business entity is prohibited; however, all other entities may elect to apply the requirements for interim periods beginning after December 15, 2014. The adoption of this guidance is not expected to have a material impact on the Bank's consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could be Achieved after the Requisite Service Period. The amendments in this ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718 as it relates to awards with performance conditions that affect vesting to account for such awards. This ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. Earlier adoption is permitted. ASU 2014-12 may be adopted either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements, and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying this update as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. The Bank is currently reviewing this ASU to determine if it will have an impact on its consolidated financial statements.



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In August 2014, the FASB issued ASU 2014-13, Consolidation (Topic 810): Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity. This ASU applies to entities that meet the following criteria:

1. they are required to consolidate a collateralized entity under the Variable Interest Entities guidance;
2. they measure all of the financial assets and the financial liabilities of that consolidated collateralized financing entity at fair value in the consolidated financial statements based on other FASB rules; and
3. those changes in fair value are reflected in earnings.

Under ASU 2014-13, entities that meet these criteria are provided an alternative under which they can choose to eliminate the difference between the fair value of financial assets and financial liabilities of a consolidated collateralized financing entity. If that alternative is not elected, then ASU 2014-13 indicates that the fair value of the financial assets and the fair value of the financial liabilities of the consolidated collateralized financing entity should be measured in accordance with ASC 820, Fair Value Measurement, and differences between the fair value of the financial assets and the financial liabilities of that consolidated collateralized financing entity should be reflected in earnings and attributed to the reporting entity in the consolidated statement of income or loss. The amendments in this ASU are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted as of the beginning of an annual period. The Bank anticipates that the adoption of this ASU will not have a material impact on its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-14, Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government - Guaranteed Mortgage Loans upon Foreclosure. The amendments in this ASU require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met:

1. the loan has a government guarantee that is not separable from the loan before foreclosure;
2. at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim; and
3. at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed.

Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in this ASU are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Bank anticipates that the adoption of this ASU will not have a material impact on its consolidated financial statements.



**Table of Contents****NOTE 3 - INVESTMENTS IN AVAILABLE-FOR-SALE SECURITIES**

Debt and equity securities have been classified in the consolidated balance sheets according to management's intent. The amortized cost basis of securities and their approximate fair values are as follows:

|  | Amortized<br>Cost<br>Basis | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--|----------------------------|------------------------------|-------------------------------|---------------|
| (In Thousands)                                 |                            |                              |                               |               |
| <b>September 30, 2014 (unaudited):</b>         |                            |                              |                               |               |
| U.S. Government and federal agency obligations | \$ 4,494                   | \$ 4                         | \$ 22                         | \$ 4,476      |
| Corporate bonds and notes                      | 15,246                     | 66                           | 40                            | 15,272        |
| Preferred stock                                | 3,000                      |                              | 156                           | 2,844         |
| Marketable equity securities                   | 14,661                     | 2,404                        | 374                           | 16,691        |
|  | \$ 37,401                  | \$ 2,474                     | \$ 592                        | \$ 39,283     |
| <b>December 31, 2013:</b>                      |                            |                              |                               |               |
| U.S. Government and federal agency obligations | \$ 4,992                   | \$ 9                         | \$ 40                         | \$ 4,961      |
| Corporate bonds and notes                      | 16,250                     | 84                           | 82                            | 16,252        |
| Preferred stock                                | 3,000                      |                              | 523                           | 2,477         |
| Marketable equity securities                   | 14,412                     | 2,084                        | 492                           | 16,004        |
|  | \$ 38,654                  | \$ 2,177                     | \$ 1,137                      | \$ 39,694     |



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The scheduled maturities of debt securities were as follows as of the dates indicated:

**September 30, 2014 (unaudited)**

|  | Fair<br>Value<br>(In Thousands) |
|--|---------------------------------|
| Due within one year                    | \$ 5,283                        |
| Due after one year through five years  | 14,465                          |
| Due after five years through ten years | 997                             |
| Due after ten years                    | 956                             |
| Preferred stock, no stated maturity    | 891                             |
|  | \$ 22,592                       |

**December 31, 2013**

|  | Fair<br>Value<br>(In Thousands) |
|--|---------------------------------|
| Due within one year                    | \$ 3,519                        |
| Due after one year through five years  | 17,694                          |
| Due after five years through ten years | 927                             |
| Due after ten years                    | 796                             |
| Preferred stock, no stated maturity    | 754                             |
|  | \$ 23,690                       |

The aggregate amortized cost basis and fair value of securities of issuers with a carrying value which exceeded 10% of equity were as follows as of September 30, 2014 (unaudited):

| Issuer  | Amortized      |               |
|---|----------------|---------------|
|   | Cost<br>Basis  | Fair<br>Value |
|   | (In Thousands) |               |
| Vanguard Total Stock Market Index Signal Fund | \$ 1,520       | \$ 2,778      |
| Vanguard 500 Index Signal Fund                | 1,356          | 2,484         |
| Prudential Short-Term Corporate Bond Fund     | 3,168          | 3,070         |

The aggregate amortized cost basis and fair value of securities of issuers with a carrying value which exceeded 10% of equity were as follows as of December 31, 2013:

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| Issuer  | Amortized  |            |
|---|------------|------------|
|   | Cost Basis | Fair Value |
| (In Thousands)                                |            |            |
| Vanguard Total Stock Market Index Signal Fund | \$ 1,485   | \$ 2,597   |
| Vanguard 500 Index Signal Fund                | 1,322      | 2,294      |
| Prudential Short-Term Corporate Bond Fund     | 3,105      | 3,036      |

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During the nine months ended September 30, 2014 and 2013 (unaudited), there were no sales of available-for-sale securities.

The Bank had no pledged securities as of September 30, 2014 (unaudited) and December 31, 2013.

The aggregate fair value and unrealized losses of securities that have been in a continuous unrealized loss position for less than twelve months and for twelve months or more, and are not other-than-temporarily impaired, are as follows:

|   | Less than 12<br>Months |                      | 12 Months or<br>Longer |                      | Total         |                      |
|---|------------------------|----------------------|------------------------|----------------------|---------------|----------------------|
|   | Fair<br>Value          | Unrealized<br>Losses | Fair<br>Value          | Unrealized<br>Losses | Fair<br>Value | Unrealized<br>Losses |
| (In Thousands)                                |                        |                      |                        |                      |               |                      |
| <b>September 30, 2014 (unaudited):</b>        |                        |                      |                        |                      |               |                      |
| U.S Government and federal agency obligations | \$ 1,493               | \$ 7                 | \$ 1,485               | \$ 15                | \$ 2,978      | \$ 22                |
| Corporate bonds and notes                     | 1,987                  | 6                    | 1,963                  | 34                   | 3,950         | 40                   |
| Preferred stock                               |                        |                      | 2,844                  | 156                  | 2,844         | 156                  |
| Marketable equity securities                  |                        |                      | 10,283                 | 374                  | 10,283        | 374                  |
| Total temporarily impaired securities         | \$ 3,480               | \$ 13                | \$ 16,575              | \$ 579               | \$ 20,055     | \$ 592               |
| <b>December 31, 2013:</b>                     |                        |                      |                        |                      |               |                      |
| U.S Government and federal agency obligations | \$ 3,453               | \$ 40                | \$                     | \$                   | \$ 3,453      | \$ 40                |
| Corporate bonds and notes                     | 6,404                  | 82                   |                        |                      | 6,404         | 82                   |
| Preferred stock                               | 2,477                  | 523                  |                        |                      | 2,477         | 523                  |
| Marketable equity securities                  | 1,113                  |                      | 9,999                  | 492                  | 11,112        | 492                  |
| Total temporarily impaired securities         | \$ 13,447              | \$ 645               | \$ 9,999               | \$ 492               | \$ 23,446     | \$ 1,137             |

**September 30, 2014 (unaudited)**

The Bank conducts periodic reviews of investment securities with unrealized losses to evaluate whether the impairment is other-than-temporary. The Bank's review for impairment generally includes a determination of the cause, severity and duration of the impairment; and an analysis of both positive and negative evidence available. The Bank also determines if it has the ability and intent to hold the investment for a period of time sufficient to allow for anticipated recovery to cost basis. Based on the Bank's recent review of securities in the investment portfolio, management deemed securities with unrealized losses as of September 30, 2014 (unaudited) to be temporarily impaired and has the ability and intent to hold these securities until recovery to cost basis occurs. A summary of this review is as follows.

Unrealized losses on U.S. Government and federal agency obligations amounted to \$22,000 and consisted of five securities. Unrealized losses on corporate bonds and notes amounted to \$40,000 and consisted of seven securities. The unrealized losses on these debt securities were individually all less than 2.5% of amortized cost basis, and the

unrealized losses were primarily due to changes in interest rates. In regard to corporate debt, the Bank also considers the issuer's current financial condition and its ability to make future scheduled interest and principal payments on a timely basis in assessing other-than-temporary impairment.

The Bank's investments in preferred stocks were purchased in the first quarter of 2013, and consist of three investments with unrealized losses amounting to \$155,000, or 5.2% of amortized cost. These three investments consist of Kayne Anderson MLP, which has an unrealized loss of \$3,000, or less than one percent of amortized cost, General Electric Capital Corporation, which has an unrealized loss of \$44,000, or 4.4% of amortized cost, and Public Storage Inc., which has an unrealized loss of \$108,000, or 10.8% of amortized cost. These losses were due to changes in interest rates. The Bank reviewed these investments for impairment by considering factors such as, among other things, the financial condition and ability of the issuer to continue to pay dividends, and any specific events that may affect the operations of the issuer.

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Unrealized losses on marketable equity securities consist of seven mutual funds. Five mutual funds invest mainly in short-term bonds, with unrealized losses amounting to \$148,000, or 2.3% of cost basis, with individual losses ranging from 0.4% to 2.9% of the mutual fund's cost basis; and two mutual funds invest in GNMA securities with a total combined unrealized loss of \$226,000, or approximately 5.3% of each mutual fund's cost basis. These seven mutual funds have been in an unrealized loss position ranging from one to three years. The cause of the impairment in these mutual funds is due to changes in interest rates and the continued underperformance of most fixed income asset classes during the nine months ended September 30, 2014 (unaudited). The Bank considered several factors in reviewing these mutual fund investments, including underlying investment performance, composition and rating of the securities in the mutual fund, and management of the mutual funds' issuer.

**December 31, 2013**

The Bank conducts periodic reviews of investment securities with unrealized losses to evaluate whether the impairment is other-than-temporary. The Bank's review for impairment generally includes a determination of the cause, severity and duration of the impairment; and an analysis of both positive and negative evidence available. The Bank also determines if it has the ability and intent to hold the investment for a period of time sufficient to allow for anticipated recovery to cost basis. Based on the Bank's recent review of securities in the investment portfolio, management deemed securities with unrealized losses as of year end 2013 to be temporarily impaired and has the ability and intent to hold these securities until recovery to cost basis occurs. A summary of this review is as follows.

Unrealized losses on U.S. Government and federal agency obligations amounted to \$40,000 and consisted of six securities. Unrealized losses on corporate bonds and notes amounted to \$82,000 and consisted of eleven securities. The unrealized losses on these debt securities were individually all less than 4% of amortized cost basis, were all for a period of less than twelve months, and the unrealized losses were primarily due to changes in interest rates. In regard to corporate debt, the Bank also considers the issuer's current financial condition and its ability to make future scheduled interest and principal payments on a timely basis in assessing other-than-temporary impairment.

The Bank's investments in preferred stocks were purchased in the first quarter of 2013, and consist of three investments with unrealized losses amounting to \$523,000, or 17.4% of amortized cost. These three investments consist of Kayne Anderson MLP, which has an unrealized loss of \$73,000, or 7% of amortized cost, General Electric Capital Corporation, which has an unrealized loss of \$204,000, or 20% of amortized cost, and Public Storage Inc., which has an unrealized loss of \$246,000, or 25% of amortized cost. These losses were due to changes in interest rates. The Bank reviewed these investments for impairment by considering factors such as, among other things, the financial condition and ability of the issuer to continue to pay dividends, and any specific events that may affect the operations of the issuer.

Unrealized losses on marketable equity securities consist of eight mutual funds, including one with an unrealized loss of less than \$1,000. Five mutual funds invest mainly in short-term bonds, with unrealized losses amounting to \$152,000, or 2.4% of cost basis, with individual losses ranging from two to four percent of the mutual fund's cost basis; and two mutual funds invest in GNMA securities with a total combined unrealized loss of \$339,000, or approximately 8% of each mutual fund's cost basis. These eight mutual funds have been in an unrealized loss position ranging from one to two years. The cause of the impairment in these mutual funds is due to changes in interest rates and the recent underperformance of most fixed income asset classes during 2013. The Bank considered several factors in reviewing these mutual fund investments, including underlying investment performance, composition and rating of the securities in the mutual fund, and management of the mutual funds' issuer.



**Table of Contents****NOTE 4 - LOANS**

Loans consisted of the following at:

|                                       | September 30,<br>2014 | December 31,<br>2013 |
|---------------------------------------|-----------------------|----------------------|
|                                       | (In Thousands)        |                      |
|                                       | (unaudited)           |                      |
| <b>Real estate loans:</b>             |                       |                      |
| One- to four- family residential      | \$ 116,421            | \$ 118,328           |
| Home equity loans and lines of credit | 11,385                | 10,037               |
| Commercial                            | 2,499                 | 2,052                |
| Construction                          | 2,315                 | 1,871                |
| Consumer loans                        | 107                   | 121                  |
|                                       | 132,727               | 132,409              |
| Allowance for loan losses             | (520)                 | (510)                |
| Deferred loan costs, net              | 77                    | 96                   |
| <br>Net loans                         | <br>\$ 132,284        | <br>\$ 131,995       |

The following tables set forth information on the allowance for loan losses at and for the nine months ended September 30, 2014 and 2013 (unaudited):

|  | Real Estate:                     |                                       |            |              |       | Consumer    |        |  |
|--|----------------------------------|---------------------------------------|------------|--------------|-------|-------------|--------|--|
|  | One- to four- Family Residential | Home Equity Loans and Lines of Credit | Commercial | Construction | Loans | Unallocated | Total  |  |
|  | (In Thousands)                   |                                       |            |              |       |             |        |  |
| <b>September 30, 2014 (unaudited):</b> |                                  |                                       |            |              |       |             |        |  |
| Allowance for loan losses:             |                                  |                                       |            |              |       |             |        |  |
| Beginning balance                      | \$ 414                           | \$ 55                                 | \$ 20      | \$ 14        | \$ 1  | \$ 6        | \$ 510 |  |
| Charge-offs                            |                                  |                                       |            |              |       |             |        |  |
| Recoveries                             |                                  |                                       |            |              |       |             |        |  |
| (Benefit) provision                    | (6)                              | 6                                     | 5          | 3            | 2     | 10          |        |  |
| Ending balance                         | \$ 408                           | \$ 61                                 | \$ 25      | \$ 17        | \$ 1  | \$ 8        | \$ 520 |  |
| Ending balance:                        |                                  |                                       |            |              |       |             |        |  |
| Individually evaluated for impairment  | \$                               | \$                                    | \$         | \$           | \$    | \$          | \$     |  |
| Ending balance:                        |                                  |                                       |            |              |       |             |        |  |
| Collectively evaluated for impairment  | 408                              | 61                                    | 25         | 17           | 1     | 8           | 520    |  |
|  | \$ 408                           | \$ 61                                 | \$ 25      | \$ 17        | \$ 1  | \$ 8        | \$ 520 |  |

Total allowance for loan losses ending  
balance

|                                       |            |           |          |          |        |    |            |
|---------------------------------------|------------|-----------|----------|----------|--------|----|------------|
| Loans:                                |            |           |          |          |        |    |            |
| Ending balance:                       |            |           |          |          |        |    |            |
| Individually evaluated for impairment | \$         | \$        | \$       | \$       | \$     | \$ | \$         |
| Ending balance:                       |            |           |          |          |        |    |            |
| Collectively evaluated for impairment | 116,421    | 11,385    | 2,499    | 2,315    | 107    |    | 132,727    |
| Total loans ending balance            | \$ 116,421 | \$ 11,385 | \$ 2,499 | \$ 2,315 | \$ 107 | \$ | \$ 132,727 |



|                                 | Real Estate:              |                             |            |              |                |             |    | Total  |
|---------------------------------|---------------------------|-----------------------------|------------|--------------|----------------|-------------|----|--------|
|                                 | One- to four- Residential | Home Equity Lines of Credit | Commercial | Construction | Consumer Loans | Unallocated |    |        |
| (In Thousands)                  |                           |                             |            |              |                |             |    |        |
| September 30, 2013 (unaudited): |                           |                             |            |              |                |             |    |        |
| Allowance for loan losses:      |                           |                             |            |              |                |             |    |        |
| Beginning balance               | \$ 392                    | \$ 53                       | \$ 19      | \$ 9         | \$ 1           | \$          | \$ | \$ 474 |
| Charge-offs                     |                           |                             |            |              | (1)            |             |    | (1)    |
| Recoveries                      |                           |                             |            |              | 1              |             |    | 1      |
| Provision                       | 21                        | (2)                         | 2          | 5            |                | 10          |    | 36     |
| Ending balance                  | \$ 413                    | \$ 51                       | \$ 21      | \$ 14        | \$ 1           | \$ 10       | \$ | \$ 510 |

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The following tables set forth information on the allowance for loan losses at and for the year ended December 31, 2013:

|  | Real Estate:                     |                     |            |              |        |             |            |  |
|--|----------------------------------|---------------------|------------|--------------|--------|-------------|------------|--|
|  | Home Equity Loans                |                     |            | Consumer     |        |             |            |  |
|  | One- to four- family Residential | and Lines of Credit | Commercial | Construction | Loans  | Unallocated | Total      |  |
|  | (In Thousands)                   |                     |            |              |        |             |            |  |
| December 31, 2013:                             |                                  |                     |            |              |        |             |            |  |
| Allowance for loan losses:                     |                                  |                     |            |              |        |             |            |  |
| Beginning balance                              | \$ 392                           | \$ 53               | \$ 19      | \$ 9         | \$ 1   | \$          | \$ 474     |  |
| Charge-offs                                    |                                  | (1)                 |            |              | (1)    |             | (2)        |  |
| Recoveries                                     |                                  |                     |            |              | 1      |             | 1          |  |
| Provision (benefit)                            | 22                               | 3                   | 1          | 5            |        | 6           | 37         |  |
| Ending balance                                 | \$ 414                           | \$ 55               | \$ 20      | \$ 14        | \$ 1   | \$ 6        | \$ 510     |  |
| Ending balance:                                |                                  |                     |            |              |        |             |            |  |
| Individually evaluated for impairment          | \$                               | \$                  | \$         | \$           | \$     | \$          | \$         |  |
| Ending balance:                                |                                  |                     |            |              |        |             |            |  |
| Collectively evaluated for impairment          | 414                              | 55                  | 20         | 14           | 1      | 6           | 510        |  |
| Total allowance for loan losses ending balance | \$ 414                           | \$ 55               | \$ 20      | \$ 14        | \$ 1   | \$ 6        | \$ 510     |  |
| Loans:   |                                  |                     |            |              |        |             |            |  |
| Ending balance:                                |                                  |                     |            |              |        |             |            |  |
| Individually evaluated for impairment          | \$                               | \$                  | \$         | \$           | \$     | \$          | \$         |  |
| Ending balance:                                |                                  |                     |            |              |        |             |            |  |
| Collectively evaluated for impairment          | 118,328                          | 10,037              | 2,052      | 1,871        | 121    |             | 132,409    |  |
| Total loans ending balance                     | \$ 118,328                       | \$ 10,037           | \$ 2,052   | \$ 1,871     | \$ 121 | \$          | \$ 132,409 |  |

The following tables set forth information regarding nonaccrual loans and past-due loans:

|  | 30 Days Past Due | 31-60 Days Past Due | 61-90 Days Past Due | 90 Days or More Past Due | Total Past Due | Total Current | 90 Days or More Past Due and Non-Accruing |
|--|------------------|---------------------|---------------------|--------------------------|----------------|---------------|---|
|--|------------------|---------------------|---------------------|--------------------------|----------------|---------------|---|

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(In Thousands)

| September 30, 2014 (unaudited):       |        |        |        |          |            |            |    |        |
|---------------------------------------|--------|--------|--------|----------|------------|------------|----|--------|
| Real estate loans:                    |        |        |        |          |            |            |    |        |
| One- to four- family residential      | \$ 292 | \$ 452 | \$ 211 | \$ 955   | \$ 115,466 | \$ 116,421 | \$ | \$ 556 |
| Home equity loans and lines of credit | 74     | 4      | 287    | 365      | 11,020     | 11,385     |    | 287    |
| Commercial                            |        |        |        |          | 2,499      | 2,499      |    |        |
| Construction                          |        |        |        |          | 2,315      | 2,315      |    |        |
| Consumer loans                        |        |        |        |          | 107        | 107        |    |        |
| Total                                 | \$ 366 | \$ 456 | \$ 498 | \$ 1,320 | \$ 131,407 | \$ 132,727 | \$ | \$ 843 |

| December 31, 2013:                    |        |        |        |          |            |            |    |        |
|---------------------------------------|--------|--------|--------|----------|------------|------------|----|--------|
| Real estate loans:                    |        |        |        |          |            |            |    |        |
| One- to four- family residential      | \$ 856 | \$ 528 | \$ 102 | \$ 1,486 | \$ 116,842 | \$ 118,328 | \$ | \$ 336 |
| Home equity loans and lines of credit |        |        |        |          | 10,037     | 10,037     |    |        |
| Commercial                            |        |        |        |          | 2,052      | 2,052      |    |        |
| Construction                          |        |        |        |          | 1,871      | 1,871      |    |        |
| Consumer loans                        |        |        |        |          | 121        | 121        |    |        |
| Total                                 | \$ 856 | \$ 528 | \$ 102 | \$ 1,486 | \$ 130,923 | \$ 132,409 | \$ | \$ 336 |

As of and during the nine months ended September 30, 2014 and 2013 (unaudited) there were no loans that met the definition of an impaired loan in ASC 310-10-35.

During the nine months ended September 30, 2014 and 2013 (unaudited) there were no loans that met the definition of a troubled debt restructured loan in ASC 310-10-50.

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### Credit Quality Information

The Bank utilizes a seven grade internal loan rating system for commercial real estate, construction and commercial loans as follows:

Loans rated 1 - 3: Loans in these categories are considered pass rated loans with low to average risk.

Loans rated 4: Loans in this category are considered special mention. These loans are starting to show signs of potential weakness and are being closely monitored by management.

Loans rated 5: Loans in this category are considered substandard. Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. There is a distinct possibility that the Bank will sustain some loss if the weakness is not corrected.

Loans rated 6: Loans in this category are considered doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.

Loans rated 7: Loans in this category are considered uncollectible ( loss ) and of such little value that their continuance as loans is not warranted.

On an annual basis, or more often if needed, the Bank formally reviews the ratings on all commercial real estate, construction and commercial loans.

As of September 30, 2014 (unaudited), one- to four- family residential real estate loans with balances totaling \$318,000 had a risk rating of substandard and all other loans outstanding had a risk rating of pass.

As of December 31, 2013, one- to four- family residential real estate loans with balances totaling \$324,000 had a risk rating of substandard and all other loans outstanding had a risk rating of pass.

### NOTE 5 - BENEFIT PLANS

The Bank provided pension benefits for its employees through participation in the CBERA Defined Benefit Plan for Financial Institutions (the Plan ), a tax-qualified defined benefit plan. The Plan's Employer Identification Number is 04-6035593 and the Plan Number is 334. The Plan operated as a multi-employer plan for accounting purposes and as a multiple-employer plan under the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code. There are no collective bargaining agreements in place that require contributions to the Plan. The Plan is a single plan under Internal Revenue Code Section 413(c) and, as a result, all of the assets stand behind all of the liabilities. Accordingly, under the Plan, contributions made by a participating employer may be used to provide benefits to participants of other participating employers. The Plan covers all salaried employees who are at least twenty-one years of age with at least one year of employment with the Bank. The plan is funded by contributions based on actuarial calculations. As is the case with multi-employer plans, separate actuarial valuations are not made with respect to each employer.

Effective April 30, 2014, the Bank froze benefit accruals earned by participants and has no future obligations to fund the Plan.

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The funded status (market value of plan assets divided by the funding target) was 86%, 88% and 97%, respectively, as of January 1, 2014, 2013 and 2012. During 2013, the Bank's funding policy was to make contributions to the Plan in order to achieve a 100% funded status.

Total contributions made to the Plan by participating institutions, as reported on Form 5500, were \$9,778,000 and \$8,473,000, respectively, for the Plan years ended December 31, 2012 and 2011. Total contributions made to the plan by participating institutions for the Plan year ended December 31, 2013, was \$9,727,000.

During the three months ended September 30, 2014 and 2013 (unaudited), the Bank contributed \$0 and \$44,000, respectively, to the Plan. During the nine months ended September 30, 2014 and 2013 (unaudited), the Bank contributed \$44,000 and \$97,000 respectively, to the Plan.

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Since April 1, 2014, the Bank participates in a 401(k) savings plan through Pentegra. Eligible employees may contribute up to 50% of their salary, subject to IRS limitations, which can be matched up to 5% by the Bank on a dollar for dollar basis. The Bank's expense under this 401(k) plan was \$15,000 for the three months ended September 30, 2014 (unaudited) and \$32,000 for the nine months ended September 30, 2014 (unaudited).

In addition, the Bank also participated in a 401(k) savings plan through CBERA. Eligible employees were able to contribute up to 50% of their salary, subject to IRS limitations, which matched by up to 5% by the Bank on a dollar for dollar basis. The Bank's expense under this 401(k) plan was \$0 and \$16,000 for the three months ended September 30, 2014 and 2013 (unaudited), respectively. The Bank's expense under the 401(k) plan was \$16,000 and \$45,000 for the nine months ended September 30, 2014 and 2013 (unaudited), respectively. This plan was transferred to Pentegra as of April 1, 2014.

The Bank adopted Supplemental Executive Retirement Agreements for two executive officers. The liability for the benefits amounted to \$176,000 and \$171,000 at September 30, 2014 (unaudited) and December 31, 2013, respectively, and is included in other liabilities. The expense recognized for these benefits was \$0 and \$16,000 for the three months ended September 30, 2014 and 2013 (unaudited), respectively. The expense recognized for these benefits was \$5,000 and \$45,000 for the nine months ended September 30, 2014 and 2013 (unaudited), respectively. These agreements were frozen as of February 1, 2014. The related liability amounts will be paid to the executive officers in 2015.

On October 21, 2014, in connection with the closing of the Conversion, the Bank entered into: (1) an employment agreement with Jeffrey D. Jones, President and Chief Executive Officer; (2) a change in control agreement with Diane Indorato, Chief Financial Officer; (3) a change in control agreement with James Oosterman, Vice President-Lending; and (4) an executive split dollar agreement with Mr. Jones (collectively, the Agreements). In addition, the Bank adopted: (1) the Melrose Cooperative Bank Supplemental Executive Retirement Plan; and (2) the Melrose Cooperative Bank Executive Annual Incentive Plan (collectively, the Benefit Plans). Please see a description of the Agreements and the Benefit Plans provided in the Company's prospectus dated August 12, 2014, as filed with the Securities and Exchange Commission on August 19, 2014.

**NOTE 6 - FINANCIAL INSTRUMENTS**

The Bank is 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 include commitments to originate loans and unadvanced funds on loans. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

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

Commitments to originate loans are agreements to lend to a customer provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include secured interests in mortgages, accounts receivable, inventory, property, plant and equipment and income-producing properties.



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Notional amounts of financial instrument liabilities with off-balance sheet credit risk are as follows:

|   | September 30,<br>2014 | December 31,<br>2013 |
|---|-----------------------|----------------------|
|   | (In Thousands)        |                      |
|   | (unaudited)           |                      |
| Commitments to originate loans                    | \$ 4,216              | \$ 1,918             |
| Unused lines of credit                            | 12,028                | 11,758               |
| Due to borrowers on unadvanced construction loans | 930                   | 886                  |
|   | \$ 17,174             | \$ 14,562            |

**NOTE 7 - FAIR VALUE MEASUREMENTS**

ASC 820-10, Fair Value Measurements and Disclosures, provides a framework for measuring fair value under generally accepted accounting principles. This guidance also allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis.

In accordance with ASC 820-10, the Bank groups its financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 - Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury, other U.S. Government and agency mortgage-backed securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities.

Level 3 - Valuations for assets and liabilities that are derived from other methodologies, including option pricing models, discounted cash flow models and similar techniques, are not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets and liabilities.

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Bank's financial assets and financial liabilities carried at fair value for September 30, 2014 (unaudited) and December 31, 2013. The Bank did not have any significant transfers of assets between levels 1 and 2 of the fair value hierarchy during the nine months ended September 30, 2014 (unaudited) and the year ended December 31, 2013.



The Bank's cash instruments are generally classified within level 1 or level 2 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency.

The Bank's investment in debt securities available-for-sale is generally classified within level 2 of the fair value hierarchy. For these securities, we obtain fair value measurements from independent pricing services. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. treasury yield curve, trading levels, market consensus prepayment speeds, credit information and the instrument's terms and conditions.

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Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used. Subsequent to inception, management only changes level 3 inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalization and other transactions across the capital structure, offerings in the equity or debt markets, and changes in financial ratios or cash flows.

The Bank's impaired loans, if any, are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using level 2 inputs based upon appraisals of similar properties obtained from a third party. For level 3 inputs, fair value is based upon management estimates of the value of the underlying collateral or the present value of the expected cash flows.

The following summarizes assets measured at fair value on a recurring basis:

|  | Fair Value Measurements at Reporting Date Using: |   |  |  |
|--|--|---|--|--|
|  | Total  | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>Level 1 | Significant<br>Other Observable<br>Inputs<br>Level 2 | Significant<br>Unobservable<br>Inputs<br>Level 3 |
| (In Thousands)                                 |  |   |  |  |
| <b>September 30, 2014 (unaudited):</b>         |  |   |  |  |
| U.S. Government and federal agency obligations | \$ 4,476   | \$  | \$ 4,476   | \$   |
| Corporate bonds and notes                      | 15,272   |   | 15,272   |  |
| Preferred stock                                | 2,844  | 2,844   |  |  |
| Marketable equity securities                   | 16,691   | 16,691  |  |  |
| <b>Totals</b>                                  | <b>\$ 39,283</b>                                 | <b>\$ 19,535</b>  | <b>\$ 19,748</b>                                     | <b>\$</b>  |
| <b>December 31, 2013:</b>                      |  |   |  |  |
| U.S. Government and federal agency obligations | \$ 4,961   | \$  | \$ 4,961   | \$   |
| Corporate bonds and notes                      | 16,252   |   | 16,252   |  |
| Preferred stock                                | 2,477  | 2,477   |  |  |
| Marketable equity securities                   | 16,004   | 16,004  |  |  |
| <b>Totals</b>                                  | <b>\$ 39,694</b>                                 | <b>\$ 18,481</b>  | <b>\$ 21,213</b>                                     | <b>\$</b>  |

Under certain circumstances the Bank makes adjustments to fair value for its assets and liabilities although they are not measured at fair value on an ongoing basis. At September 30, 2014 (unaudited) and December 31, 2013, there were no financial instruments carried on the consolidated balance sheet for which a nonrecurring change in fair value has been recorded.



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The estimated fair values of the Bank's financial instruments, all of which are held or issued for purposes other than trading, are as follows:

|                                   | Carrying<br>Amount | September 30, 2014 (unaudited)<br>Fair Value |         |         | Total     |
|-----------------------------------|--------------------|--|---------|---------|-----------|
|                                   |                    | Level 1                                      | Level 2 | Level 3 |           |
| (In Thousands)                    |                    |  |         |         |           |
| <b>Financial assets:</b>          |                    |  |         |         |           |
| Cash and cash equivalents         | \$ 31,993          | \$ 31,993                                    | \$      | \$      | \$ 31,993 |
| Available-for-sale securities     | 39,283             | 19,535                                       | 19,748  |         | 39,283    |
| Federal Home Loan Bank stock      | 437                | 437  |         |         | 437       |
| Loans, net                        | 132,284            |  |         | 133,242 | 133,242   |
| Co-operative Central Bank deposit | 881                | 881  |         |         | 881       |
| Accrued interest receivable       | 380                | 380  |         |         | 380       |
| <b>Financial liabilities:</b>     |                    |  |         |         |           |
| Deposits                          | 189,965            |  | 190,640 |         | 190,640   |

|                                   | Carrying<br>Amount | December 31, 2013<br>Fair Value |         |         | Total     |
|-----------------------------------|--------------------|---------------------------------|---------|---------|-----------|
|                                   |                    | Level 1                         | Level 2 | Level 3 |           |
| (In Thousands)                    |                    |                                 |         |         |           |
| <b>Financial assets:</b>          |                    |                                 |         |         |           |
| Cash and cash equivalents         | \$ 16,995          | \$ 16,995                       | \$      | \$      | \$ 16,995 |
| Available-for-sale securities     | 39,694             | 18,481                          | 21,213  |         | 39,694    |
| Federal Home Loan Bank stock      | 409                | 409                             |         |         | 409       |
| Loans, net                        | 131,995            |                                 |         | 132,139 | 132,139   |
| Co-operative Central Bank deposit | 881                | 881                             |         |         | 881       |
| Accrued interest receivable       | 408                | 408                             |         |         | 408       |
| <b>Financial liabilities:</b>     |                    |                                 |         |         |           |
| Deposits                          | 175,510            |                                 | 176,622 |         | 176,622   |

The carrying amounts of financial instruments shown in the above table are included in the consolidated balance sheets under the indicated captions. Accounting policies related to financial instruments are described in Note 2.

**NOTE 8 - OTHER COMPREHENSIVE (LOSS) INCOME**

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities are reported as a separate component of the equity section of the consolidated balance sheets, such items, along with net income, are components of comprehensive income.

The components of other comprehensive (loss) income included in equity are as follows:

Three Months Ended September 30, 2014      Nine Months Ended September 30, 2014

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|  | 2014    | 2013  | 2014           | 2013     |
|--|---------|-------|----------------|----------|
|  |         |       | (In Thousands) |          |
|  |         |       | (unaudited)    |          |
| Net unrealized holding (losses) gains on available-for-sale securities | \$ (76) | \$ 35 | \$ 842         | \$ (121) |
| Reclassification adjustment for realized gains in net income           |         |       |                |          |
| Other comprehensive (loss) income before income tax effect             | (76)    | 35    | 842            | (121)    |
| Income tax benefit (expense)   | 26      | (23)  | (312)          | 12       |
| Other comprehensive (loss) income, net of tax                          | \$ (50) | \$ 12 | \$ 530         | \$ (109) |

Accumulated other comprehensive income as of September 30, 2014 (unaudited) and as of December 31, 2013 consists of net unrealized holding gains on available-for-sale securities, net of taxes.

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**NOTE 9 - PLAN OF CONVERSION**

On October 21, 2014, Melrose Cooperative Bank consummated its mutual-to-stock conversion, and Melrose Bancorp, Inc. consummated its initial stock offering. In the Offering, the Company sold 2,723,409 shares of common stock, including 226,366 shares to the employee stock ownership plan, equal to 8.0% of the shares sold in the offering and contributed to Melrose Cooperative Bank Foundation, at \$10.00 per share, for gross offering proceeds of \$27.2 million. In addition to the shares sold, the Company contributed 106,170 shares of the common stock and \$300,000 in cash to Melrose Cooperative Bank Foundation.

The cost of conversion and the stock offering were deferred and deducted from the proceeds of the offering. Conversion costs incurred for the nine months ended September 30, 2014 (unaudited) were approximately \$1.0 million.

In accordance with applicable conversion regulations, at the time of the completion of our mutual-to-stock conversion, we established a liquidation account in an amount equal to the Bank's total equity as of the latest balance sheet date in the final prospectus used in the Conversion. Each eligible account holder or supplemental account holder is entitled to a proportionate share of this liquidation account in the event of a complete liquidation of the Bank, and only in such event. This share will be reduced if the eligible account holder's or supplemental account holder's deposit balance falls below the amounts on the date of record as of any December 31 and will cease to exist if the account is closed. The liquidation account will never be increased despite any increase after Conversion in the related deposit balance.

Following completion of the Conversion, the Bank may not declare, pay a dividend on, or repurchase any of its capital stock of the Bank, if the effect thereof would cause retained earnings to be reduced below the liquidation account amount or regulatory capital requirements.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**General**

Management's discussion and analysis of the financial condition and results of operations at and for the three and nine months ended September 30, 2014 and 2013 is intended to assist in understanding the financial condition and results of operations of the Bank. The information contained in this section should be read in conjunction with the unaudited financial statements and the notes thereto, appearing on Part I, Item 1 of this quarterly report on Form 10-Q.

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This quarterly report contains forward-looking statements, which can be identified by the use of words such as estimate, project, believe, intend, anticipate, plan, seek, expect and words of similar meaning. These forward-looking statements include, but are not limited to:

statements of our goals, intentions and expectations;

statements regarding our business plans, prospects, growth and operating strategies;

statements regarding the quality of our loan and investment portfolios; and

estimates of our risks and future costs and benefits.

These forward-looking statements are based on current beliefs and expectations of our management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change.

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The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

general economic conditions, either nationally or in our market area, that are worse than expected;

our success in growing our commercial real estate loan portfolio;

increased competition among depository and other financial institutions;

inflation and changes in the interest rate environment that reduce our margins and yields, reduce the fair value of financial instruments or increase our funding costs;

changes in laws or government regulations or policies that adversely affect financial institutions, including changes in regulatory fees and capital requirements;

our ability to manage operations in the current economic conditions;

our ability to capitalize on growth opportunities;

changes in consumer spending, borrowing and savings habits;

changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission or the Public Company Accounting Oversight Board;

changes in our organization, compensation and benefit plans;

changes in the level of government support for housing finance;

significant increases in delinquencies and our loan losses; and

changes in our financial condition or results of operations that reduce capital.

**Critical Accounting Policies**



There are no material changes to the critical accounting policies disclosed in Melrose Bancorp, Inc.'s Prospectus dated August 12, 2014, as filed with the Securities and Exchange Commission pursuant to Securities Act Rule 424(b)(3) on August 19, 2014.

**Comparison of Financial Condition at September 30, 2014 (unaudited) and December 31, 2013**

Total assets increased \$16.0 million, or 8.1%, to \$212.7 million at September 30, 2014 from \$196.7 million at December 31, 2013. The increase was primarily the result of increases in cash and cash equivalents, net loans, and other assets.

Net loans increased \$289,000, or 0.2%, to \$132.3 million at September 30, 2014 from \$132.0 million at December 31, 2013. The increase was primarily due to originations of new loans.

Cash and cash equivalents increased \$15.0 million, or 88.2%, to \$32.0 million at September 30, 2014 from \$17.0 million at December 31, 2013. The increase was due primarily to the funds that were being held in escrow from subscribers to the stock offering.

Securities available-for-sale decreased slightly to \$39.3 million at September 30, 2014 from \$39.7 million at December 31, 2013.

At September 30, 2014 our investment in bank-owned life insurance was \$5.0 million, an increase of \$105,000, from \$4.8 million at December 31, 2013. We invest in bank-owned life insurance to provide us with a funding offset for certain benefit obligations. Bank-owned life insurance also generally provides us with non-taxable noninterest income.

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Other assets increased \$1.0 million, or 509.0%, to \$1.2 million at September 30, 2014 from \$199,000 at December 31, 2013. The increase was due primarily to costs related to the mutual to stock conversion and related stock offering which are included in other assets as deferred offering costs.

Total deposits increased \$14.5 million, or 8.3%, to \$190.0 million at September 30, 2014 from \$175.5 million at December 31, 2013. The increase was due primarily to funds deposited in escrow from subscribers to the stock offering.

We had no borrowings outstanding at September 30, 2014 or at December 31, 2013. At September 30, 2014, we had the ability to borrow approximately \$84.8 million from the Federal Home Loan Bank of Boston, subject to certain collateral requirements. Additionally, at September 30, 2014 we had the ability to borrow up to \$5.0 million on a federal funds line of credit with the Co-Operative Central Bank.

Total equity increased \$1.0 million, or 4.9%, to \$21.6 million at September 30, 2014 from \$20.6 million at December 31, 2013 resulting primarily from an increase of \$530,000 in the unrealized gain on securities net of tax, and net income of \$521,000 for the nine months ended September 30, 2014.

**Comparison of Operating Results for the Three Months Ended September 30, 2014 and 2013**

**General.** Net income increased \$24,000, or 17.6%, to \$160,000 for the three months ended September 30, 2014 from \$136,000 for the three months ended September 30, 2013. The increase in net income resulted primarily from a decrease of \$79,000 in interest expense quarter to quarter and a decrease of \$3,000 in noninterest expense, offset in part by a decrease of \$37,000 in interest and dividend income and a decrease of \$20,000 in noninterest income.

**Interest and Dividend Income.** Interest and dividend income decreased \$37,000, or 2.7%, to \$1.3 million for the three months ended September 30, 2014 from \$1.4 million for the three months ended September 30, 2013 due to a decrease of \$13,000 in interest and fees on loans which decreased to \$1.2 million for the three months ended September 30, 2014 from \$1.2 million for the three months ended September 30, 2013. The decrease of interest and fees on loans was primarily due to a decrease in the average yield earned on loans to 3.52% for the 2014 quarter from 3.60% during the 2013 quarter.

The decrease in interest and dividend income was also due to a decrease in interest and dividends on securities of \$21,000, or 10.8%, to \$173,000 for the quarter ended September 30, 2014 from \$194,000 for the quarter ended September 30, 2013. This decrease was a result of a decrease of 46 basis points in the average yield on securities to 1.74% for the 2014 period from 2.20% for the 2013 period reflecting lower market interest rates.

Other interest income decreased \$3,000 for the three months ended September 30, 2014 due to a \$12.2 million decrease in the average balance of other interest-earning assets, partially offset by an increase of 2 basis points to 0.14% for the 2014 quarter from 0.12% for the 2013 quarter in the average rate received on these deposits.

**Interest Expense.** Interest expense decreased \$79,000, or 19.9%, to \$317,000 for the three months ended September 30, 2014 from \$396,000 for the three month period ended September 30, 2013. The decrease was due to a decrease of \$596,000, or 0.4%, in average interest-bearing deposits to \$163.8 million for the three months ended September 30, 2014 from \$164.4 million for the three months ended September 30, 2013 and a decrease of 19 basis points to 0.77% for the 2014 quarter from 0.96% for the 2013 quarter in the average rate paid on these deposits. The decrease in average interest-bearing deposits resulted primarily from a decrease of \$10.4 million, or 12.3%, in the average balance of certificates of deposit to \$74.2 million for the three months ended September 30, 2014 from \$84.6 million for the three months ended September 30, 2013. The decrease in our average balance of certificates of deposit

accounts was partially offset by an increase of \$1.9 million, or 6.2%, in the average balance of savings accounts, which increased to \$32.0 million for the 2014 quarter from \$30.1 million for the 2013 quarter and an increase of \$2.9 million, or 7.2%, in the average balance of money market accounts, which increased to \$42.0 million for the 2014 quarter from \$39.2 million for the 2013 quarter.

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**Net Interest and Dividend Income.** Net interest and dividend income increased \$42,000, or 4.3%, to \$1.0 million for the three months ended September 30, 2014 from \$971,000 for the three months ended September 30, 2013 as our net interest rate spread increased 20 basis points to 2.14% for the 2014 period from 1.94% for the 2013 period. Our net interest margin also increased 16 basis points to 2.22% for the three months ended September 30, 2014 from 2.06% for the three months ended September 30, 2013.

**Average Balances and Yields.** The following tables set forth average balance sheets, average yields and costs, and certain other information for the three months ended September 30, 2014 and 2013 (unaudited). All average balances are daily average balances based upon amortized costs. Non-accrual loans were included in the computation of average balances. The yields set forth below include the effect of deferred fees, discounts, and premiums that are amortized or accreted to interest income or interest expense.

|   | FOR THE THREE MONTHS ENDED<br>September 30, 2014 |                             |                | FOR THE THREE MONTHS ENDED<br>September 30, 2013 |                             |                |
|---|--|-----------------------------|----------------|--|-----------------------------|----------------|
|   | AVERAGE<br>BALANCE                               | INTEREST<br>EARNED/<br>PAID | YIELD/<br>RATE | AVERAGE<br>BALANCE                               | INTEREST<br>EARNED/<br>PAID | YIELD/<br>RATE |
| (Dollars in Thousands)                  |  |                             |                |  |                             |                |
| <b>Interest-earning assets:</b>         |  |                             |                |  |                             |                |
| Loans                                   | \$ 131,179                                       | \$ 1,153                    | 3.52%          | \$ 129,562                                       | \$ 1,166                    | 3.60%          |
| Securities                              | 39,826   | 173                         | 1.74%          | 35,262   | 194                         | 2.20%          |
| Other interest-earning assets (1)       | 11,780   | 4                           | 0.14%          | 23,987   | 7                           | 0.12%          |
| Total interest-earning assets           | 182,785  | 1,330                       | 2.91%          | 188,811  | 1,367                       | 2.90%          |
| Non-interest earning assets             | 11,653   |                             |                | 7,185  |                             |                |
| Total assets                            | \$ 194,438                                       |                             |                | \$ 195,996                                       |                             |                |
| <b>Interest-bearing liabilities:</b>    |  |                             |                |  |                             |                |
| Savings accounts                        | \$ 31,989  | 17                          | 0.21%          | \$ 30,129  | 23                          | 0.31%          |
| Certificates of deposit                 | 74,158   | 257                         | 1.39%          | 84,557   | 323                         | 1.53%          |
| Money market accounts                   | 42,040   | 40                          | 0.38%          | 39,214   | 47                          | 0.48%          |
| NOW accounts                            | 15,662   | 3                           | 0.08%          | 10,545   | 3                           | 0.11%          |
| Total interest-bearing deposits         | 163,849  | 317                         | 0.77%          | 164,445  | 396                         | 0.96%          |
| Borrowings                              | 0  | 0                           | 0.00%          | 0  | 0                           | 0.00%          |
| Total interest-bearing liabilities      | 163,849  | 317                         | 0.77%          | 164,445  | 396                         | 0.96%          |
| <b>Noninterest-bearing liabilities:</b> |  |                             |                |  |                             |                |
| Noninterest-bearing deposits            | 7,907  |                             |                | 10,838   |                             |                |
| Other noninterest-bearing liabilities   | 1,101  |                             |                | 610  |                             |                |
| Total liabilities                       | 172,857  |                             |                | 175,893  |                             |                |

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|   |            |            |
|---|------------|------------|
| Total equity  | 21,581     | 20,103     |
| Total liabilities and equity                                    | \$ 194,438 | \$ 195,996 |
| Net interest income   | \$ 1,013   | \$ 971     |
| Net Interest rate spread (2)                                    | 2.14%      | 1.94%      |
| Net interest-earning assets (3)                                 | \$ 18,936  | \$ 24,366  |
| Net interest margin (4)   | 2.22%      | 2.06%      |
| Average interest-earning assets to interest-bearing liabilities | 111.56%    | 114.82%    |

- (1) Includes Federal Home Loan Bank stock, correspondent bank accounts, federal funds sold, money market funds and Co-operative Central Bank deposit.
- (2) Net interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest-bearing liabilities.
- (3) Net interest-earning assets represents total interest-earning assets less total interest-bearing liabilities.
- (4) Net interest margin represents net interest income as a percentage of average interest-earning assets.

**Provision for loan losses.** We recorded no provision for loan losses for the three months ended September 30, 2014, a decrease of \$5,000, from the provision of \$5,000 for the three months ended September 30, 2013.

The provision for loan losses for the three months ended September 30, 2014 reflected no charge-offs or recoveries. Net charge-offs of \$1,000 were recorded in the three months ended September 30, 2013. The allowance for loan losses was \$520,000, or 0.39% of total loans at September 30, 2014, compared to \$510,000, or 0.39% of total loans, at September 30, 2013. Total nonperforming loans were \$843,000 at September 30, 2014 compared to \$696,000 at September 30, 2013. As a percentage of nonperforming loans, the allowance for loan losses was 61.68% at September 30, 2014 compared to 73.27% at September 30, 2013.

**Noninterest income.** Noninterest income decreased \$20,000, or 27.0%, to \$54,000 for the three months ended September 30, 2014 from \$74,000 for the three months ended September 30, 2013 primarily due to a decrease of \$25,000 in gain on sale of loans, partially offset by an increase of \$4,000 in fees and service charges. The decrease in gain on sale of loans resulted from a decrease in the number of loans sold. There were no loans sold during the three months ended September 30, 2014 compared to three during the three months ended September 30, 2013.

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**Noninterest Expense.** Noninterest expense decreased \$3,000, or 0.4%, to \$838,000 for the three months ended September 30, 2014 from \$841,000 for the three months ended September 30, 2013 primarily as a result of a \$24,000 decrease in data processing expense, offset partly by an increase in audit and examinations expense of \$15,000 and an increase in equipment expense of \$7,000.

**Income Tax Expense.** Income tax expense increased \$6,000, or 9.5%, to \$69,000 for the three months ended September 30, 2014 from \$63,000 for the three months ended September 30, 2013. The increase in the income tax expense was principally due to a higher level of pre-tax income. The effective tax rates were 30.13% and 31.66% for the three months ended September 30, 2014 and 2013, respectively.

**Comparison of Operating Results for the Nine Months Ended September 30, 2014 and 2013**

**General.** Net income increased \$17,000, or 3.4%, to \$521,000 for the nine months ended September 30, 2014 from \$504,000 for the nine months ended September 30, 2013. The increase resulted primarily from a decrease of \$214,000 in interest expense and a decrease of \$26,000 in provision for loan losses, offset in part by a decrease in interest and dividend income of \$111,000, a decrease in noninterest income of \$62,000, an increase in noninterest expense of \$47,000 and an increase of \$3,000 in income tax expense.

**Interest and Dividend Income.** Interest and dividend income decreased \$111,000, or 2.7%, to \$4.0 million for the nine months ended September 30, 2014 from \$4.1 million for the nine months ended September 30, 2013 due to a decrease of \$98,000 in interest and fees on loans which decreased to \$3.4 million for the 2014 period from \$3.5 million for the 2013 period, and a decrease on interest and dividends on securities from period to period. The decrease of interest and fees on loans was due primarily to the payoff of one significant construction loan and a decrease in the average yield earned on loans to 3.50% for the nine months ended September 30, 2014 from 3.66% for the nine months ended September 30, 2013.

Interest and dividends on securities decreased \$6,000, or 1.1%, to \$538,000 for the nine months ended September 30, 2014 from \$544,000 for the nine months ended September 30, 2013, resulting from a decrease of 40 basis points in the average yield earned on securities to 1.80% for the nine months ended September 30, 2014 from 2.20% for the nine months ended September 30, 2013, offset partially by an increase in the average balance of securities to \$39.8 million for the 2014 period from \$32.9 million for the 2013 period.

Other interest income decreased \$7,000 for the nine month period ended September 30, 2014 due to a \$11.8 million decrease in the average balance of other interest-earning assets, offset in part by an increase of 3 basis points in the average yield on these assets.

**Interest Expense.** Interest expense decreased \$214,000, or 18.3%, to \$958,000 for the nine months ended September 30, 2014 from \$1.2 million for the nine month period ended September 30, 2013. The decrease was due primarily to a decrease of 17 basis points in the average rate paid on deposits to 0.79% for the 2014 period from 0.96% for the 2013 period.

**Net Interest and Dividend Income.** Net interest and dividend income increased \$103,000, or 3.5%, to \$3.0 million for the nine months ended September 30, 2014, from \$2.9 million for the nine months ended September 30, 2013 as our net interest rate spread increased 13 basis points to 2.11% for the 2014 period from 1.98% for the 2013 period. Our net interest margin also increased 10 basis points to 2.20% for the nine months ended September 30, 2014 from 2.10% for the nine months ended September 30, 2013.



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**Average Balances and Yields.** The following tables set forth average balance sheets, average yields and costs, and certain other information for the nine months ended September 30, 2014 and 2013 (unaudited). All average balances are daily average balances based upon amortized costs. Non-accrual loans were included in the computation of average balances. The yields set forth below include the effect of deferred fees, discounts, and premiums that are amortized or accreted to interest income or interest expense.

|                                       | FOR THE NINE MONTHS<br>ENDED<br>September 30, 2014 |                 |                | FOR THE NINE MONTHS<br>ENDED<br>September 30, 2013 |                 |                |
|---------------------------------------|--|-----------------|----------------|--|-----------------|----------------|
|                                       | AVERAGE<br>BALANCE                                 | EARNED/<br>PAID | YIELD/<br>RATE | AVERAGE<br>BALANCE                                 | EARNED/<br>PAID | YIELD/<br>RATE |
|                                       | (Dollars in thousands)                             |                 |                |  |                 |                |
| <b>Interest-earning assets:</b>       |  |                 |                |  |                 |                |
| Loans                                 | \$ 131,217   | \$ 3,444        | 3.50%          | \$ 128,920   | \$ 3,542        | 3.66%          |
| Securities                            | 39,794   | 538             | 1.80%          | 32,925   | 544             | 2.20%          |
| Other interest-earning assets (1)     | 12,657   | 12              | 0.13%          | 24,445   | 19              | 0.10%          |
| Total interest-earning assets         | 183,668  | 3,994           | 2.90%          | 186,290  | 4,105           | 2.94%          |
| Non-interest earning assets           | 10,576   |                 |                | 7,407  |                 |                |
| Total assets                          | \$ 194,244   |                 |                | \$ 193,697   |                 |                |
| <b>Interest-bearing liabilities:</b>  |  |                 |                |  |                 |                |
| Savings accounts                      | \$ 32,302  | 51              | 0.21%          | \$ 29,228  | 79              | 0.36%          |
| Certificates of deposit               | 75,355   | 782             | 1.38%          | 82,317   | 944             | 1.53%          |
| Money market accounts                 | 41,889   | 117             | 0.37%          | 40,482   | 141             | 0.46%          |
| NOW accounts                          | 12,514   | 8               | 0.09%          | 10,508   | 8               | 0.10%          |
| Total interest-bearing deposits       | 162,060  | 958             | 0.79%          | 162,535  | 1,172           | 0.96%          |
| Borrowings                            | 0  | 0               | 0.00%          | 0  | 0               | 0.00%          |
| Total interest-bearing liabilities    | 162,060  | 958             | 0.79%          | 162,535  | 1,172           | 0.96%          |
| Noninterest-bearing liabilities:      |  |                 |                |  |                 |                |
| Noninterest-bearing deposits          | 10,111   |                 |                | 10,368   |                 |                |
| Other noninterest-bearing liabilities | 889  |                 |                | 675  |                 |                |
| Total liabilities                     | 173,060  |                 |                | 173,578  |                 |                |
| Total equity                          | 21,184   |                 |                | 20,119   |                 |                |
| Total liabilities and equity          | \$ 194,244   |                 |                | \$ 193,697   |                 |                |
| Net interest income                   |  | \$ 3,036        |                |  | \$ 2,933        |                |



|   |           |           |       |
|---|-----------|-----------|-------|
| Net interest rate spread(2)                                     |           | 2.11%     | 1.98% |
| Net interest-earning assets (3)                                 | \$ 21,608 | \$ 23,755 |       |
| Net interest margin (4)   |           | 2.20%     | 2.10% |
| Average interest-earning assets to interest-bearing liabilities | 113.33%   | 114.62%   |       |

- (1) Includes Federal home loan Bank stock, correspondent bank accounts, federal funds sold, money market funds and Co-operative Central Bank deposit.
- (2) Net interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest-bearing liabilities.
- (3) Net interest-earning assets represents total interest-earning assets less total interest-bearing liabilities.
- (4) Net interest margin represents net interest income as a percentage of average interest-earning assets.

**Provision for loan losses.** We recorded a provision for loan losses of \$10,000 for the nine months ended September 30, 2014, a decrease of \$26,000, or 72.2%, from the provision of \$36,000 for the nine months ended September 30, 2013. The decrease in the provision resulted from changes in the composition of the loan portfolio.

Charge-offs and recoveries were less than \$1,000 during each of the nine month periods ended September 30, 2014 and 2013. The allowance for loan losses was \$520,000, or 0.39% of total loans, at September 30, 2014 compared to \$510,000, or 0.39% of total loans, at September 30, 2013. Total nonperforming loans were \$843,000 at September 30, 2014 compared to \$696,000 at September 30, 2013. As a percentage of nonperforming loans, the allowance for loan losses was 61.68% at September 30, 2014 compared to 73.27% at September 30, 2013.

**Noninterest Income.** Noninterest income decreased \$62,000, or 25.4%, to \$182,000 for the nine months ended September 30, 2014 from \$244,000 for the nine months ended September 30, 2013 primarily due to a decrease of \$69,000 in gain on sale of loans as the number of loans sold decreased to six during the 2014 period from 18 for the 2013 period.

**Noninterest Expense.** Noninterest expense increased \$47,000, or 2.0%, to \$2.5 million for the nine months ended September 30, 2014 from \$2.4 million for the nine months ended September 30, 2013. Noninterest expense increased primarily due to increases in audits and examinations expense, salaries and employee benefits and professional fees. Professional fees increased \$15,000, or 39.5%, while audits and examinations expense increased \$14,000, or 16.5% and salaries and employee benefits increased \$8,000, or 0.5%.

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**Income Tax Expense.** Income tax expense increased \$3,000, or 1.3%, to \$237,000 for the nine months ended September 30, 2014 from \$234,000 for the nine months ended September 30, 2013. The increase in the income tax expense was principally due to a higher level of pre-tax income in the 2014 period. The effective tax rate was 31.27% for the nine months ended September 30, 2014 and 31.71% for the nine months ended September 30, 2013.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Not applicable, as the Registrant is a smaller reporting company.

### **Item 4. Controls and Procedures**

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of September 30, 2014. Based on that evaluation, the Company's management, including the Chief Executive Officer and the Chief Financial Officer, concluded that the Registrant's disclosure controls and procedures were effective.

During the quarter ended September 30, 2014, there have been no changes in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **Part II Other Information**

### **Item 1. Legal Proceedings**

The Bank is subject to various legal actions arising in the normal course of business. In the opinion of management, the resolution of these legal actions is not expected to have a material adverse effect on the Bank's or the Company's financial condition or results of operations.

### **Item 1A. Risk Factors**

Not applicable, as the Registrant is a smaller reporting company.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(a) There were no sales of unregistered securities during the period covered by this Report.

(b) **Use of Proceeds.** On February 27, 2014, the Board of Directors of Melrose Cooperative Bank adopted a plan of conversion (the Plan), pursuant to which the Bank would convert from the mutual to the stock form of ownership and Melrose Bancorp would sell shares of common stock to the public. On March 11, 2014, Melrose Bancorp filed a Registration Statement on Form S-1 with the Securities and Exchange Commission (File No. 333-194475) with respect to the shares to be offered and sold pursuant to the Plan. Melrose Bancorp registered for offer and sale up to

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3,580,425 shares of common stock, par value \$0.01 per share, at a sales price of \$10.00 per share. The registration statement was declared effective by the Securities and Exchange Commission on August 12, 2014.

The public stock offering closed on October 21, 2014, and on October 22, 2014 the common stock began trading on the Nasdaq Capital Market under the symbol MELR.

In accordance with the Plan and pursuant to the registration statement, the shares of common stock were offered to eligible depositors of Melrose Cooperative Bank and Melrose's tax-qualified employee benefit plans, including its employee stock ownership. Keefe, Bruyette & Woods, Inc. was engaged to assist in the marketing of the common stock. For its services, Keefe, Bruyette & Woods, Inc. received a management fee of \$30,000 and success fee of 1.00% of the dollar value of the shares sold in the subscription offering, excluding shares sold to the tax qualified employee plans, including 226,366 shares, equal to 8.0% of the shares sold in the offering and contributed to Melrose Cooperative Bank Foundation, and shares sold to our officers, employees and directors and members of their immediate families. The success fee was reduced by the management fee.

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The stock offering resulted in gross proceeds of \$27.2 million through the sale of 2,723,409 shares at \$10.00 per share.

Melrose Bancorp received gross proceeds from the initial public offering of \$27.2 million. Expenses related to the offering were approximately \$1.6 million. Net proceeds were \$25.7 million, of which \$12.8 million was contributed to Melrose Cooperative Bank in the form of additional paid in capital, and the remainder was retained by Melrose Bancorp to be utilized for general corporate purposes. Melrose Bancorp loaned \$2,263,660 to Melrose Cooperative Bank's employee stock ownership plan to enable it to purchase 226,366 shares of common stock in the offering and contributed 106,170 shares of the common stock and \$300,000 in cash to Melrose Cooperative Bank Foundation. Initially, upon the closing of the offering, a substantial portion of the proceeds have been invested in overnight investments and short-term investments.

(c) There were no issuer repurchases of securities during the period covered by this Report.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

- 10.1 Melrose Cooperative Bank Employee Stock Ownership Plan
- 10.2 Employment Agreement between Melrose Cooperative Bank and Jeffrey Jones
- 10.3 Change in Control Agreement between Melrose Cooperative Bank and Diane Indorato
- 10.4 Change in Control Agreement between Melrose Cooperative Bank and James Oosterman
- 10.5 Melrose Cooperative Bank Supplemental Executive Retirement Plan
- 10.6 Melrose Cooperative Bank Executive Annual Incentive Plan
- 10.7 Executive Split Dollar Agreement between Melrose Cooperative Bank and Jeffrey Jones
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2

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Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

|         |  |
|---------|--|
| 32      | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS | XBRL Instance Document   |
| 101.SCH | XBRL Taxonomy Extension Schema Document  |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document   |

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**MELROSE BANCORP, INC.**

Date: November 13, 2014

/s/ Jeffrey D. Jones  
Jeffrey D. Jones  
President and Chief Executive Officer

Date: November 13, 2014

/s/ Diane Indorato  
Diane Indorato  
Senior Vice President and Chief Financial Officer