

Kearny Financial Corp.  
Form 10-Q  
February 10, 2014

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2013

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 Number 000-51093

KEARNY FINANCIAL CORP.  
(Exact name of registrant as specified in its charter)

UNITED STATES  
(State or other jurisdiction of  
incorporation or organization)

22-3803741  
(I.R.S. Employer  
Identification Number)

120 Passaic Ave., Fairfield, New Jersey  
(Address of principal executive offices)

07004-3510  
(Zip Code)

Registrant's telephone number, including area code 973-244-4500

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 filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit 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.

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Large accelerated filer   
Non-accelerated filer

Accelerated filer   
Smaller reporting company

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

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:  
February 7, 2014.

\$0.10 par value common stock - 66,131,460 shares outstanding

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION  
(In Thousands, Except Share and Per Share Data)

	December 31, 2013 (Unaudited)	June 30, 2013
<b>Assets</b>		
Cash and amounts due from depository institutions	\$ 12,423	\$ 13,102
Interest-bearing deposits in other banks	140,869	113,932
Cash and Cash Equivalents	153,292	127,034
Debt securities available for sale (amortized cost \$304,792 and \$305,283)	298,056	300,122
Debt securities held to maturity (fair value \$203,580 and \$202,328)	211,342	210,015
Loans receivable, including unamortized yield adjustments of \$(1,799) and \$(847)	1,554,788	1,360,871
Less allowance for loan losses	(11,493 )	(10,896 )
Net Loans Receivable	1,543,295	1,349,975
Mortgage-backed securities available for sale (amortized cost \$675,197 and \$782,866)	664,480	780,652
Mortgage-backed securities held to maturity (fair value \$94,002 and \$96,447)	100,245	101,114
Premises and equipment	37,312	36,994
Federal Home Loan Bank of New York ("FHLB") stock	21,064	15,666
Interest receivable	7,925	8,028
Goodwill	108,591	108,591
Bank owned life insurance	87,494	86,084
Deferred income tax assets, net	13,250	9,782
Other assets	12,680	11,303
Total Assets	\$ 3,259,026	\$ 3,145,360
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
<b>Deposits:</b>		
Non-interest-bearing	\$ 193,549	\$ 190,964
Interest-bearing	2,184,068	2,179,544
Total Deposits	2,377,617	2,370,508
Borrowings	396,868	287,695
Advance payments by borrowers for taxes	8,202	7,840
Other liabilities	11,824	11,610

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Total Liabilities	2,794,511	2,677,653
Stockholders' Equity		
Preferred stock, \$0.10 par value, 25,000,000 shares authorized; none issued and outstanding	-	-
Common stock, \$0.10 par value, 75,000,000 shares authorized; 72,737,500 shares issued; 66,134,860 and 66,500,740 shares outstanding, respectively	7,274	7,274
Paid-in capital	215,857	215,722
Retained earnings	331,740	326,167
Unearned Employee Stock Ownership Plan shares; 460,666 shares and 533,400 shares, respectively	(4,607 )	(5,334 )
Treasury stock, at cost; 6,602,640 shares and 6,236,760 shares, respectively	(75,775 )	(71,983 )
Accumulated other comprehensive loss	(9,974 )	(4,139 )
Total Stockholders' Equity	464,515	467,707
Total Liabilities and Stockholders' Equity	\$ 3,259,026	\$ 3,145,360

See notes to unaudited consolidated financial statements.

KEARNY FINANCIAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME  
(In Thousands, Except Per Share Data, Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Interest Income				
Loans	\$16,509	\$15,165	\$32,325	\$30,941
Mortgage-backed securities	5,505	6,162	11,059	13,165
Securities:				
Taxable	1,221	274	2,499	500
Tax-exempt	460	6	914	12
Other interest-earning assets	238	195	436	390
Total Interest Income	23,933	21,802	47,233	45,008
Interest Expense				
Deposits	3,594	3,773	7,226	8,050
Borrowings	1,864	2,035	3,336	4,089
Total Interest Expense	5,458	5,808	10,562	12,139
Net Interest Income	18,475	15,994	36,671	32,869
Provision for Loan Losses	559	1,393	1,727	1,732
Net Interest Income after Provision for Loan Losses	17,916	14,601	34,944	31,137
Non-Interest Income				
Fees and service charges	630	617	1,321	1,246
Gain on sale of loans	-	-	53	-
Gain on sale of securities	226	1,097	226	1,097
(Loss) gain on sale and write down of real estate owned	-	(239)	1	(533)
Income from bank owned life insurance	707	393	1,409	776
Electronic banking fees and charges	296	285	640	574
Miscellaneous	70	132	140	325
Total Non-Interest Income	1,929	2,285	3,790	3,485
Non-Interest Expenses				
Salaries and employee benefits	8,723	8,791	17,676	17,603
Net occupancy expense of premises	1,607	1,655	3,269	3,253
Equipment and systems	2,055	1,896	3,929	3,873
Advertising and marketing	308	275	559	561
Federal deposit insurance premium	618	549	1,130	1,101

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Directors' compensation	172	175	344	342
Miscellaneous	2,074	1,850	3,932	3,731
Total Non-Interest Expenses	\$15,557	\$15,191	\$30,839	\$30,464

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME (Continued)  
(In Thousands, Except Per Share Data, Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Income Before Income Taxes	\$4,288	\$1,695	\$7,895	\$4,158
Income Taxes	1,301	518	2,322	1,321
Net Income	\$2,987	\$1,177	\$5,573	\$2,837
Net Income per Common Share (EPS):				
Basic	\$0.05	\$0.02	\$0.08	\$0.04
Diluted	\$0.05	\$0.02	\$0.08	\$0.04
Weighted Average Number of Common Shares Outstanding:				
Basic	65,767	66,188	65,851	66,222
Diluted	65,767	66,188	65,851	66,222
Dividends Declared Per Common Share	\$-	\$-	\$-	\$-

See notes to unaudited consolidated financial statements.

KEARNY FINANCIAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
(In Thousands, Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Net Income	\$2,987	\$1,177	\$5,573	\$2,837
Other Comprehensive Loss				
Net realized gain on securities available for sale, net of deferred income tax expense of 2013 \$(93), \$(93) and 2012 \$(452), \$(452)	(133	) (651	) (133	) (651
Net unrealized loss on securities available for sale, net of deferred income tax benefit of: 2013 \$(4,336), \$(3,802) and, 2012 \$(3,305), \$(371)	(6,993	) (4,860	) (6,050	) (507
Net unrealized gain (loss) on derivatives, net of deferred income tax expense (benefit) of: 2013 \$1,059, \$(96) and 2012 \$ -, \$ -	1,532	-	(140	) -
Benefit plans, net of deferred income tax expense (benefit) of: 2013 \$4, \$337 and, 2012 \$10, \$(464)	7	15	488	(671
Total Other Comprehensive Loss	(5,587	) (5,496	) (5,835	) (1,829
Total Comprehensive (Loss) Income	\$(2,600	) \$(4,319	) \$(262	) \$1,008

See notes to unaudited consolidated financial statements.

KEARNY FINANCIAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
Six Months Ended December 31, 2012  
(In Thousands, Unaudited)

	Common Stock Shares	Common Stock Amount	Paid-In Capital	Retained Earnings	Unearned ESOP Shares	Treasury Stock	Accumulated Other Comprehensive Income	Total
Balance - June 30, 2012	66,936	\$7,274	\$215,539	\$319,661	\$(6,789 )	\$(67,664 )	\$ 23,596	\$491,617
Net income	-	-	-	2,837	-	-	-	2,837
Other comprehensive loss, net of income tax benefit	-	-	-	-	-	-	(1,829 )	(1,829 )
ESOP shares committed to be released (72 shares)	-	-	(33 )	-	727	-	-	694
Dividends contributed for payment of ESOP loan	-	-	(2 )	-	-	-	-	(2 )
Stock option expense	-	-	21	-	-	-	-	21
Treasury stock purchases	(171 )	-	-	-	-	(1,635 )	-	(1,635 )
Restricted stock plan shares earned (8 shares)	-	-	84	-	-	-	-	84
Balance - December 31, 2012	66,765	\$7,274	\$215,609	\$322,498	\$(6,062 )	\$(69,299 )	\$ 21,767	\$491,787

See notes to unaudited consolidated financial statements.

KEARNY FINANCIAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
Six Months Ended December 31, 2013  
(In Thousands, Unaudited)

	Common Stock		Paid-In	Retained	Unearned	Treasury	Accumulated	
	Shares	Amount	Capital	Earnings	ESOP	Stock	Other	Total
					Shares		Comprehensive	
							Loss	
Balance - June 30, 2013	66,501	\$7,274	\$215,722	\$326,167	\$(5,334 )	\$(71,983 )	\$(4,139 )	\$467,707
Net income	-	-	-	5,573	-	-	-	5,573
Other comprehensive income, net of income tax	-	-	-	-	-	-	(5,836 )	(5,836 )
ESOP shares committed to be released (72 shares)	-	-	31	-	728	-	-	759
Stock option expense	-	-	20	-	-	-	-	20
Treasury stock purchases	(366 )	-	-	-	-	(3,792 )	-	(3,792 )
Restricted stock plan shares earned (8 shares)	-	-	84	-	-	-	-	84
Balance - December 31, 2013	66,135	\$7,274	\$215,857	\$331,740	\$(4,606 )	\$(75,775 )	\$(9,975 )	\$464,515

See notes to unaudited consolidated financial statements.

KEARNY FINANCIAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In Thousands, Unaudited)

	Six Months Ended December 31,	
	2013	2012
Cash Flows from Operating Activities:		
Net income	\$ 5,573	\$ 2,837
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	1,262	1,307
Net amortization of premiums, discounts and loan fees and costs	1,663	5,759
Deferred income taxes	186	304
Amortization of intangible assets	64	72
Amortization of benefit plans' unrecognized net loss	22	50
Provision for loan losses	1,727	1,732
(Gain) loss on write-down and sales of real estate owned	(1 )	533
Realized gain on sale of loans	(53 )	-
Proceeds from sale of loans	496	-
Realized loss on sale of debt securities available for sale	1,294	-
Realized gain on sale of mortgage-backed securities available for sale	(1,520 )	(1,103 )
Realized loss on sale of mortgage-backed securities held to maturity	-	6
Realized gain on disposition of premises and equipment	-	(100 )
Increase in cash surrender value of bank owned life insurance	(1,409 )	(776 )
ESOP, stock option plan and restricted stock plan expenses	862	799
Decrease in interest receivable	103	519
(Increase) decrease in other assets	(1,361 )	685
Increase in interest payable	113	14
Increase (decrease) in other liabilities	991	(1,047 )
Net Cash Provided by Operating Activities	10,012	11,591
Cash Flows from Investing Activities:		
Purchase of debt securities available for sale	(55,217 )	-
Proceeds from sale of debt securities available for sale	54,075	-
Proceeds from repayments of debt securities available for sale	455	389
Purchase of debt securities held to maturity	(2,530 )	(144,163 )
Proceeds from calls and maturities of debt securities held to maturity	270	31,068
Proceeds from repayments of debt securities held to maturity	847	518
Purchase of loans	(58,319 )	(8,085 )
Net increase in loans receivable	(137,695 )	(12,834 )
Proceeds from sale of real estate owned	403	2,249

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Purchases of mortgage-backed securities available for sale	(17,061 )	(79,603 )
Principal repayments on mortgage-backed securities available for sale	70,719	200,267
Principal repayments on mortgage-backed securities held to maturity	827	134
Proceeds from sale of mortgage-backed securities held to maturity	-	15
Proceeds from sale of mortgage-backed securities available for sale	53,613	70,739
Purchase of FHLB stock	(14,445 )	(1,125 )
Redemption of FHLB stock	9,047	1,127
Purchase of bank owned life insurance	-	(503 )
Proceeds from cash settlement of premises and equipment	-	200
Additions to premises and equipment	(1,580 )	(543 )
Net Cash (Used in) Provided by Investing Activities	\$ (96,591 )	\$ 59,850

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)  
(In Thousands, Unaudited)

	Six Months Ended December 31,	
	2013	2012
Cash Flows from Financing Activities:		
Net increase (decrease) in deposits	\$ 7,085	\$ (31,167 )
Repayment of term FHLB advances	(275,043 )	(42 )
Proceeds from term FHLB advances	400,000	-
Net change in overnight borrowings	(5,000 )	-
Decrease in other short-term borrowings	(10,775 )	(7,515 )
Increase in advance payments by borrowers for taxes	362	327
Purchase of common stock of Kearny Financial Corp. for treasury	(3,792 )	(1,635 )
Dividends contributed for payment of ESOP loan	-	(2 )
Net Cash Provided by (Used in) Financing Activities	112,837	(40,034 )
Net Increase in Cash and Cash Equivalents	26,258	31,407
Cash and Cash Equivalents – Beginning	127,034	155,584
Cash and Cash Equivalents – Ending	\$ 153,292	\$ 186,991
Supplemental Disclosures of Cash Flows Information:		
Cash paid during the year for:		
Income taxes, net of refunds	\$ 2,341	\$ 714
Interest	\$ 10,448	\$ 12,125
Non-cash investing and financing activities:		
Acquisition of real estate owned in settlement of loans	\$ 720	\$ 2,164

See notes to unaudited consolidated financial statements.

KEARNY FINANCIAL CORP. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. PRINCIPLES OF CONSOLIDATION

The unaudited consolidated financial statements include the accounts of Kearny Financial Corp. (the “Company”), its wholly-owned subsidiary, Kearny Federal Savings Bank (the “Bank”) and the Bank’s wholly-owned subsidiaries, KFS Investment Corp., CJB Investment Corp. and KFS Financial Services, Inc. and its wholly-owned subsidiary KFS Insurance Services, Inc. The Company conducts its business principally through the Bank. Management prepared the unaudited consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”), including the elimination of all significant inter-company accounts and transactions during consolidation.

2. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and Regulation S-X and do not include information or footnotes necessary for a complete presentation of financial condition, income, comprehensive income, changes in stockholders’ equity and cash flows in conformity with GAAP. However, in the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the unaudited consolidated financial statements have been included. The results of operations for the three-and six-month periods ended December 31, 2013, are not necessarily indicative of the results that may be expected for the entire fiscal year or any other period.

The data in the consolidated statement of financial condition for June 30, 2013 was derived from the Company’s 2013 annual report on Form 10-K. That data, along with the interim unaudited financial information presented in the consolidated statements of financial condition, income, comprehensive income (loss), changes in stockholders’ equity and cash flows should be read in conjunction with the audited consolidated financial statements, including the notes thereto included in the Company’s 2013 annual report on Form 10-K.

3. NET INCOME PER COMMON SHARE (“EPS”)

Basic EPS is based on the weighted average number of common shares actually outstanding including restricted stock awards (see following paragraph) adjusted for Employee Stock Ownership Plan (“ESOP”) shares not yet committed to be released. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as outstanding stock options, were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. Diluted EPS is calculated by adjusting the weighted average number of shares of common stock outstanding to include the effect of contracts or securities exercisable or which could be converted into common stock, if dilutive, using the treasury stock method. Shares issued and reacquired during any period are weighted for the portion of the period they were outstanding.

The Financial Accounting Standards Board (“FASB”) has issued guidance on determining whether instruments granted in share-based payment transactions are participating securities. This guidance clarifies that all outstanding unvested share-based payment awards that contain rights to non-forfeitable dividends participate in undistributed earnings with common shareholders. Awards of this nature are considered participating securities and the two-class method of computing basic and diluted earnings per share must be applied.





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The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations:

	Three Months Ended December 31, 2013			Six Months Ended December 31, 2013		
	Income (Numerator) (In Thousands, Except Per Share Data)	Shares (Denominator)	Per Share Amount	Income (Numerator) (In Thousands, Except Per Share Data)	Shares (Denominator)	Per Share Amount
Net income	\$2,987			\$5,573		
Basic earnings per share, income available to common stockholders	\$2,987	65,767	\$0.05	\$5,573	65,851	\$0.08
Effect of dilutive securities:						
Stock options	-	-		-	-	
	\$2,987	65,767	\$0.05	\$5,573	65,851	\$0.08
	Three Months Ended December 31, 2012			Six Months Ended December 31, 2012		
	Income (Numerator) (In Thousands, Except Per Share Data)	Shares (Denominator)	Per Share Amount	Income (Numerator) (In Thousands, Except Per Share Data)	Shares (Denominator)	Per Share Amount
Net income	\$1,177			\$2,837		
Basic earnings per share, income available to common stockholders	\$1,177	66,188	\$0.02	\$2,837	66,222	\$0.04
Effect of dilutive securities:						
Stock options	-	-		-	-	
	\$1,177	66,188	\$0.02	\$2,837	66,222	\$0.04

During the three and six months ended December 31, 2013, the average number of options which were considered anti-dilutive totaled approximately 3,053,000 and 3,122,000, respectively. During the three and six months ended December 31, 2012, the average number of options which were considered anti-dilutive totaled approximately 3,193,000 and 3,193,000, respectively.

#### 4. SUBSEQUENT EVENTS

On January 30, 2014, the Company announced the execution of a merger agreement with Atlas Bank (“Atlas”) pursuant to which Atlas will merge with and into the Bank. Atlas is headquartered in Brooklyn, New York and had approximately \$112.8 million in total assets at December 31, 2013. The acquisition will add Atlas’s branch offices located in Brooklyn and Staten Island, New York to Kearny’s 41 branch network located throughout northern and central New Jersey. Atlas’s branch offices are expected to operate under the name, “Atlas Bank, a division of Kearny Federal Savings Bank,” for a period of at least one year following the merger.



Under the terms of the merger agreement, depositors of Atlas will become depositors of the Bank and will have the same rights and privileges in Kearny MHC, the mutual holding company parent of the Company, as if their accounts had been established at the Bank on the date they were originally established at Atlas. As part of the transaction, the Company will issue additional shares of its common stock to Kearny MHC in an amount equal to the fair value of Atlas as determined by an independent appraiser. These shares are expected to be issued immediately prior to the completion of the merger.

The transaction is expected to close during the fourth fiscal quarter ending June 30, 2014 or the subsequent quarter ending September 30, 2014 subject to certain conditions, including approval by Atlas's depositors and customary regulatory approvals.

## 5. RECENT ACCOUNTING PRONOUNCEMENTS

In January, 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-01, Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. In the past, the FASB issued ASU 2011-11 as the result of a joint project with the IASB to enhance and provide converged disclosures about financial and derivative instruments that are offset on the balance sheet or are subject to an enforceable master netting arrangement. ASU 2011-11 did not change the conditions for when offsetting is appropriate in US GAAP. However, those conditions differ under IFRS, which results in the single largest financial reporting difference for certain financial institutions. As a result, ASU 2011-11 established new disclosures to reconcile US GAAP and IFRS primarily through the requirement to present information on both a "gross" and "net" basis in the footnotes.

After the issuance of ASU 2011-11, stakeholders informed the FASB that the scope of the new disclosures was unclear, particularly because many contracts contain standard commercial provisions that would equate to a master netting arrangement. In order to clarify its intent and narrow the scope of the new disclosures, the Board issued ASU 2013-01. It states that the disclosures established in ASU 2011-11 only apply to recognized derivative instruments accounted for in accordance with Topic 815, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are offset on the balance sheet under ASC 210-20-45 or 815-10-45, or subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset under ASC 210-20-45 or 815-10-45.

ASU 2013-01 is effective for fiscal years beginning on or after January 1, 2013 and interim periods within those years. Retrospective application is required. The new pronouncement did not have an impact on the Company's consolidated financial statements.

On July 17, 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-10, Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes. The ASU allows the Fed Funds Effective Swap Rate to be used as a U.S. benchmark interest rate for hedge accounting purposes. In the past, only rates on U.S. Treasury obligations and LIBOR were permitted. The ASU was issued as a result of changes in the marketplace that have occurred since the issuance of Statement 133, and more particularly, as a result of the 2008 financial crisis. ASU 2013-10 is applicable to all entities that elect to apply hedge accounting of the benchmark interest rate under Topic 815, Derivatives and Hedging. The ASU is effective July 17, 2013, but only for qualifying new or redesignated hedging relationships entered into on or after that date. In other words, retrospective adoption is not available because it would be inconsistent with the requirement to prepare appropriate documentation at the inception of a hedge. The new pronouncement did not have an impact on the Company's consolidated financial statements.



## 6. STOCK REPURCHASE PLANS

On March 23, 2012, the Company announced that the Board of Directors authorized a stock repurchase plan to acquire up to 802,780 shares, or 5% of the Company's outstanding stock held by persons other than Kearny MHC. The Company completed that share repurchase plan during the quarter ended December 31, 2013 at a total cost of approximately \$8,088,000 and at an average cost per share of \$10.07.

On December 2, 2013, the Company announced that the Board of Directors authorized a subsequent stock repurchase plan to acquire up to 762,640 shares, or 5% of the Company's outstanding stock held by persons other than Kearny MHC. Through December 31, 2013 the Company has repurchased a total of 34,200 shares in accordance with this repurchase plan at a total cost of approximately \$358,000 and at an average cost per share of \$10.46.

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## 7. SECURITIES AVAILABLE FOR SALE

The amortized cost, gross unrealized gains and losses and fair values of debt and mortgage-backed securities available for sale at December 31, 2013 and June 30, 2013 and stratification by contractual maturity of debt securities available for sale at December 31, 2013 are presented below:

	At December 31, 2013			
	Amortized	Gross	Gross	Fair
	Cost	Unrealized	Unrealized	Value
		Gains	Losses	
		(In Thousands)		
Securities available for sale:				
Debt securities:				
U.S. agency securities	\$4,466	\$19	\$3	\$4,482
Obligations of state and political subdivisions	27,548	-	2,463	25,085
Asset-backed securities	73,741	-	1,159	72,582
Collateralized loan obligations	30,060	-	272	29,788
Corporate bonds	160,094	126	1,525	158,695
Trust preferred securities	8,883	-	1,459	7,424
Total debt securities	304,792	145	6,881	298,056
Mortgage-backed securities:				
Collateralized mortgage obligations:				
Federal Home Loan Mortgage Corporation	9,487	-	728	8,759
Federal National Mortgage Association	53,582	12	4,364	49,230
Total collateralized mortgage obligations	63,069	12	5,092	57,989
Mortgage pass-through securities:				
Residential pass-through securities:				
Government National Mortgage Association	5,288	297	-	5,585
Federal Home Loan Mortgage Corporation	251,131	3,987	5,705	249,413
Federal National Mortgage Association	270,496	6,460	5,706	271,250
Total residential pass-through securities	526,915	10,744	11,411	526,248
Commercial pass-through securities:				
Federal Home Loan Mortgage Corporation	94	2	-	96
Federal National Mortgage Association	85,119	2	4,974	80,147
Total commercial pass-through securities	85,213	4	4,974	80,243
Total mortgage-backed securities	675,197	10,760	21,477	664,480
Total securities available for sale	\$979,989	\$10,905	\$28,358	\$962,536

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	At December 31, 2013	
	Amortized Cost	Fair Value
	(In Thousands)	
Debt securities available for sale:		
Due in one year or less	\$ -	\$ -
Due after one year through five years	20,038	19,978
Due after five years through ten years	156,517	154,853
Due after ten years	128,237	123,225
Total	\$ 304,792	\$ 298,056

	At June 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Securities available for sale:				
Debt securities:				
U.S. agency securities	\$ 4,955	\$ 60	\$ -	\$ 5,015
Obligations of state and political subdivisions	27,560	-	2,253	25,307
Asset-backed securities	25,417	1	620	24,798
Collateralized loan obligations	78,366	190	70	78,486
Corporate bonds	160,107	34	949	159,192
Trust preferred securities	8,878	-	1,554	7,324
Total debt securities	305,283	285	5,446	300,122
Mortgage-backed securities:				
Collateralized mortgage obligations:				
Federal Home Loan Mortgage Corporation	9,825	-	470	9,355
Federal National Mortgage Association	56,158	24	3,055	53,127
Total collateralized mortgage obligations	65,983	24	3,525	62,482
Mortgage pass-through securities:				
Residential pass-through securities:				
Government National Mortgage Association	5,889	444	-	6,333
Federal Home Loan Mortgage Corporation	290,133	4,827	4,600	290,360
Federal National Mortgage Association	326,356	9,050	3,945	331,461
Total residential pass-through securities	622,378	14,321	8,545	628,154
Commercial pass-through securities:				
Federal Home Loan Mortgage Corporation	116	2	-	118
Federal National Mortgage Association	94,389	3	4,494	88,898
Total commercial pass-through securities	94,505	5	4,494	90,016



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Total mortgage-backed securities	782,866	14,350	16,564	780,652
Total securities available for sale	\$ 1,088,149	\$ 14,635	\$ 22,010	\$ 1,080,774

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During the six months ended December 31, 2013, proceeds from sales of securities available for sale totaled \$107.7 million and resulted in gross gains of \$2,060,000 and gross losses of \$1,834,000. Proceeds from sales of securities available for sale during the six months ended December 31, 2012, totaled \$70.7 million and resulted in gross gains of \$1,150,000 and gross losses of \$47,000.

At December 31, 2013 and June 30, 2013, securities available for sale with carrying values of approximately \$73.1 million and \$99.4 million, respectively, were utilized as collateral for borrowings through the FHLB of New York. As of those same dates, securities available for sale with carrying values of approximately \$6.8 million and \$4.4 million, respectively, were pledged to secure public funds on deposit.

The Company's available for sale mortgage-backed securities are generally secured by both residential and commercial mortgage loans with original contractual maturities of ten to thirty years. The effective lives of mortgage-backed securities are generally shorter than their contractual maturities due to principal amortization and prepayment of the mortgage loans comprised within those securities. Investors in mortgage pass-through securities generally share in the receipt of principal repayments on a pro-rata basis as paid by the borrowers. By comparison, collateralized mortgage obligations generally represent individual tranches within a larger investment vehicle that is designed to distribute cash flows received on securitized mortgage loans to investors in a manner determined by the overall terms and structure of the investment vehicle and those applying to the individual tranches within that structure.

8. SECURITIES HELD TO MATURITY

The amortized cost, gross unrealized gains and losses and fair values of debt and mortgage-backed securities held to maturity at December 31, 2013 and June 30, 2013 and stratification by contractual maturity of debt securities held to maturity at December 31, 2013 are presented below:

		At December 31, 2013		
	Amortized	Gross	Gross	Fair Value
	Cost	Unrealized	Unrealized	
		Gains	Losses	
		(In Thousands)		
Securities held to maturity:				
Debt securities:				
U.S. agency securities	\$144,480	\$10	\$3,330	\$141,160
Obligations of state and political subdivisions	66,862	12	4,454	62,420
Total debt securities	211,342	22	7,784	203,580
Mortgage-backed securities:				
Collateralized mortgage obligations:				
Federal Home Loan Mortgage Corporation	19	1	-	20
Federal National Mortgage Association	296	24	-	320
Non-agency securities	93	1	1	93
Total collateralized mortgage obligations	408	26	1	433
Mortgage pass-through securities:				
Residential pass-through securities:				
Federal Home Loan Mortgage Corporation	87	4	-	91
Federal National Mortgage Association	210	7	-	217
Total residential pass-through securities	297	11	-	308
Commercial pass-through securities:				
Federal National Mortgage Association	99,540	-	6,279	93,261
Total commercial pass-through securities	99,540	-	6,279	93,261
Total mortgage-backed securities	100,245	37	6,280	94,002
Total securities held to maturity	\$311,587	\$59	\$14,064	\$297,582

	At December 31, 2013	
	Amortized	Fair Value
	Cost	
	(In Thousands)	
Debt securities held to maturity:		
Due in one year or less	\$ 3,760	\$ 3,771
Due after one year through five years	145,735	142,404
Due after five years through ten years	32,270	30,545
Due after ten years	29,577	26,860
Total	\$ 211,342	\$ 203,580

		At June 30, 2013		
	Amortized	Gross	Gross	Fair Value
	Cost	Unrealized	Unrealized	
		Gains	Losses	
		(In Thousands)		
Securities held to maturity:				
Debt securities:				
U.S. agency securities	\$144,747	\$14	\$3,622	\$141,139
Obligations of state and political subdivisions	65,268	4	4,083	61,189
Total debt securities	210,015	18	7,705	202,328
Mortgage-backed securities:				
Collateralized mortgage obligations:				
Federal Home Loan Mortgage Corporation	22	3	-	25
Federal National Mortgage Association	350	32	-	382
Non-agency securities	105	3	2	106
Total collateralized mortgage obligations	477	38	2	513
Mortgage pass-through securities:				
Residential pass-through securities:				
Federal Home Loan Mortgage Corporation	98	4	-	102
Federal National Mortgage Association	231	9	-	240
Total residential pass-through securities	329	13	-	342
Commercial pass-through securities:				
Federal National Mortgage Association	100,308	-	4,716	95,592
Total commercial pass-through securities	100,308	-	4,716	95,592
Total mortgage-backed securities	101,114	51	4,718	96,447
Total securities held to maturity	\$311,129	\$69	\$12,423	\$298,775

There were no sales of securities held to maturity during the six months ended December 31, 2013. During the six months ended December 31, 2012, proceeds from sales of held to maturity securities totaled \$15,000 resulting in losses of \$6,000. The proceeds and losses were fully attributable to the sale of non-investment grade, non-agency collateralized mortgage obligations during the earlier period. The securities sold were originally acquired as investment grade securities upon the in-kind redemption of the Company's interest in the AMF Ultra Short Mortgage Fund during the first quarter of fiscal 2009. The rating of the securities subsequently declined below investment grade resulting in their eligibility for sale from the held-to-maturity portfolio without tainting the status of the remaining securities within the portfolio.

At December 31, 2013 and June 30, 2013, securities held to maturity with carrying values of approximately \$123.3 million and \$123.3 million, respectively, were utilized as collateral for borrowings through the FHLB of New York. Held to maturity securities were not utilized to secure public funds on deposit at December 31, 2013 or June 30, 2013.

The Company's held to maturity mortgage-backed securities are generally secured by both residential and commercial mortgage loans with original contractual maturities of ten to thirty years. The effective lives of mortgage-backed securities are generally shorter than their contractual maturities due to principal amortization and prepayment of the mortgage loans comprised within those securities. Investors in mortgage pass-through securities generally share in the receipt of principal repayments on a pro-rata basis as paid by the borrowers. By comparison, collateralized mortgage obligations generally represent individual tranches within a larger investment vehicle that is designed to distribute cash flows received on securitized mortgage loans to investors in a manner determined by the overall terms and structure of the investment vehicle and those applying to the individual tranches within that structure.

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## 9. IMPAIRMENT OF SECURITIES

The following two tables summarize the fair values and gross unrealized losses within the available for sale and held to maturity portfolios at December 31, 2013 and June 30, 2013. The gross unrealized losses, presented by security type, represent temporary impairments of value within each portfolio as of the dates presented. Temporary impairments within the available for sale portfolio have been recognized through other comprehensive income as reductions in stockholders' equity on a tax-effected basis.

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(In Thousands)						
Securities Available for Sale:						
At December 31, 2013:						
U.S. agency securities	\$957	\$3	\$-	\$-	\$957	\$3
Obligations of state and political subdivisions	25,086	2,463	-	-	25,086	2,463
Asset-backed securities	72,582	1,159	-	-	72,582	1,159
Collateralized loan obligations	29,788	272	-	-	29,788	272
Corporate bonds	113,600	1,525	-	-	113,600	1,525
Trust preferred securities	-	-	6,424	1,459	6,424	1,459
Collateralized mortgage obligations	56,566	5,092	-	-	56,566	5,092
Residential pass-through securities	237,655	10,488	8,912	923	246,567	11,411
Commercial pass-through securities	79,972	4,974	-	-	79,972	4,974
Total	\$616,206	\$25,976	\$15,336	\$2,382	\$631,542	\$28,358
At June 30, 2013:						
Obligations of state and political subdivisions	\$25,307	\$2,253	\$-	\$-	\$25,307	\$2,253
Asset-backed securities	19,675	620	-	-	19,675	620
Collateralized loan obligations	27,930	70	-	-	27,930	70
Corporate bonds	149,190	949	-	-	149,190	949
Trust preferred securities	-	-	6,324	1,554	6,324	1,554
Collateralized mortgage obligations	60,740	3,525	-	-	60,740	3,525
Residential pass-through securities	244,429	8,545	-	-	244,429	8,545
Commercial pass-through securities	89,695	4,494	-	-	89,695	4,494
Total	\$616,966	\$20,456	\$6,324	\$1,554	\$623,290	\$22,010

The number of available for sale securities with unrealized losses at December 31, 2013 totaled 160 and included four U.S. agency securities, 70 municipal obligations, five asset-backed securities, four collateralized loan obligations, 11 corporate bonds, four trust preferred securities, four collateralized mortgage obligations, 43 residential pass-through securities and 15 commercial pass-through securities. The number of available for sale securities with unrealized losses at June 30, 2013 totaled 153 and included 70 municipal obligations, two asset-backed securities, five collateralized loan obligations, 13 corporate bonds, four trust preferred securities, four collateralized mortgage obligations, 38 residential pass-through securities and 17 commercial pass-through securities.

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(In Thousands)						
Securities Held to Maturity:						
At December 31, 2013:						
U.S. agency securities	\$130,274	\$3,050	\$9,720	\$280	\$139,994	\$3,330
Obligations of state and political subdivisions	58,648	4,454	-	-	58,648	4,454
Collateralized mortgage obligations	-	-	38	1	38	1
Commercial pass-through securities	93,261	6,279	-	-	93,261	6,279
Total	\$282,183	\$13,783	\$9,758	\$281	\$291,941	\$14,064
At June 30, 2013:						
U.S. agency securities	\$139,699	\$3,622	\$-	\$-	\$139,699	\$3,622
Obligations of state and political subdivisions	59,109	4,083	-	-	59,109	4,083
Collateralized mortgage obligations	4	1	44	1	48	2
Commercial pass-through securities	90,935	4,716	-	-	90,935	4,716
Total	\$289,747	\$12,422	\$44	\$1	\$289,791	\$12,423

The number of held to maturity securities with unrealized losses at December 31, 2013 totaled 162 and included seven U.S. agency securities, 132 municipal obligations, three collateralized mortgage obligations and 20 commercial pass-through securities. The number of held to maturity securities with unrealized losses at June 30, 2013 totaled 162 and included seven U.S. agency securities, 132 municipal obligations, four collateralized mortgage obligations and 19 commercial pass-through securities.

In general, if the fair value of a debt security is less than its amortized cost basis at the time of evaluation, the security is "impaired" and the impairment is to be evaluated to determine if it is other than temporary. The Company evaluates the impaired securities in its portfolio for possible other than temporary impairment (OTTI) on at least a quarterly basis. The following represents the circumstances under which an impaired security is determined to be other than temporarily impaired:

- When the Company intends to sell the impaired debt security;





- When the Company more likely than not will be required to sell the impaired debt security before recovery of its amortized cost (for example, whether liquidity requirements or contractual or regulatory obligations indicate that the security will be required to be sold before a forecasted recovery occurs); and
- When an impaired debt security does not meet either of the two conditions above, but the Company does not expect to recover the entire amortized cost of the security. According to applicable accounting guidance for debt securities, this is generally when the present value of cash flows expected to be collected is less than the amortized cost of the security.

In the first two circumstances noted above, the amount of OTTI recognized in earnings is the entire difference between the security's amortized cost basis and its fair value at the balance sheet date. In the third circumstance, however, the OTTI is to be separated into the amount representing the credit loss from the amount related to all other factors. The credit loss component is to be recognized in earnings while the non-credit loss component is to be recognized in other comprehensive income. In these cases, OTTI is generally predicated on an adverse change in cash flows (e.g. principal and/or interest payment deferrals or losses) versus those expected at the time of purchase. The absence of an adverse change in expected cash flows generally indicates that a security's impairment is related to other "non-credit loss" factors and is thereby generally not recognized as OTTI.

The Company considers a variety of factors when determining whether a credit loss exists for an impaired security including, but not limited to:

- The length of time and the extent (a percentage) to which the fair value has been less than the amortized cost basis;
- Adverse conditions specifically related to the security, an industry, or a geographic area (e.g. changes in the financial condition of the issuer of the security, or in the case of an asset backed debt security, in the financial condition of the underlying loan obligors, including changes in technology or the discontinuance of a segment of the business that may affect the future earnings potential of the issuer or underlying loan obligors of the security or changes in the quality of the credit enhancement);
- The historical and implied volatility of the fair value of the security;
- The payment structure of the debt security;
- Actual or expected failure of the issuer of the security to make scheduled interest or principal payments;
- Changes to the rating of the security by external rating agencies; and
- Recoveries or additional declines in fair value subsequent to the balance sheet date.

At December 31, 2013 and June 30, 2013, the Company held no securities on which credit-related OTTI had been recognized in earnings. The following discussion summarizes the Company's rationale for recognizing the impairments reported in the tables above as "temporary" versus "other-than-temporary". Such rationale is presented by investment type and generally applies consistently to both the available for sale and held to maturity portfolios, except where specifically noted.

Mortgage-backed Securities. The carrying value of the Company's mortgage-backed securities totaled \$764.7 million at December 31, 2013 and comprised 60.0% of total investments and 23.5% of total assets as of that date. This category of securities primarily includes mortgage pass-through securities and collateralized mortgage obligations issued by U.S. government agencies and/or government-sponsored entities ("GSEs") such as Ginnie Mae, Fannie Mae and Freddie Mac who guarantee the contractual cash flows associated with those securities. Those guarantees were strengthened during the 2008-2009 financial crisis at which time Fannie Mae and Freddie Mac were placed into receivership by the federal government. Through those actions, the U.S. government effectively reinforced the guarantees of their agencies thereby strengthening the creditworthiness of the mortgage-backed securities issued by those agencies.

With credit risk being reduced to negligible levels due primarily to the U.S. government's support of most of these agencies, the unrealized losses on the Company's investment in U.S. agency mortgage-backed securities are due largely to the combined effects of several market-related factors including, most notably, changes in market interest rates. In general, the fair value of certain debt securities, including the Company's mortgage-backed securities, move inversely with changes in market interest rates. As market interest rates increase, the value of the securities, which are generally characterized by fixed interest rates or adjustable rates that lag the movement in market interest rates, decline and vice-versa.

Additionally, movements in market interest rates significantly impact the average lives of mortgage-backed securities by influencing the rate of principal prepayment attributable to refinancing activity. Changes in the expected average lives of such securities significantly impact their fair values due to the extension or contraction of the cash flows that an investor expects to receive over the life of the security. Generally, lower market interest rates prompt greater refinancing activity thereby shortening the average lives of mortgage-backed securities and vice-versa. The historically low mortgage rates prevalent in the marketplace during recent years created significant refinancing incentive for qualified borrowers.

Prepayment rates are also influenced by fluctuating real estate values and the overall availability of credit in the marketplace which significantly impacts the ability of borrowers to qualify for refinancing. The residential real estate marketplace in recent years has been characterized by diminished property values and reduced availability of credit due to tightening underwriting standards. As a consequence, the ability of certain borrowers to qualify for the refinancing of existing loans has been reduced while residential real estate purchase activity has been stifled. These factors have partially offset the effects of historically low interest rates on mortgage-backed security prepayment rates.

The market price of mortgage-backed securities, being the key measure of the fair value to an investor in such securities, is also influenced by the overall supply and demand for such securities in the marketplace. Absent other factors, an increase in the demand for, or a decrease in the supply of a security increases its price. Conversely, a decrease in the demand for, or an increase in the supply of a security decreases its price.

In sum, the factors influencing the fair value of the Company's U.S. agency mortgage-backed securities, as described above, generally result from movements in market interest rates and changing real estate and financial market conditions which affect the supply and demand for such securities. Such market conditions may fluctuate over time resulting in certain securities being impaired for periods in excess of 12 months. However, the longevity of such impairment is not necessarily reflective of an expectation for an adverse change in cash flows signifying a credit loss. Consequently, the impairments of value resulting directly from these changing market conditions are considered "noncredit-related" and "temporary" in nature.

Finally, the Company has the stated ability and intent to “hold to maturity” those securities so designated at December 31, 2013 and does not intend to sell the temporarily impaired available for sale securities prior to the recovery of their fair value to a level equal to or greater than the Company’s amortized cost. Moreover, the Company has concluded that the possibility of being required to sell the securities prior to their anticipated recovery is unlikely based upon its strong liquidity, asset quality and capital position as of that date. In light of the factors noted, the Company does not consider its U.S. agency and GSE mortgage-backed securities with unrealized losses at December 31, 2013 to be “other-than-temporarily” impaired as of that date.

In addition to those mortgage-backed securities issued by U.S. agencies and GSEs, the Company held a nominal balance of non-agency mortgage-backed securities at December 31, 2013. Unlike agency and GSE mortgage-backed securities, non-agency collateralized mortgage obligations are not explicitly guaranteed by a U.S. government sponsored entity. Rather, such securities generally utilize the structure of the larger investment vehicle to reallocate credit risk among the individual tranches comprised within that vehicle. Through this process, investors in different tranches are subject to varying degrees of risk that the cash flows of their tranche will be adversely impacted by borrowers defaulting on the underlying mortgage loans. The creditworthiness of certain tranches may also be further enhanced by additional credit insurance protection embedded within the terms of the total investment vehicle.

The fair values of the non-agency mortgage-backed securities are subject to many of the factors applicable to the agency securities that may result in “temporary” impairments in value. However, due to the lack of agency guaranty, the Company also monitors the general level of credit risk for each of its non-agency mortgage-backed securities based upon a variety of factors including, but not limited to, the ratings assigned to its specific tranches by one or more credit rating agencies. As noted above, the level of such ratings and changes thereto, is one of several factors considered by the Company in identifying those securities that may be other-than-temporarily impaired.

The applicable securities maintained their credit-ratings at levels supporting the investment grade assessment by the Company. The Company has the stated ability and intent to “hold to maturity” those securities at December 31, 2013 and has further concluded that the possibility of being required to sell the securities prior to their anticipated recovery is unlikely based upon its strong liquidity, asset quality and capital position as of that date. In light of the factors noted, the Company does not consider its non-agency mortgage-backed securities with unrealized losses at December 31, 2013 to be “other-than-temporarily” impaired as of that date.

**U.S. Agency Debt Securities.** The carrying value of the Company’s U.S. agency debt securities totaled \$149.0 million at December 31, 2013 and comprised 11.7% of total investments and 4.6% of total assets as of that date. Such securities included \$144.5 million of fixed-rate U.S. agency debentures and \$4.5 million of securities representing securitized pools of loans issued and fully guaranteed by the Small Business Administration (“SBA”), a U.S. government agency.

With credit risk being reduced to negligible levels due to the issuer’s guarantee, the unrealized losses on the Company’s investment in U.S. agency debentures are due largely to the combined effects of several market-related factors including, most notably, changes in market interest rates. In general, the fair value of certain debt securities, including the Company’s U.S. agency debentures, move inversely with changes in market interest rates. As market interest rates increase, the value of the securities, which are generally characterized by fixed interest rates, decline and vice-versa.

The market price of U.S. agency debentures is also influenced by the overall supply and demand for such securities in the marketplace. Absent other factors, an increase in the demand for, or a decrease

in the supply of a security increases its price. Conversely, a decrease in the demand for, or an increase in the supply of a security decreases its price.

In sum, the factors influencing the fair value of the Company's U.S. agency debentures, as described above, generally result from movements in market interest rates and changing market conditions which affect the supply and demand for such securities. Those market conditions may fluctuate over time resulting in certain securities being impaired for periods in excess of 12 months. However, the longevity of such impairment is not necessarily reflective of an expectation for an adverse change in cash flows signifying a credit loss. Consequently, the impairments of value resulting directly from these changing market conditions are considered "noncredit-related" and "temporary" in nature.

Finally, the Company has the stated ability and intent to "hold to maturity" those securities so designated at December 31, 2013 and does not intend to sell the temporarily impaired available for sale securities prior to the recovery of their fair value to a level equal to or greater than the Company's amortized cost. Furthermore, the Company has concluded that the possibility of being required to sell the securities prior to their anticipated recovery is unlikely based upon its strong liquidity, asset quality and capital position as of that date. In light of the factors noted, the Company does not consider its balance of U.S. agency securities with unrealized losses at December 31, 2013 to be "other-than-temporarily" impaired as of that date.

**Obligations of State and Political Subdivisions.** The carrying value of the Company's securities representing obligations of state and political subdivisions totaled \$91.9 million at December 31, 2013 and comprised 7.2% of total investments and 2.8% of total assets as of that date. Such securities include approximately \$88.8 million of fixed-rate, bank-qualified securities representing general obligations of municipalities located within the U.S. or the obligations of their related entities such as boards of education or school districts. The portfolio also includes \$3.1 million of non-rated bond anticipation notes ("BANs") comprising nine short-term obligations issued by a total of five New Jersey municipalities with whom the Company maintains or seeks to maintain deposit relationships. At December 31, 2013, the fair value of each of the Company's BANs equaled or exceeded their respective carrying values resulting in no reported impairment on those securities as of that date.

As noted earlier, the Company considers the ratings assigned by one or more credit rating agencies, where available, in its evaluation of the impairment attributable to each of its municipal obligations. The Company uses such ratings, in conjunction with the other criteria noted earlier, to identify those securities whose impairments are potentially "credit-related" versus "noncredit-related".

Unrealized losses associated with municipal obligations whose credit ratings exceed certain internally defined thresholds are considered to be indicative of "noncredit-related" impairment given the nominal level of credit losses that would be expected based upon such ratings. That conclusion is generally reinforced, as appropriate, by additional internal analysis supporting the Company's periodic internal investment grade assessment of the security.

At December 31, 2013, each of the Company's impaired municipal obligations were consistently rated by Moody's Investors Service ("Moody's") and Standard & Poor's Financial Services ("S&P") well above the thresholds that generally support the Company's investment grade assessment with such ratings equaling or exceeding "A" or higher by S&P and/or "A1" or higher by Moody's, where rated by those agencies. In the absence of such ratings, the Company relies upon its own internal analysis of the issuer's financial condition to validate its investment grade assessment.

Given the absence of any expectation for an adverse change in cash flows signifying a credit loss, the unrealized losses on the Company's investment in municipal obligations are due largely to the



combined effects of several market-related factors including, most notably, changes in market interest rates. In general, the fair value of certain debt securities, including the Company's municipal obligations, move inversely with changes in market interest rates. As market interest rates increase, the value of the securities, which are generally characterized by fixed interest rates, decline and vice-versa.

The market price of municipal obligations is also influenced by the overall supply and demand for such securities in the marketplace. While these factors may generally reflect the level of available liquidity in the marketplace, demand for individual securities will specifically reflect investors' assessment of an issuer's creditworthiness and resulting expectations for timely and full repayment in accordance with the terms of the applicable security agreement. Absent other factors, an increase in the demand for, or a decrease in the supply of a security increases its price. Conversely, a decrease in the demand for, or an increase in the supply of a security decreases its price.

In sum, the factors influencing the fair value of the Company's municipal obligations, as described above, generally result from movements in market interest rates and changing market conditions which affect the supply and demand for such securities. Those market conditions may fluctuate over time resulting in certain securities being impaired for periods in excess of 12 months. However, the longevity of such impairment is not necessarily reflective of an expectation for an adverse change in cash flows signifying a credit loss. Consequently, the impairments of value resulting directly from these changing market conditions are considered "noncredit-related" and "temporary" in nature.

Finally, the Company has the stated ability and intent to "hold to maturity" those securities so designated at December 31, 2013 and does not intend to sell the temporarily impaired available for sale securities prior to the recovery of their fair value to a level equal to or greater than the Company's amortized cost. Furthermore, the Company has concluded that the possibility of being required to sell the securities prior to their anticipated recovery is unlikely based upon its strong liquidity, asset quality and capital position as of that date. In light of the factors noted, the Company does not consider its balance of obligations of state and political subdivisions with unrealized losses at December 31, 2013 to be "other-than-temporarily" impaired as of that date.

**Asset-backed Securities.** The carrying value of the Company's asset-backed securities totaled \$72.6 million at December 31, 2013 and comprised 5.7% of total investments and 2.2% of total assets as of that date. This category of securities is comprised entirely of structured, floating-rate securities representing securitized federal education loans with 97% U.S. government guarantees. The securities represent tranches of a larger investment vehicle designed to reallocate credit risk among the individual tranches comprised within that vehicle. Through this process, investors in different tranches are subject to varying degrees of risk that the cash flows of their tranche will be adversely impacted by borrowers defaulting on the underlying loans. The Company's securities represent the highest credit-quality tranches within the overall structures with each being rated "AA+" by S&P at December 31, 2013.

With credit risk being reduced to nominal levels due to the guarantees and structural support noted above, the unrealized losses on the Company's investment in asset-backed securities are due largely to the combined effects of several market-related factors including changes in market interest rates and fluctuating demand for such securities in the marketplace. In general, the fair value of certain debt securities, including the Company's asset-backed securities, move inversely with changes in market interest rates. As market interest rates increase, the value of the securities decline and vice-versa. However, the floating-rate nature of the Company's asset-backed securities greatly reduces their sensitivity to such changes in market rates.

More significantly, the market price of asset-backed securities is also influenced by the overall supply and demand for such securities in the marketplace. Absent other factors, an increase in the



demand for, or a decrease in the supply of a security increases its price. Conversely, a decrease in the demand for, or an increase in the supply of a security decreases its price.

In sum, the factors influencing the fair value of the Company's asset-backed securities, as described above, generally result from movements in market interest rates and changing market conditions which affect the supply and demand for such securities. Those market conditions may fluctuate over time resulting in certain securities being impaired for periods in excess of 12 months. However, the longevity of such impairment is not necessarily reflective of an expectation for an adverse change in cash flows signifying a credit loss. Consequently, the impairments of value resulting directly from these changing market conditions are considered "noncredit-related" and "temporary" in nature.

Finally, the Company does not intend to sell the temporarily impaired available for sale securities prior to the recovery of their fair value to a level equal to or greater than the Company's amortized cost. Furthermore, the Company has concluded that the possibility of being required to sell the securities prior to their anticipated recovery is unlikely based upon its strong liquidity, asset quality and capital position as of December 31, 2013. In light of the factors noted, the Company does not consider its balance of asset-backed securities with unrealized losses at December 31, 2013 to be "other-than-temporarily" impaired as of that date.

**Collateralized Loan Obligations.** The outstanding balance of the Company's collateralized loan obligations totaled \$29.8 million at December 31, 2013 and comprised 2.3% of total investments and less than one percent total assets as of that date. This category of securities is comprised entirely of structured, floating-rate securities comprised of securitized commercial loans to large, U.S. corporations. The Company's securities represent tranches of a larger investment vehicle designed to reallocate cash flows and credit risk among the individual tranches comprised within that vehicle. Through this process, investors in different tranches are subject to varying degrees of risk that the cash flows of their tranche will be adversely impacted by borrowers defaulting on the underlying loans.

As noted earlier, the Company considers the ratings assigned by one or more credit rating agencies, where available, in its evaluation of the impairment attributable to each of its collateralized loan obligations. The Company uses such ratings, in conjunction with the other criteria noted earlier, to identify those securities whose impairments are potentially "credit-related" versus "noncredit-related".

Unrealized losses associated with collateralized loan obligations whose credit ratings exceed certain internally defined thresholds are considered to be indicative of "noncredit-related" impairment given the nominal level of credit losses that would be expected based upon such ratings. That conclusion is generally reinforced, as appropriate, by additional internal analysis supporting the Company's periodic internal investment grade assessment of the security.

At December 31, 2013, each of the Company's impaired collateralized loan obligations were consistently rated by Moody's and S&P well above the thresholds that generally support the Company's investment grade assessment with such ratings equaling "AAA" S&P and "Aaa" by Moody's, where rated by those agencies.

Given the absence of any expectation for an adverse change in cash flows signifying a credit loss, the unrealized losses on the Company's investment in collateralized loan obligations are due largely to the combined effects of several market-related factors including changes in market interest rates and fluctuating demand for such securities in the marketplace. In general, the fair value of certain debt securities, including the Company's collateralized loan obligations, move inversely with changes in market interest rates. As market interest rates increase, the value of the securities decline and vice-versa.



However, the floating-rate nature of the Company's collateralized loan obligations greatly reduces their sensitivity to such changes in market rates.

More significantly, the market price of collateralized loan obligations is also influenced by the overall supply and demand for such securities in the marketplace. While these factors may generally reflect the level of available liquidity in the marketplace, demand for individual securities will specifically reflect the performance of the underlying collateral in conjunction with the resiliency of the security's structural support as they affect investors' expectations for timely and full repayment. Absent other factors, an increase in the demand for, or a decrease in the supply of a security increases its price. Conversely, a decrease in the demand for, or an increase in the supply of a security decreases its price.

In sum, the factors influencing the fair value of the Company's collateralized loan obligations, as described above, generally result from movements in market interest rates and changing market conditions which affect the supply and demand for such securities. Those market conditions may fluctuate over time resulting in certain securities being impaired for periods in excess of 12 months. However, the longevity of such impairment is not necessarily reflective of an expectation for an adverse change in cash flows signifying a credit loss. Consequently, the impairments of value resulting directly from these changing market conditions are considered "noncredit-related" and "temporary" in nature.

Finally, the Company does not intend to sell the temporarily impaired available for sale securities prior to the recovery of their fair value to a level equal to or greater than the Company's amortized cost. During the quarter ended December 31, 2013, the Company evaluated its entire portfolio of collateralized loan obligations and sold those securities that it identified as potentially ineligible investments under the terms of the "Volcker Rule" whose provisions were enacted by regulatory agencies during the current quarter in conjunction with the ongoing adoption and implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Company concluded that the possibility of being required to sell its remaining collateralized loan obligations prior to their anticipated recovery is unlikely based upon their eligibility under the terms of the Volcker Rule in conjunction with the overall strength of the Company's liquidity, asset quality and capital position as of December 31, 2013.

In light of the factors noted, the Company does not consider its balance of collateralized loan obligations with unrealized losses at December 31, 2013 to be "other-than-temporarily" impaired as of that date.

**Corporate Bonds.** The carrying value of the Company's corporate bonds totaled \$158.7 million at December 31, 2013 and comprised 12.5% of total investments and 4.9% of total assets as of that date. This category of securities is comprised entirely of floating-rate corporate debt obligations of large financial institutions.

As noted earlier, the Company considers the ratings assigned by one or more credit rating agencies, where available, in its evaluation of the impairment attributable to each of its corporate bonds. The Company uses such ratings, in conjunction with the other criteria noted earlier, to identify those securities whose impairments are potentially "credit-related" versus "noncredit-related".

Unrealized losses associated with corporate bonds whose credit ratings exceed certain internally defined thresholds are considered to be indicative of "noncredit-related" impairment given the nominal level of credit losses that would be expected based upon such ratings. That conclusion is generally reinforced, as appropriate, by additional internal analysis supporting the Company's periodic internal investment grade assessment of the security.

At December 31, 2013, each of the Company's impaired corporate bonds were consistently rated by Moody's and S&P above the thresholds that generally support the Company's investment grade assessment with such ratings equaling or exceeding "A-" or higher by S&P and/or "Baa1" or higher by Moody's, where rated by those agencies.

Given the absence of any expectation for an adverse change in cash flows signifying a credit loss, the unrealized losses on the Company's investment in corporate bonds are due largely to the combined effects of several market-related factors including changes in market interest rates and fluctuating demand for such securities in the marketplace. In general, the fair value of certain debt securities, including the Company's corporate bonds, move inversely with changes in market interest rates. As market interest rates increase, the value of the securities decline and vice-versa. However, the floating-rate nature of the Company's corporate bonds greatly reduces their sensitivity to such changes in market rates.

More significantly, the market price of corporate bonds is also influenced by the overall supply and demand for such securities in the marketplace. While these factors may generally reflect the level of available liquidity in the marketplace, demand for individual securities will specifically reflect investors' assessment of an issuer's creditworthiness and resulting expectations for timely and full repayment in accordance with the terms of the applicable security agreement. Absent other factors, an increase in the demand for, or a decrease in the supply of a security increases its price. Conversely, a decrease in the demand for, or an increase in the supply of a security decreases its price.

In sum, the factors influencing the fair value of the Company's corporate bonds, as described above, generally result from movements in market interest rates and changing market conditions which affect the supply and demand for such securities. Those market conditions may fluctuate over time resulting in certain securities being impaired for periods in excess of 12 months. However, the longevity of such impairment is not necessarily reflective of an expectation for an adverse change in cash flows signifying a credit loss. Consequently, the impairments of value resulting directly from these changing market conditions are considered "noncredit-related" and "temporary" in nature.

Finally, the Company does not intend to sell the temporarily impaired available for sale securities prior to the recovery of their fair value to a level equal to or greater than the Company's amortized cost. Furthermore, the Company has concluded that the possibility of being required to sell the securities prior to their anticipated recovery is unlikely based upon its strong liquidity, asset quality and capital position as of December 31, 2013. In light of the factors noted, the Company does not consider its balance of corporate bonds with unrealized losses at December 31, 2013 to be "other-than-temporarily" impaired as of that date.

**Trust Preferred Securities.** The carrying value of the Company's trust preferred securities totaled \$7.4 million at December 31, 2013 and comprised less than one percent of total investments and total assets as of that date. The category comprises a total of five "single-issuer" (i.e. non-pooled) trust preferred securities, four of which are impaired as of December 31, 2013, that were originally issued by four separate financial institutions. As a result of bank mergers involving the issuers of these securities, the Company's five trust preferred securities currently represent the de-facto obligations of three separate financial institutions.

As noted earlier, the Company considers the ratings assigned by one or more credit rating agencies, where such ratings are available, in its evaluation of the impairment attributable to each of its trust preferred securities. The Company uses such ratings, in conjunction with other criteria, to identify those securities whose impairments are potentially "credit-related" versus "noncredit-related".

Unrealized losses associated with trust preferred securities whose credit ratings exceed certain internally defined thresholds are considered to be indicative of “noncredit-related” impairment given the nominal level of credit losses that would be expected based upon such ratings. That conclusion is generally reinforced, as appropriate, by additional internal analysis supporting the Company’s internal investment grade assessment of the security.

At December 31, 2013, the Company owned two securities at an amortized cost of \$3.0 million that were consistently rated by Moody’s and S&P above the thresholds that generally support the Company’s investment grade assessment. The securities were originally issued through Chase Capital II and currently represent de-facto obligations of JPMorgan Chase & Co.

The Company has attributed the unrealized losses on these securities to the combined effects of several market-related factors including movements in market interest rates and general level of liquidity of such securities in the marketplace based on overall supply and demand.

With regard to interest rates, the Company’s impaired trust preferred securities are variable rate securities whose interest rates generally float with three-month LIBOR plus a margin. Based upon the historically low level of short-term market interest rates, the current yield on these securities is comparatively low. Consequently, the fair value of the securities, as determined based upon their market price, reflects the adverse effects of the historically low market interest rates at December 31, 2013.

More significantly, the market prices of the impaired trust preferred securities also currently reflect the effect of reduced demand for such securities given the increasingly credit risk-averse nature of financial institutions in the current marketplace. Additionally, such prices reflect the effects of increased supply arising from financial institutions selling such investments and reducing assets for capital adequacy purposes, as noted earlier.

In addition to the securities noted above, the Company owned two additional trust preferred securities at an amortized cost of \$4.9 million whose external credit ratings by both S&P and Moody’s fell below the thresholds that the Company normally associates with investment grade securities. The securities were originally issued through BankBoston Capital Trust IV and MBNA Capital B and currently represent de-facto obligations of Bank of America Corporation.

The Company’s evaluation of the unrealized loss associated with these securities considered a variety of factors to determine if any portion of the impairment was credit-related at December 31, 2013. Factors generally considered in such evaluations included the financial strength and viability of the issuer and its parent company, the security’s historical performance through prior business and economic cycles, rating consistency or variability among rating companies, the security’s current and anticipated status regarding payment default or deferral of contractual payments to investors and the impact of these factors on the present value of the security’s expected future cash flows in relation to its amortized cost basis.

In its evaluation, the Company noted the overall financial strength and continuing expected viability of the issuing entity’s parent, particularly given their systemically critical role in the marketplace. The Company noted the security’s absence of historical defaults or payment deferrals throughout prior business cycles including the recent fiscal crisis that triggered the current economic weaknesses prevalent in the marketplace. Given these factors, the Company had no basis upon which to estimate an adverse change in the expected cash flows over the securities’ remaining terms to maturity.

In sum, the factors influencing the fair value of the Company’s trust preferred securities and the resulting impairment attributable to each generally resulted from movements in market interest rates and changing market conditions which affect the supply and demand for such securities. Such market



conditions may generally fluctuate over time resulting in the securities being impaired for periods in excess of 12 months. However, the longevity of such impairment is not reflective of an expectation for an adverse change in cash flows signifying a credit loss. Consequently, the impairments of value arising from these changing market conditions are both “noncredit-related” and “temporary” in nature.

Finally, the Company does not intend to sell the temporarily impaired available for sale securities prior to the recovery of their fair value to a level equal to or greater than the Company’s amortized cost. Furthermore, the Company has concluded that the possibility of being required to sell the securities prior to their anticipated recovery is unlikely based upon its strong liquidity, asset quality and capital position as of December 31, 2013. Moreover, as “single issuer” obligations, these securities fall outside the scope of the Volker rule discussed earlier that originally identified pooled trust preferred securities as potentially ineligible investments for banks. In light of the factors noted, the Company does not consider its investments in trust preferred securities with unrealized losses at December 31, 2013 to be “other-than-temporarily” impaired as of that date.

## 10. LOAN QUALITY AND ALLOWANCE FOR LOAN LOSSES

**Past Due Loans.** A loan’s “past due” status is generally determined based upon its “P&I delinquency” status in conjunction with its “past maturity” status, where applicable. A loan’s “P&I delinquency” status is based upon the number of calendar days between the date of the earliest P&I payment due and the “as of” measurement date. A loan’s “past maturity” status, where applicable, is based upon the number of calendar days between a loan’s contractual maturity date and the “as of” measurement date. Based upon the larger of these criteria, loans are categorized into the following “past due” tiers for financial statement reporting and disclosure purposes: Current (including 1-29 days past due), 30-59 days, 60-89 days and 90 or more days.

**Nonaccrual Loans.** Loans are generally placed on nonaccrual status when contractual payments become 90 days or more past due, and are otherwise placed on nonaccrual when the Company does not expect to receive all P&I payments owed substantially in accordance with the terms of the loan agreement. Loans that become 90 days past maturity, but remain non-delinquent with regard to ongoing P&I payments may remain on accrual status if: (1) the Company expects to receive all P&I payments owed substantially in accordance with the terms of the loan agreement, past maturity status notwithstanding, and (2) the borrower is working actively and cooperatively with the Company to remedy the past maturity status through an expected refinance, payoff or modification of the loan agreement that is not expected to result in a troubled debt restructuring (“TDR”) classification. All TDRs are placed on nonaccrual status for a period of no less than six months after restructuring, irrespective of past due status. Nonaccrual loans and accruing loans that are 90 days or more past due are generally defined as “nonperforming loans”.

Payments received in cash on nonaccrual loans, including both the principal and interest portions of those payments, are generally applied to reduce the carrying value of the loan for financial statement purposes. When a loan is returned to accrual status, any accumulated interest payments previously applied to the carrying value of the loan during its nonaccrual period are recognized as interest income as an adjustment to the loan’s yield over its remaining term.

Loans that are not considered to be TDRs are generally returned to accrual status when payments due are brought current and the Company expects to receive all remaining P&I payments owed substantially in accordance with the terms of the loan agreement. Non-TDR loans may also be returned to accrual status when a loan’s payment status falls below 90 days past due and the Company: (1) expects receipt of the remaining past due amounts within a reasonable timeframe, and (2) expects to receive all remaining P&I payments owed substantially in accordance with the terms of the loan agreement.



Acquired Loans. Loans that we acquire through acquisitions are recorded at fair value with no carryover of the related allowance for credit losses. Determining the fair value of the loans involves estimating the amount and timing of principal and interest cash flows expected to be collected on the loans and discounting those cash flows at a market rate of interest.

The excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loan. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable discount. The nonaccretable discount represents estimated future credit losses expected to be incurred over the life of the loan. Subsequent decreases to the expected cash flows require us to evaluate the need for an allowance for credit losses. Subsequent improvements in expected cash flows result in the reversal of a corresponding amount of the nonaccretable discount which we then reclassify as accretable discount that is recognized into interest income over the remaining life of the loan using the interest method. Our evaluation of the amount of future cash flows that we expect to collect is performed in a similar manner as that used to determine our allowance for credit losses. Charge-offs of the principal amount on acquired loans would be first applied to the nonaccretable discount portion of the fair value adjustment.

Acquired loans that met the criteria for nonaccrual of interest prior to the acquisition may be considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if we can reasonably estimate the timing and amount of the expected cash flows on such loans and if we expect to fully collect the new carrying value of the loans. As such, we may no longer consider the loan to be nonaccrual or nonperforming and may accrue interest on these loans, including the impact of any accretable discount.

At December 31, 2013, the remaining outstanding principal balance and carrying amount of acquired credit-impaired loans totaled approximately \$12,265,000 and \$9,992,000 respectively. By comparison, at June 30, 2013, the remaining outstanding principal balance and carrying amount of acquired credit-impaired loans totaled approximately \$9,874,000 and \$6,050,000 respectively. The increase in the balances between comparative periods primarily reflects the Company's repurchase of a prior participant's interest in a performing loan that was originally designated as credit impaired at the time of acquisition.

The carrying amount of acquired credit-impaired loans for which interest is not being recognized due to the uncertainty of the cash flows relating to such loans totaled \$1,926,000 and \$1,952,000 at December 31, 2013 and June 30, 2013, respectively.

The balance of the allowance for loan losses at December 31, 2013 and June 30, 2013 included approximately \$14,000 and \$17,000 of valuation allowances, respectively, for a specifically identified impairment attributable to acquired credit-impaired loans. The valuation allowances were attributable to additional impairment recognized on the applicable loans subsequent to their acquisition, net of any charge offs recognized during that time.

The following table presents the changes in the accretable yield relating to the acquired credit-impaired loans for the three and six months ended December 31, 2013 and December 31, 2012.

	Three Months Ended December 31, 2013 (in thousands)	Three Months Ended December 31, 2012 (in thousands)
Beginning balance	\$ 2,180	\$ 1,182
Accretion to interest income	(57 )	(94 )
Disposals	-	-
Reclassifications from nonaccretable difference	-	-
Ending balance	\$ 2,123	\$ 1,088

  

	Six Months Ended December 31, 2013 (in thousands)	Six Months Ended December 31, 2012 (in thousands)
Beginning balance	\$ 741	\$ 1,461
Accretion to interest income	(112 )	(282 )
Disposals	-	(91 )
Reclassifications from nonaccretable difference	1,494	-
Ending balance	\$ 2,123	\$ 1,088

**Classification of Assets.** In compliance with the regulatory guidelines, the Company’s loan review system includes an evaluation process through which certain loans exhibiting adverse credit quality characteristics are classified “Special Mention”, “Substandard”, “Doubtful” or “Loss”.

An asset is classified as “Substandard” if it is inadequately protected by the paying capacity and net worth of the obligor or the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. Assets classified as “Doubtful” have all of the weaknesses inherent in those classified as “Substandard”, with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions and values. Assets, or portions thereof, classified as “Loss” are considered uncollectible or of so little value that their continuance as assets is not warranted.

Management evaluates loans classified as substandard or doubtful for impairment in accordance with applicable accounting requirements. As discussed in greater detail below, a valuation allowance is established through the provision for loan losses for any impairment identified through such evaluations. To the extent that impairment identified on a loan is classified as “Loss”, that portion of the loan is charged off against the allowance for loan losses. In a limited number of cases, the entire net carrying value of a loan may be determined to be impaired based upon a collateral-dependent impairment analysis. However, the borrower’s adherence to contractual repayment terms precludes the recognition of a “Loss” classification and charge off. In these limited cases, a valuation allowance equal to 100% of the impaired loan’s carrying value may be maintained against the net carrying value of the asset.

The classification of loan impairment as “Loss” is based upon a confirmed expectation for loss. For loans primarily secured by real estate, the expectation for loss is generally confirmed when: (a) impairment is identified on a loan individually evaluated in the manner described below and, (b) the loan is presumed to be collateral-dependent such that the source of loan repayment is expected to arise solely from sale of the collateral securing the applicable loan. Impairment identified on non-collateral-dependent loans may or may not be eligible for a “Loss” classification depending upon the other salient





facts and circumstances that affect the manner and likelihood of loan repayment. However, loan impairment that is classified as “Loss” is charged off against the ALLL concurrent with that classification.

Assets which do not currently expose the Company to a sufficient degree of risk to warrant an adverse classification but have some credit deficiencies or other potential weaknesses are designated as “Special Mention” by management. Adversely classified assets, together with those rated as “Special Mention”, are generally referred to as “Classified Assets”. Non-classified assets are internally rated within one of four “Pass” categories or as “Watch” with the latter denoting a potential deficiency or concern that warrants increased oversight or tracking by management until remediated.

Management performs a classification of assets review, including the regulatory classification of assets, generally on a monthly basis. The results of the classification of assets review are validated by the Company’s third party loan review firm during their quarterly, independent review. In the event of a difference in rating or classification between those assigned by the internal and external resources, the Company will generally utilize the more critical or conservative rating or classification. Final loan ratings and regulatory classifications are presented monthly to the Board of Directors and are reviewed by regulators during the examination process.

Allowance for Loan Losses. The allowance for loan losses is a valuation account that reflects the Company’s estimation of the losses in its loan portfolio to the extent they are both probable and reasonable to estimate. The balance of the allowance is generally maintained through provisions for loan losses that are charged to income in the period that estimated losses on loans are identified by the Company’s loan review system. The Company charges confirmed losses on loans against the allowance as such losses are identified. Recoveries on loans previously charged-off are added back to the allowance.

The Company’s allowance for loan loss calculation methodology utilizes a “two-tier” loss measurement process that is generally performed monthly. Based upon the results of the classification of assets and credit file review processes described earlier, the Company first identifies the loans that must be reviewed individually for impairment. Factors considered in identifying individual loans to be reviewed include, but may not be limited to, loan type, classification status, contractual payment status, performance/accrual status and impaired status.

The loans considered by the Company to be eligible for individual impairment review include its commercial mortgage loans, comprising multi-family and nonresidential real estate loans, construction loans and commercial business loans as well as its one-to-four family mortgage loans comprising first mortgage loans, home equity loans and home equity lines of credit.

A reviewed loan is deemed to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Once a loan is determined to be impaired, management performs an analysis to determine the amount of impairment associated with that loan.

In measuring the impairment associated with collateral dependent loans, the fair value of the real estate collateralizing the loan is generally used as a measurement proxy for that of the impaired loan itself as a practical expedient. Such values are generally determined based upon a discounted market value obtained through an automated valuation module or prepared by a qualified, independent real estate appraiser.

The Company generally obtains independent appraisals on properties securing mortgage loans when such loans are initially placed on nonperforming or impaired status with such values updated approximately every six to twelve months thereafter throughout the collections, bankruptcy and/or foreclosure processes. Appraised values are typically updated at the point of foreclosure, where applicable, and approximately every six to twelve months thereafter while the repossessed property is held as real estate owned.

As supported by accounting and regulatory guidance, the Company reduces the fair value of the collateral by estimated selling costs, such as real estate brokerage commissions, to measure impairment when such costs are expected to reduce the cash flows available to repay the loan.

The Company establishes valuation allowances in the fiscal period during which the loan impairments are identified. The results of management's individual loan impairment evaluations are validated by the Company's third party loan review firm during their quarterly, independent review. Such valuation allowances are adjusted in subsequent fiscal periods, where appropriate, to reflect any changes in carrying value or fair value identified during subsequent impairment evaluations which are generally updated monthly by management.

The second tier of the loss measurement process involves estimating the probable and estimable losses which addresses loans not otherwise reviewed individually for impairment as well as those individually reviewed loans that are determined to be non-impaired. Such loans include groups of smaller-balance homogeneous loans that may generally be excluded from individual impairment analysis, and therefore collectively evaluated for impairment, as well as the non-impaired loans within categories that are otherwise eligible for individual impairment review.

Valuation allowances established through the second tier of the loss measurement process utilize historical and environmental loss factors to collectively estimate the level of probable losses within defined segments of the Company's loan portfolio. These segments aggregate homogeneous subsets of loans with similar risk characteristics based upon loan type. For allowance for loan loss calculation and reporting purposes, the Company currently stratifies its loan portfolio into seven primary segments: residential mortgage loans, commercial mortgage loans, construction loans, commercial business loans, home equity loans, home equity lines of credit and other consumer loans. Each primary segment is further stratified to distinguish between loans originated and purchased through third parties from loans acquired through business combinations. Commercial business loans include secured and unsecured loans as well as loans originated through SBA programs. Additional criteria may be used to further group loans with common risk characteristics. For example, such criteria may distinguish between loans secured by different collateral types or separately identify loans supported by government guarantees such as those issued by the SBA.

In regard to historical loss factors, the Company's allowance for loan loss calculation calls for an analysis of historical charge-offs and recoveries for each of the defined segments within the loan portfolio. The Company currently utilizes a two-year moving average of annual net charge-off rates (charge-offs net of recoveries) by loan segment, where available, to calculate its actual, historical loss experience. The outstanding principal balance of the non-impaired portion of each loan segment is multiplied by the applicable historical loss factor to estimate the level of probable losses based upon the Company's historical loss experience.

The timeframe between when loan impairment is first identified by the Company and when such impairment may ultimately be charged off varies by loan type. For example, unsecured consumer and commercial loans are generally classified as "Loss" at 120 days past due resulting in their outstanding balances being charged off at that time.

By contrast, the timing of charge offs regarding the impairment associated with secured loans has historically been far more variable. The Company's secured loans, comprising a large majority of its loan total portfolio, consist primarily of residential and nonresidential mortgage loans and commercial/business loans secured by properties located in New Jersey where the foreclosure process currently takes 24-36 months to complete. The charge off of impairment relating to secured loans is generally recognized upon the confirmation of an expected loss which is generally triggered by the condition of collateral dependency. While the facts and circumstances that affect the manner and likelihood of repayment vary from loan to loan, the Company generally considers the referral of a loan to foreclosure, coupled with the absence of other viable sources of loan repayment, to be demonstrable evidence of collateral dependency. Depending upon the nature of the collections process applicable to a particular loan, an early determination of collateral dependency could result in a nearly concurrent charge off of a newly identified impairment. By contrast, a presumption of collateral dependency may only be determined after the completion of lengthy loan collection and/or workout efforts, including bankruptcy proceedings, which may extend several months or more after a loan's impairment is first identified.

As noted, the second tier of the Company's allowance for loan loss calculation also utilizes environmental loss factors to estimate the probable losses within the loan portfolio. Environmental loss factors are based upon specific qualitative criteria representing key sources of risk within the loan portfolio. Such risk criteria includes the level of and trends in nonperforming loans; the effects of changes in credit policy; the experience, ability and depth of the lending function's management and staff; national and local economic trends and conditions; credit risk concentrations and changes in local and regional real estate values. For each category of the loan portfolio, a level of risk, developed from a number of internal and external resources, is assigned to each of the qualitative criteria utilizing a scale ranging from zero (negligible risk) to 15 (high risk), with higher values potentially ascribed to exceptional levels of risk that exceed the standard range, as appropriate. The sum of the risk values, expressed as a whole number, is multiplied by .01% to arrive at an overall environmental loss factor, expressed in basis points, for each loan category.

The Company's ALLL calculation methodology incorporates its risk-rating classification system into the calculation of environmental loss factors by loan type. The risk-rating classification system ascribes a numerical rating of "1" through "9" to each loan within the portfolio. The ratings "5" through "9" represent the numerical equivalents of the traditional loan classifications "Watch", "Special Mention", "Substandard", "Doubtful" and "Loss", respectively, while lower ratings, "1" through "4", represent risk-ratings within the least risky "Pass" category. The environmental loss factor applicable to each non-impaired loan within a category, as described above, is "weighted" by a multiplier based upon the loan's risk-rating classification. Within any single loan category, a "higher" environmental loss factor is ascribed to those loans with comparatively higher risk-rating classifications resulting in a proportionately greater ALLL requirement attributable to such loans compared to the comparatively lower risk-rated loans within that category.

In evaluating the impact of the level and trends in nonperforming loans on environmental loss factors, the Company first broadly considers the occurrence and overall magnitude of prior losses recognized on such loans over an extended period of time. For this purpose, losses are considered to include both charge offs as well as loan impairments for which valuation allowances have been recognized through provisions to the allowance for loan losses, but have not yet been charged off. To the extent that prior losses have generally been recognized on nonperforming loans within a category, a basis is established to recognize existing losses on loans collectively evaluated for impairment based upon the current levels of nonperforming loans within that category. Conversely, the absence of material prior losses attributable to delinquent or nonperforming loans within a category may significantly diminish, or even preclude, the consideration of the level of nonperforming loans in the calculation of the environmental loss factors attributable to that category of loans.

Once the basis for considering the level of nonperforming loans on environmental loss factors is established, the Company then considers the current dollar amount of nonperforming loans by loan type in relation to the total outstanding balance of loans within the category. A greater portion of nonperforming loans within a category in relation to the total suggests a comparatively greater level of risk and expected loss within that loan category and vice-versa.

In addition to considering the current level of nonperforming loans in relation to the total outstanding balance for each category, the Company also considers the degree to which those levels have changed from period to period. A significant and sustained increase in nonperforming loans over a 12-24 month period suggests a growing level of expected loss within that loan category and vice-versa.

As noted above, the Company considers these factors in a qualitative, rather than quantitative fashion when ascribing the risk value, as described above, to the level and trends of nonperforming loans that is applicable to a particular loan category. As with all environmental loss factors, the risk value assigned ultimately reflects the Company's best judgment as to the level of expected losses on loans collectively evaluated for impairment.

The sum of the probable and estimable loan losses calculated through the first and second tiers of the loss measurement processes as described above, represents the total targeted balance for the Company's allowance for loan losses at the end of a fiscal period. As noted earlier, the Company establishes all additional valuation allowances in the fiscal period during which additional individually identified loan impairments and additional estimated losses on loans collectively evaluated for impairment are identified. The Company adjusts its balance of valuation allowances through the provision for loan losses as required to ensure that the balance of the allowance for loan losses reflects all probable and estimable loans losses at the close of the fiscal period. Notwithstanding calculation methodology and the noted distinction between valuation allowances established on loans collectively versus individually evaluated for impairment, the Company's entire allowance for loan losses is available to cover all charge-offs that arise from the loan portfolio.

Although management believes that the Company's allowance for loans losses is established in accordance with management's best estimate, actual losses are dependent upon future events and, as such, further additions to the level of loan loss allowances may be necessary.

The following tables present the balance of the allowance for loan losses at December 31, 2013 and June 30, 2013 based upon the calculation methodology described above. The table identifies the valuation allowances attributable to identified impairments on individually evaluated loans, including those acquired with deteriorated credit quality, as well as those valuation allowances for impairments on loans evaluated collectively. The underlying balance of loans receivable applicable to each category is also presented. The balance of loans receivable reported in the tables below excludes yield adjustments and the allowance for loan losses.

Allowance for Loan Losses and Loans Receivable  
at December 31, 2013

	Residential Mortgage	Commercial Mortgage	Construction	Commercial Business	Home Equity Loans	Home Equity Lines of Credit	Other Consumer	Total
	(In Thousands)							
Balance of allowance for loan losses:								
Originated and purchased loans								
Loans individually evaluated for impairment	\$ 706	\$ 383	\$ -	\$ -	\$ 76	\$ -	\$ -	\$ 1,165
Loans collectively evaluated for impairment	2,545	5,813	36	259	295	36	23	9,007
Allowance for loan losses on originated and purchased loans	3,251	6,196	36	259	371	36	23	10,172
Loans acquired at fair value								
Loans acquired with deteriorated credit quality	-	-	-	14	-	-	-	14
Other acquired loans individually evaluated for impairment	-	33	-	267	-	-	-	300
Loans collectively evaluated for impairment	23	345	35	502	64	38	-	1,007
Allowance for loan losses on loans acquired at fair value	23	378	35	783	64	38	-	1,321
Total allowance for loan losses	\$ 3,274	\$ 6,574	\$ 71	\$ 1,042	\$ 435	\$ 74	\$ 23	\$ 11,493

Allowance for Loan Losses and Loans Receivable  
at December 31, 2013 (continued)

	Residential Mortgage	Commercial Mortgage	Construction	Commercial Business	Home Equity Loans	Home Equity Lines of Credit	Other Consumer	Total
	(In Thousands)							
Changes in the allowance for loan losses for the three months ended December 31, 2013:								
At September 30, 2013:								
Allocated	\$3,547	\$ 6,220	\$ 103	\$ 980	\$469	\$76	\$ 11	\$11,406
Unallocated	-	-	-	-	-	-	-	-
Total allowance for loan losses	3,547	6,220	103	980	469	76	11	11,406
Total charge offs	(278 )	-	-	(672 )	(1 )	-	(28 )	(979 )
Total recoveries	7	497	-	3	-	-	-	507
Total allocated provisions	(2 )	(143 )	(32 )	731	(33 )	(2 )	40	559
Total unallocated provisions	-	-	-	-	-	-	-	-
At December 31, 2013:								
Allocated	3,274	6,574	71	1,042	435	74	23	11,493
Unallocated	-	-	-	-	-	-	-	-
Total allowance for loan losses	\$3,274	\$ 6,574	\$ 71	\$ 1,042	\$435	\$74	\$ 23	\$11,493

Allowance for Loan Losses and Loans Receivable  
at December 31, 2013 (continued)

	Residential Mortgage	Commercial Mortgage	Construction	Commercial Business	Home Equity Loans	Home Equity Lines of Credit	Other Consumer	Total
	(in Thousands)							
Changes in the allowance for loan losses for the six months ended December 31, 2013:								
At June 30, 2013:								
Allocated	\$3,660	\$ 5,359	\$ 81	\$ 1,218	\$490	\$76	\$ 12	\$10,896
Unallocated	-	-	-	-	-	-	-	-
Total allowance for loan losses	3,660	5,359	81	1,218	490	76	12	10,896
Total charge offs	(508 )	(34 )	-	(1,080 )	(34 )	-	(29 )	(1,685 )
Total recoveries	25	525	-	5	-	-	-	555
Total allocated provisions	97	724	(10 )	899	(21 )	(2 )	40	1,727
Total unallocated provisions	-	-	-	-	-	-	-	-
At December 31, 2013:								
Allocated	3,274	6,574	71	1,042	435	74	23	11,493
Unallocated	-	-	-	-	-	-	-	-
Total allowance for loan losses	\$3,274	\$ 6,574	\$ 71	\$ 1,042	\$435	\$74	\$ 23	\$11,493



Allowance for Loan Losses and Loans Receivable  
at December 31, 2012

	Residential Mortgage	Commercial Mortgage	Construction	Commercial Business	Home Equity Loans	Home Equity Lines of Credit	Other Consumer	Total
	(in Thousands)							
Changes in the allowance for loan losses for the three months ended December 31, 2012:								
At September 30, 2012:								
Allocated	\$4,115	\$ 3,592	\$ 232	\$ 1,401	\$429	\$67	\$ 13	\$9,849
Unallocated	-	-	-	-	-	-	-	-
Total allowance for loan losses	4,115	3,592	232	1,401	429	67	13	9,849
Total charge offs	(405 )	(187 )	-	-	(63 )	-	(1 )	(656 )
Total recoveries	-	-	-	-	8	-	-	8
Total allocated provisions	393	734	(45 )	189	111	8	3	1,393
Total unallocated provisions	-	-	-	-	-	-	-	-
At December 31, 2012:								
Allocated	4,103	4,139	187	1,590	485	75	15	10,594
Unallocated	-	-	-	-	-	-	-	-
Total allowance for loan losses	\$4,103	\$ 4,139	\$ 187	\$ 1,590	\$485	\$75	\$ 15	\$10,594

Allowance for Loan Losses and Loans Receivable  
at December 31, 2012 (continued)

	Residential Mortgage	Commercial Mortgage	Construction	Commercial Business	Home Equity Loans	Home Equity Lines of Credit	Other Consumer	Total
	(in Thousands)							
Changes in the allowance for loan losses for the six months ended December 31, 2012:								
At June 30, 2012:								
Allocated	\$4,572	\$ 3,443	\$ 277	\$ 1,310	\$447	\$54	\$ 14	\$10,117
Unallocated	-	-	-	-	-	-	-	-
Total allowance for loan losses	4,572	3,443	277	1,310	447	54	14	10,117
Total charge offs	(903 )	(200 )	-	(116 )	(70 )	-	(2 )	(1,291 )
Total recoveries	9	-	-	18	9	-	-	36
Total allocated provisions	425	896	(90 )	378	99	21	3	1,732
Total unallocated provisions	-	-	-	-	-	-	-	-
At December 31, 2012:								
Allocated	4,103	4,139	187	1,590	485	75	15	10,594
Unallocated	-	-	-	-	-	-	-	-
Total allowance for loan losses	\$4,103	\$ 4,139	\$ 187	\$ 1,590	\$485	\$75	\$ 15	\$10,594

Allowance for Loan Losses and Loans Receivable  
at December 31, 2013

Residential Mortgage	Commercial Mortgage	Construction	Commercial Business	Home Equity Loans	Home Equity Lines of Credit	Other Consumer
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