Kearny Financial Corp.
Form 10-Q
November 09, 2010

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

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<br>(State or other jurisdiction of incorporation or organization) | 22-3803741<br>(I.R.S. Employer Identification Number) |
| 120 Passaic Ave., Fairfield, New Jersey<br>(Address of principal executive offices) | 07004-3510<br>(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 [X] 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.

| | |
|---|---|
| Large accelerated filer [ ] | Accelerated filer [X] |
| Non-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 [X]

The number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: November 5, 2010.

$0.10 par value common stock - 67,975,477 shares outstanding

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, Unaudited)

| | September 30, 2010 | June 30, 2010 |
|---|---|---|
| Assets | | |
| Cash and amounts due from depository institutions | $ 45,211 | $ 3,286 |
| Interest-bearing deposits in other banks | 73,873 | 178,136 |
| Cash and Cash Equivalents | 119,084 | 181,422 |
| Securities available for sale (amortized cost $30,441 and $30,960) | 29,382 | 29,497 |
| Securities held to maturity (estimated fair value $232,063 and $256,914) | 229,976 | 255,000 |
| Loans receivable, including net deferred loan costs of $351 and $564 | 997,744 | 1,013,713 |
| Less allowance for loan losses | (9,377) | (8,561) |
| Net Loans Receivable | 988,367 | 1,005,152 |
| Mortgage-backed securities available for sale (amortized cost $815,706 and $673,414) | 844,042 | 703,455 |
| Mortgage-backed securities held to maturity (estimated fair value $1,701 and $1,754) | 1,625 | 1,700 |
| Premises and equipment | 34,854 | 34,989 |
| Federal Home Loan Bank of New York (“FHLB”) stock | 12,867 | 12,867 |
| Interest receivable | 8,298 | 8,338 |
| Goodwill | 82,263 | 82,263 |
| Bank owned life insurance | 19,996 | 19,833 |
| Other assets | 5,518 | 5,297 |
| Total Assets | $ 2,376,272 | $ 2,339,813 |
| Liabilities and Stockholders’ Equity | | |
| Liabilities | | |
| Deposits: | | |
| Non-interest-bearing | $ 49,785 | $ 53,309 |
| Interest-bearing | 1,613,603 | 1,569,853 |
| Total Deposits | 1,663,388 | 1,623,562 |
| Advances from FHLB | 210,000 | 210,000 |
| Advance payments by borrowers for taxes | 5,338 | 5,699 |
| Deferred income tax liabilities, net | 3,093 | 4,391 |

| | | | | |
|---|---|---|---|---|
| Other liabilities | | 10,481 | | 10,235 |
| Total Liabilities | | 1,892,300 | | 1,853,887 |
| 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; 67,975,477 and 68,344,277 shares outstanding, respectively | | 7,274 | | 7,274 |
| Paid-in capital | | 214,777 | | 213,529 |
| Retained earnings | | 313,379 | | 312,844 |
| Unearned Employee Stock Ownership Plan shares; 933,464 shares and 969,828 shares, respectively | | (9,335) | | (9,698) |
| Treasury stock, at cost; 4,762,023 shares and 4,393,223 shares, respectively | | (58,054) | | (54,738) |
| Accumulated other comprehensive income | | 15,931 | | 16,715 |
| Total Stockholders' Equity | | 483,972 | | 485,926 |
| Total Liabilities and Stockholders' Equity | $ | 2,376,272 | $ | 2,339,813 |

See notes to consolidated financial statements.

KEARNY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In Thousands, Except Per Share Data, Unaudited)

| | Three Months Ended September 30, 2010 | Three Months Ended September 30, 2009 |
|---|---|---|
| Interest Income: | | |
| Loans | $ 13,801 | $ 14,879 |
| Mortgage-backed securities | 7,398 | 7,829 |
| Securities: | | |
| Taxable | 1,408 | 60 |
| Tax-exempt | 157 | 158 |
| Other interest-earning assets | 179 | 230 |
| Total Interest Income | 22,943 | 23,156 |
| Interest Expense: | | |
| Deposits | 6,323 | 7,828 |
| Borrowings | 2,075 | 2,075 |
| Total Interest Expense | 8,398 | 9,903 |
| Net Interest Income | 14,545 | 13,253 |
| Provision for Loan Losses | 1,251 | 858 |
| Net Interest Income after Provision for Loan Losses | 13,294 | 12,395 |
| Non-Interest Income: | | |
| Fees and service charges | 342 | 378 |
| Other-than-temporary security impairment: | | |
| Total | - | (295) |
| Less: Portion recognized in other comprehensive income | - | 197 |
| Portion recognized in earnings | - | (98) |
| Miscellaneous | 289 | 240 |
| Total Non-Interest Income | 631 | 520 |
| Non-Interest Expenses: | | |
| Salaries and employee benefits | 6,953 | 6,682 |
| Net occupancy expense of premises | 1,049 | 1,017 |
| Equipment and systems | 1,177 | 1,072 |
| Advertising and marketing | 246 | 214 |

| | | |
|---|---|---|
| Federal deposit insurance premium | 447 | 157 |
| Directors' compensation | 558 | 556 |
| Merger-related expenses | 40 | - |
| Miscellaneous | 1,174 | 1,319 |
| Total Non-Interest Expenses | $ 11,644 | $ 11,017 |

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

| | Three Months Ended September 30, 2010 | Three Months Ended September 30, 2009 |
|---|---|---|
| Income Before Income Taxes | $ 2,281 | $ 1,898 |
| Income Taxes | 946 | 803 |
| Net Income | $ 1,335 | $ 1,095 |
| Net Income per Common Share (EPS): | | |
| Basic | $ 0.02 | $ 0.02 |
| Diluted | 0.02 | 0.02 |
| Weighted Average Number of Common Shares Outstanding: | | |
| Basic | 67,219 | 68,074 |
| Diluted | 67,219 | 68,074 |
| Dividends Declared Per Common Share (Excluding dividends waived by Kearny MHC) | $ 0.05 | $ 0.05 |

See notes to consolidated financial statements.

KEARNY FINANCIAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Three Months Ended September 30, 2009
(In Thousands, Except Per Share Data, 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, 2009 | 69,242 | $ 7,274 | $ 208,577 | $ 309,687 | $ (11,153) | $ (45,985) | 8,320 | $476,720 |
| Comprehensive income: | | | | | | | | |
| Net income | - | - | - | 1,095 | - | - | - | 1,095 |
| Unrealized gain on securities available for sale, net of deferred income tax expense of $3,020 | - | - | - | - | - | - | 4,372 | 4,372 |
| Non-credit related other-than-temporary impairment losses on securities held to maturity, net of deferred income tax benefit of $78 | | | | | | | (115) | (115) |
| Benefit plans, net of deferred income tax benefit of $7 | - | - | - | - | - | - | (10) | (10) |
| Total Comprehensive | | | | | | | | 5,342 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| income | | | | | | | | |
| ESOP shares committed to be released (36 shares) | - | - | 38 | - | 364 | - | - | 402 |
| Dividends contributed for payment of ESOP loan | - | - | 25 | - | - | - | - | 25 |
| Stock option expense | - | - | 476 | - | - | - | - | 476 |
| Treasury stock purchases | (87) | - | - | - | - | (968) | - | (968) |
| Restricted stock plan shares earned (63 shares) | - | - | 771 | - | - | - | - | 771 |
| Tax effect from stock based compensation | - | - | 41 | - | - | - | - | 41 |
| Cash dividends declared ($0.05/public share) | - | - | - | (852) | - | - | - | (852) |
| Balance - September 30, 2009 | 69,155 | $ 7,274 | $ 209,928 | $ 309,930 | $ (10,789) | $ (46,953) | 12,567 | $481,957 |

See notes to consolidated financial statements.

KEARNY FINANCIAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Three Months Ended September 30, 2010
(In Thousands, Except Per Share Data, 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, 2010 | 68,344 | $ 7,274 | $213,529 | $ 312,844 | $ (9,698) | $ (54,738) | $ 16,715 | $485,926 |
| Comprehensive income: | | | | | | | | |
| Net income | - | - | - | 1,335 | - | - | - | 1,335 |
| Unrealized loss on securities available for sale, net of deferred income tax benefit of $531 | - | - | - | - | - | - | (769) | (769) |
| Benefit plans, net of deferred income tax benefit of $10 | - | - | - | - | - | - | (15) | (15) |
| Total Comprehensive income | | | | | | | | 551 |
| ESOP shares committed to be released (36 shares) | - | - | (37) | - | 363 | - | - | 326 |
| Dividends contributed for payment of ESOP loan | - | - | 32 | - | - | - | - | 32 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Stock option expense | - | - | 477 | - | - | - | - | 477 |
| Treasury stock purchases | (369) | - | - | - | - | (3,316) | - | (3,316) |
| Restricted stock plan shares earned (63 shares) | - | - | 771 | - | - | - | - | 771 |
| Tax effect from stock based compensation | - | - | 5 | - | - | - | - | 5 |
| Cash dividends declared ($0.05/ public share) | - | - | - | (800) | - | - | - | (800) |
| Balance - September 30, 2010 | 67,975 | $ 7,274 | $214,777 | $ 313,379 | $ (9,335) | $ (58,054) | $ 15,931 | $483,972 |

See notes to consolidated financial statments.

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

| | Three Months Ended September 30, 2010 | Three Months Ended September 30, 2009 |
|---|---|---|
| Cash Flows from Operating Activities: | | |
| Net income | $ 1,335 | $ 1,095 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization of premises and equipment | 440 | 425 |
| Net amortization of premiums, discounts and loan fees and costs | 468 | 162 |
| Deferred income taxes | (756) | (507) |
| Amortization of intangible assets | - | 7 |
| Amortization of benefit plans' unrecognized net loss | 17 | 36 |
| Provision for loan losses | 1,251 | 858 |
| Loss on write-down of real estate owned | 14 | - |
| Loss on other-than-temporary impairment of securities | - | 98 |
| Increase in cash surrender value of bank owned life insurance | (163) | (140) |
| ESOP, stock option plan and restricted stock plan expenses | 1,574 | 1,649 |
| Decrease in interest receivable | 40 | 101 |
| Decrease (increase) in other assets | 213 | (232) |
| (Decrease) increase in interest payable | (3) | 4 |
| Increase (decrease) in other liabilities | 208 | (1,138) |
| Net Cash Provided by Operating Activities | 4,638 | 2,418 |
| Cash Flows from Investing Activities: | | |
| Proceeds from repayments of securities available for sale | 518 | 126 |
| Purchase of securities held to maturity | (64,975) | (50,000) |
| Proceeds from calls of securities held to maturity | 90,000 | - |
| Purchase of loans | (1,437) | (20,659) |
| Net decrease in loans receivable | 16,461 | 5,747 |
| Purchases of mortgage-backed securities available for sale | (186,437) | (105,098) |
| Principal repayments on mortgage-backed securities available for sale | 43,732 | 45,236 |
| Principal repayments on mortgage-backed securities held to maturity | 82 | 264 |
| Additions to premises and equipment | (305) | (740) |
| Net Cash Used in Investing Activities | $ (102,361) | $ (125,124) |

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

| | Three Months Ended September 30, 2010 | Three Months Ended September 30, 2009 |
|---|---|---|
| Cash Flows from Financing Activities: | | |
| Net increase in deposits | $ 39,842 | $ 34,801 |
| Decrease in advance payments by borrowers for taxes | (361) | (258) |
| Dividends paid to stockholders of Kearny Financial Corp. | (817) | (855) |
| Purchase of common stock of Kearny Financial Corp. for treasury | (3,316) | (968) |
| Dividends contributed for payment of ESOP loan | 32 | 25 |
| Tax benefit from stock based compensation | 5 | 41 |
| Net Cash Provided by Financing Activities | 35,385 | 32,786 |
| Net Decrease in Cash and Cash Equivalents | (62,338) | (89,920) |
| Cash and Cash Equivalents – Beginning | 181,422 | 211,525 |
| Cash and Cash Equivalents – Ending | $ 119,084 | $ 121,605 |
| Supplemental Disclosures of Cash Flows Information: | | |
| Cash paid during the year for: | | |
| Income taxes, net of refunds | $ 2,104 | $ 1,506 |
| Interest | $ 8,401 | $ 9,899 |
| Non-cash investing activities: | | |
| Acquisition of real estate owned in settlement of loans | $ 449 | $ 543 |

See notes to consolidated financial statements.

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

## 1. PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of Kearny Financial Corp. (the "Company"), its wholly-owned subsidiaries, Kearny Federal Savings Bank (the "Bank") and Kearny Financial Securities, Inc., and the Bank's wholly-owned subsidiaries, KFS Financial Services, Inc. and KFS Investment Corp. The Company conducts its business principally through the Bank. Management prepared the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, 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, changes in stockholders' equity and cash flows in conformity with generally accepted accounting principles ("GAAP"). However, in the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the consolidated financial statements have been included. The results of operations for the three month period ended September 30, 2010, 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 statements of financial condition for June 30, 2010 was derived from the Company's annual report on Form 10-K. That data, along with the interim financial information presented in the consolidated statements of financial condition, income, changes in stockholders' equity and cash flows should be read in conjunction with the 2010 consolidated financial statements, including the notes thereto included in the Company's 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.

In June 2008, the Financial Accounting Standards Board ("FASB") 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 September 30, 2010 | | |
|---|---|---|---|
| | Income (Numerator) | Shares (Denominator) | Per Share Amount |
| | (In Thousands, Except Per Share Data) | | |
| Net income | $ 1,335 | | |
| Basic earnings per share, income available to common stockholders | $ 1,335 | 67,219 | $ 0.02 |
| Effect of dilutive securities: | | | |
| Stock options | - | - | |
| | $ 1,335 | 67,219 | $ 0.02 |

| | Three Months Ended September 30, 2009 | | |
|---|---|---|---|
| | Income (Numerator) | Shares (Denominator) | Per Share Amount |
| | (In Thousands, Except Per Share Data) | | |
| Net income | $ 1,095 | | |
| Basic earnings per share, income available to common stockholders | $ 1,095 | 68,074 | $ 0.02 |
| Effect of dilutive securities: | | | |
| Stock options | - | - | |
| | $ 1,095 | 68,074 | $ 0.02 |

4. SUBSEQUENT EVENTS

The Company has evaluated events and transactions occurring subsequent to the statement of financial condition date of September 30, 2010, for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through the date this document was filed.

5. PROPOSED ACQUISITION OF CENTRAL JERSEY BANCORP

On May 25, 2010, the Company and the Bank entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Central Jersey Bancorp (“Central Jersey”) and its wholly owned subsidiary, Central Jersey Bank, National Association (“Central Jersey Bank”), pursuant to which Central Jersey will merge with a to-be-formed subsidiary of the Company and thereby become a wholly owned subsidiary of the Company (the “Merger”). Immediately thereafter, Central Jersey Bank will merge with and into the Bank (the “Bank Merger”). Central Jersey Bank will operate as a division of the Bank for at least 18 months after closing. At September 30, 2010, Central Jersey Bank had $589.4 million in assets and 13 branch offices in Monmouth and Ocean Counties, New Jersey.

Under the terms of the Merger Agreement, shareholders of Central Jersey will receive $7.50 in cash (the "Merger Consideration") for each share of Central Jersey common stock held. The Merger Agreement also provides that all options to purchase Central Jersey stock that are outstanding and unexercised immediately prior to the closing under Central Jersey's various stock option plans will be cancelled in exchange for a cash payment equal to the positive difference between $7.50 and the exercise price. The estimated aggregate value of the transaction is $72.3 million.

Central Jersey will use its best efforts to redeem the 11,300 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A previously issued to the U.S. Department of Treasury under the TARP Capital Purchase Plan immediately before or contemporaneously with closing. The warrant issued to the U.S. Treasury in connection with Treasury's preferred stock investment will be converted into the right to receive the difference between $7.50 and the warrant exercise price times the number of shares covered by the warrant.

Consummation of the Merger is subject to certain conditions, including, among others, approval of the Merger by shareholders of Central Jersey, governmental filings and regulatory approvals and expiration of applicable waiting periods, absence of litigation, accuracy of specified representations and warranties of the other party, and obtaining material permits and authorizations for the lawful consummation of the Merger and the Bank Merger. The Merger is also conditioned upon Central Jersey's nonperforming assets, as defined in the Merger Agreement, not exceeding $20.0 million between March 31, 2010 and the Closing Date.

The shareholders of Central Jersey approved the transaction on September 14, 2010 while the Office of Thrift Supervision issued the requisite regulatory approval on October 20, 2010. The transaction is expected to close during the Company's second fiscal quarter ending December 31, 2010.

6. MERGER-RELATED EXPENSES

Merger-related expenses are recorded in the Consolidated Statements of Income and include costs relating to Kearny Financial Corp.'s proposed acquisition of Central Jersey Bancorp as described above. These charges represent one-time costs associated with acquisition activities and do not represent ongoing costs of the fully integrated combined organization. Accounting guidance requires that acquisition-related transaction and restructuring costs incurred by the Company be charged to expense as incurred.

7. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2009, the FASB issued guidance concerning accounting for transfers of financial assets, an amendment to previous guidance on the topic. This statement prescribes the information that a reporting entity must provide in its financial reports about a transfer of financial assets; the effects of a transfer on its financial position, financial performance and cash flows; and a transferor's continuing involvement in transferred financial assets. Specifically, among other aspects, this guidance amends previous guidance concerning accounting for transfers and servicing of financial assets and extinguishments of liabilities by removing the concept of a qualifying special-purpose entity from previous guidance on transfers and servicing and removes the exception from applying previous guidance on transfers and servicing to variable interest entities that are qualifying special-purpose entities. It also modifies the financial-components approach used in previous guidance. This guidance is effective for fiscal years beginning after November 15, 2009. The implementation of this standard did not have a material impact on the Company's consolidated financial position or results of operations.

In June 2009, the FASB issued guidance concerning consolidation of variable interest entities to require an enterprise to determine whether its variable interest or interests give it a controlling financial

interest in a variable interest entity. The primary beneficiary of a variable interest entity is the enterprise that has both (1) the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (2) the obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. This guidance also amends previous guidance to require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity. This guidance is effective for fiscal years beginning after November 15, 2009. The implementation of this standard did not have a material impact on the Company's consolidated financial position or results of operations.

In October 2009, the FASB issued guidance concerning accounting for own-share lending arrangements in contemplation of convertible debt issuance or other financing. The guidance amends earlier guidance and provides direction for accounting and reporting for own-share lending arrangements issued in contemplation of a convertible debt issuance. At the date of issuance, a share-lending arrangement entered into on an entity's own shares should be measured at fair value in accordance with the guidance on fair value measurements and disclosures and recognized as an issuance cost, with an offset to additional paid-in capital. Loaned shares are excluded from basic and diluted earnings per share unless default of the share-lending arrangement occurs. The amendments also require several disclosures including a description and the terms of the arrangement and the reason for entering into the arrangement. The effective dates of the amendments are dependent upon the date the share-lending arrangement was entered into and include retrospective application for arrangements outstanding as of the beginning of fiscal years beginning on or after December 15, 2009. The implementation of this standard did not have a material impact on the Company's consolidated financial position or results of operations.

In January 2010, the FASB issued guidance concerning fair value measurement and disclosures. The guidance mandates additional disclosure requiring that a reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers while also requiring that in the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). The guidance clarifies existing fair value disclosure requirements such that a reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. Moreover, a reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. This guidance also includes conforming amendments regarding employers' disclosures about postretirement benefit plan assets. The conforming amendments change the terminology from "major categories" of assets to "classes" of assets and provide a cross reference to the guidance in Subtopic 820-10 on how to determine appropriate classes to present fair value disclosures. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The implementation of the new pronouncement during the quarter ended March 31, 2010 did not have a material impact on the Company's consolidated financial position or results of operations. The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements for those disclosures that go into effect during fiscal 2012.

In April, 2010, the FASB issued amended guidance that codifies the consensus reached regarding the effect of a loan modification when the loan is part of a pool that is accounted for as a single asset. The amendments to the Codification provide that modifications of loans that are accounted for within a pool under Subtopic 310-30 do not result in the removal of those loans from the pool even if the modification of those loans would otherwise be considered a troubled debt restructuring. An entity will continue to be required to consider whether the pool of assets in which the loan is included is impaired if expected cash flows for the pool change. The amended guidance does not affect the accounting for loans under the scope of Subtopic 310-30 that are not accounted for within pools. Loans accounted for individually under Subtopic 310-30 continue to be subject to the troubled debt restructuring accounting provisions within Subtopic 310-40. The amended guidance is effective prospectively for modifications of loans accounted for within pools under Subtopic 310-30 occurring in the first interim or annual period ending on or after July 15, 2010. Upon initial adoption of ASU 2010-18, an entity may make a one-time election to terminate accounting for loans as a pool under Subtopic 310-30. This election may be applied on a pool-by-pool basis and does not preclude an entity from applying pool accounting to subsequent acquisitions of loans with credit deterioration. The implementation of this standard did not have a material impact on the Company's consolidated financial position or results of operations.

In July, 2010, the FASB issued guidance concerning disclosures about the credit quality of financing receivables and the allowance for credit losses that will help investors assess the credit risk of a company's receivables portfolio and the adequacy of its allowance for credit losses held against the portfolios by expanding credit risk disclosures. This guidance requires more information about the credit quality of financing receivables in the disclosures to financial statements, such as aging information and credit quality indicators. Both new and existing disclosures must be disaggregated by portfolio segment or class. The disaggregation of information is based on how a company develops its allowance for credit losses and how it manages its credit exposure. The amendments in this guidance apply to all public and nonpublic entities with financing receivables. Financing receivables include loans and trade accounts receivable. However, short-term trade accounts receivable, receivables measured at fair value or lower of cost or fair value, and debt securities are exempt from these disclosure amendments. The effective date of the guidance differs for public and nonpublic companies. For public companies, the amendments that require disclosures as of the end of a reporting period are effective for periods ending on or after December 15, 2010. The amendments that require disclosures about activity that occurs during a reporting period are effective for periods beginning on or after December 15, 2010. For nonpublic companies, the amendments are effective for annual reporting periods ending on or after December 15, 2011. The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.

8. STOCK REPURCHASE PLANS

On May 26, 2010, the Company announced that the Board of Directors authorized a stock repurchase plan to acquire up to 889,506 shares, or 5% of the Company's outstanding stock held by persons other than Kearny MHC. In accordance with that plan, during the three months ended September 30, 2010, the Company purchased in the open market 368,800 shares at a cost of $3,316,000 and at an average cost per share of $8.99. Through September 30, 2010, the Company has repurchased a total of 730,900 shares in accordance with this repurchase plan at a total cost of $6,600,000 and at an average cost per share of $9.03.

9. DIVIDEND WAIVER

During the three months ended September 30, 2010, Kearny MHC, the federally chartered mutual holding company of the Company waived its right, in accordance with the non-objection previously

granted by the Office of Thrift Supervision ("OTS"), to receive cash dividends of approximately $2.5 million declared on the 50,916,250 shares of Company common stock it owns.

10. SECURITIES AVAILABLE FOR SALE

The amortized cost, gross unrealized gains and losses, estimated fair value and stratification by contractual maturity of securities available for sale at September 30, 2010 and June 30, 2010 are presented below:

| | At September 30, 2010 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Carrying Value |
| | (In Thousands) | | | |
| Securities: | | | | |
| Debt securities: | | | | |
| Trust preferred securities | $ 8,857 | $ - | $ 2,125 | $ 6,732 |
| U.S. agency securities | 3,460 | 1 | 12 | 3,449 |
| Obligations of state and political subdivisions | 18,124 | 1,077 | - | 19,201 |
| Total securities | 30,441 | 1,078 | 2,137 | 29,382 |
| Mortgage-backed securities: | | | | |
| Mortgage pass-through securities: | | | | |
| Government National Mortgage Association | 14,097 | 948 | 29 | 15,016 |
| Federal Home Loan Mortgage Corporation | 308,969 | 10,044 | 69 | 318,944 |
| Federal National Mortgage Association | 492,640 | 17,556 | 114 | 510,082 |
| Total mortgage-backed securities | 815,706 | 28,548 | 212 | 844,042 |
| Total securities available for sale | $ 846,147 | $ 29,626 | $ 2,349 | $ 873,424 |

| | At September 30, 2010 | |
|---|---|---|
| | Amortized Cost | Carrying Value |
| | (In Thousands) | |
| Debt securities: | | |
| Due in one year or less | $ - | $ - |
| Due after one year through five years | 6,306 | 6,653 |
| Due after five years through ten years | 12,135 | 12,867 |
| Due after ten years | 12,000 | 9,862 |

| | | | | |
|---|---|---|---|---|
| Total | $ | 30,441 | $ | 29,382 |

| | At June 30, 2010 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Carrying Value |
| | (In Thousands) | | | |
| Securities: | | | | |
| Debt securities: | | | | |
| Trust preferred securities | $ 8,855 | $ - | $ 2,255 | $ 6,600 |
| U.S. agency securities | 3,980 | 1 | 39 | 3,942 |
| Obligations of state and political subdivisions | 18,125 | 830 | - | 18,955 |
| Total securities | 30,960 | 831 | 2,294 | 29,497 |
| Mortgage-backed securities: | | | | |
| Mortgage pass-through securities: | | | | |
| Government National Mortgage Association | 14,660 | 999 | 31 | 15,628 |
| Federal Home Loan Mortgage Corporation | 263,481 | 10,267 | 44 | 273,704 |
| Federal National Mortgage Association | 395,273 | 18,884 | 34 | 414,123 |
| Total mortgage-backed securities | 673,414 | 30,150 | 109 | 703,455 |
| Total securities available for sale | $ 704,374 | $ 30,981 | $ 2,403 | $ 732,952 |

There were no sales of securities from the available for sale portfolio during the three months ended September 30, 2010 and September 30, 2009.

At September 30, 2010 and June 30, 2010, securities available for sale with carrying value of approximately $247.9 million and $243.7 million, respectively, were utilized as collateral for borrowings via repurchase agreements through the FHLB of New York. As of those same dates, securities available for sale with carrying values of approximately $1.7 million and $1.4 million, respectively, were pledged to secure public funds on deposit.

At September 30, 2010 and June 30, 2010, all obligations of states and political subdivisions were guaranteed by insurance policies issued by various insurance companies.

The Company's available for sale mortgage-backed securities are generally secured by residential mortgage loans with original contractual maturities of ten to thirty years. However, the effective lives of those 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.

11. SECURITIES HELD TO MATURITY

The amortized cost, gross unrealized gains and losses, estimated fair value and stratification by contractual maturity of securities held to maturity at September 30, 2010 and June 30, 2010 are as follows:

| | At September 30, 2010 | | | |
|---|---|---|---|---|
| | Carrying Value | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | (In Thousands) | | | |
| Securities: | | | | |
| Debt securities: | | | | |
| U.S. agency securities | $ 229,976 | $ 2,087 | $ - | $ 232,063 |
| Total securities | 229,976 | 2,087 | - | 232,063 |
| Mortgage-backed securities: | | | | |
| Collateralized mortgage obligations: | | | | |
| Federal Home Loan Mortgage Corporation | 91 | 12 | - | 103 |
| Federal National Mortgage Association | 732 | 89 | - | 821 |
| Non-agency securities | 299 | 3 | 39 | 263 |
| Total collateralized mortgage obligations | 1,122 | 104 | 39 | 1,187 |
| Mortgage pass-through securities: | | | | |
| Federal Home Loan Mortgage Corporation | 163 | 5 | - | 168 |
| Federal National Mortgage Association | 340 | 7 | 1 | 346 |
| Total mortgage pass-through securities | 503 | 12 | 1 | 514 |
| Total mortgage-backed securities | 1,625 | 116 | 40 | 1,701 |
| Total securities held to maturity | $ 231,601 | $ 2,203 | $ 40 | $ 233,764 |

| | At September 30, 2010 | |
|---|---|---|
| | Carrying Value | Fair Value |

| | (In Thousands) | |
|---|---|---|
| Debt securities: | | |
| Due in one year or less | $ - | $ - |
| Due after one year through five years | 160,000 | 161,678 |
| Due after five years through ten years | 20,000 | 20,102 |
| Due after ten years | 49,976 | 50,283 |
| Total | $ 229,976 | $ 232,063 |

| | At June 30, 2010 | | | |
|---|---|---|---|---|
| | Carrying Value | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | (In Thousands) | | | |
| Securities: | | | | |
| Debt securities: | | | | |
| U.S. agency securities | $ 255,000 | $ 1,914 | $ - | $ 256,914 |
| Total securities | 255,000 | 1,914 | - | 256,914 |
| Mortgage-backed securities: | | | | |
| Collateralized mortgage obligations: | | | | |
| Federal Home Loan Mortgage Corporation | 99 | 12 | - | 111 |
| Federal National Mortgage Association | 767 | 71 | 1 | 837 |
| Non-agency securities | 310 | 2 | 43 | 269 |
| Total collateralized mortgage obligations | 1,176 | 85 | 44 | 1,217 |
| Mortgage pass-through securities: | | | | |
| Federal Home Loan Mortgage Corporation | 168 | 5 | - | 173 |
| Federal National Mortgage Association | 356 | 9 | 1 | 364 |
| Total mortgage pass-through securities | 524 | 14 | 1 | 537 |
| Total mortgage-backed securities | 1,700 | 99 | 45 | 1,754 |
| Total securities held to maturity | $ 256,700 | $ 2,013 | $ 45 | $ 258,668 |

There were no sales of securities from the held to maturity portfolio during the three months ended September 30, 2010 and September 30, 2009. Held to maturity securities were not utilized as collateral for borrowings nor pledged to secure public funds on deposit during the three months ended September 30, 2010.

The Company's held to maturity collateralized mortgage obligations and mortgage pass-through securities are generally secured by residential mortgage loans with original contractual maturities of ten to thirty years. However, the effective lives of those 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-though securities generally share in the receipt of principal repayments on a pro-rata basis as paid by the borrowers. In addition to mortgage pass-through securities, the held to maturity portfolio also contains collateralized mortgage obligations. Such securities 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.

12. IMPAIRMENT OF SECURITIES

The following three tables summarize the fair values and gross unrealized losses within the available for sale and held to maturity portfolios at September 30, 2010 and June 30, 2010. 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.

The tables are followed by a discussion that summarizes the Company's rationale for recognizing the certain impairments as "temporary" versus those identified as "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. As noted earlier, the Company's mortgage-backed securities held in the available for sale and held to maturity portfolios are generally secured by residential mortgage loans.

| | 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 September 30, 2010: | | | | | | |
| Trust preferred securities | $ - | $ - | $ 5,731 | $ 2,125 | $ 5,731 | $ 2,125 |
| U.S. agency securities | - | - | 3,130 | 12 | 3,130 | 12 |
| Mortgage pass-through securities | 95,239 | 115 | 815 | 97 | 96,054 | 212 |
| Total | $ 95,239 | $ 115 | $ 9,676 | $ 2,234 | $ 104,915 | $ 2,349 |
| At June 30, 2010: | | | | | | |
| Trust preferred securities | $ - | $ - | $ 5,600 | $ 2,255 | $ 5,600 | $ 2,255 |
| U.S. agency securities | - | - | 3,667 | 39 | 3,667 | 39 |
| Mortgage pass-through securities | 559 | 4 | 906 | 105 | 1,465 | 109 |
| Total | $ 559 | $ 4 | $ 10,173 | $ 2,399 | $ 10,732 | $ 2,403 |

The number of available for sale securities with unrealized losses at September 30, 2010 totaled 33 comprising four trust preferred securities, five U.S. agency securities and 24 mortgage pass-through securities. The number of available for sale securities with unrealized losses at June 30, 2010 totaled 28 comprising four trust preferred securities, six U.S. agency securities and 18 mortgage 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 September 30, 2010: | | | | | | |
| Collateralized mortgage obligations | $ 10 | $ 2 | $ 198 | $ 37 | $ 208 | $ 39 |
| Mortgage pass-through securities | 63 | 1 | - | - | 63 | 1 |
| Total | $ 73 | $ 3 | $ 198 | $ 37 | $ 271 | $ 40 |
| At June 30, 2010: | | | | | | |
| Collateralized mortgage obligations | $ 76 | $ 3 | $ 218 | $ 41 | $ 294 | $ 44 |
| Mortgage pass-through securities | 66 | 1 | - | - | 66 | 1 |
| Total | $ 142 | $ 4 | $ 218 | $ 41 | $ 360 | $ 45 |

The number of held to maturity securities with unrealized losses at September 30, 2010 totaled 20 comprising 19 collateralized mortgage obligations and one mortgage pass-through security. The number of held to maturity securities with unrealized losses at June 30, 2010 totaled 23 comprising 22 collateralized mortgage obligations and one mortgage pass-through security.

U.S. Agency Mortgage-backed Securities. The carrying value of the Company's agency mortgage-backed securities totaled $845.4 million at September 30, 2010 and comprised 76.5% of total investments and 35.6% of total assets as of that date. This category of securities generally includes mortgage pass-through securities and collateralized mortgage obligations issued by U.S. government-sponsored entities 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 during 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 assuring the creditworthiness of the mortgage-backed securities issued by those agencies.

With credit risk being reduced to negligible levels due to the U.S. government's support 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. First, 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 currently prevalent in the marketplace have created significant refinancing incentive for qualified borrowers. However, 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 deteriorating real estate market values and reduced availability of credit that have characterized the residential real estate marketplace in recent years have stifled demand for residential real estate while reducing the ability of certain borrowers to qualify for the refinancing of existing loans. To some extent, these factors have 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. During fiscal 2008 and fiscal 2009, the volatility and uncertainty in the marketplace had reduced the overall level of demand for mortgage-backed securities which generally had an adverse impact on their prices in the open market. This was further exacerbated by many larger institutions shedding mortgage-related assets to shrink their balance sheets for capital adequacy purposes thereby increasing the supply of such securities.

During fiscal 2010, however, institutional demand for mortgage-backed securities increased reflecting greater stability and liquidity in the financial markets coupled with the intervention of the Federal Reserve as a buyer/holder of such securities. Moreover, many financial institutions, including the Bank, are experiencing the concurrent effects of strong deposit growth and diminished loan origination volume resulting in increased institutional demand for mortgage-backed securities as investment alternatives to loans. These factors have continued into fiscal 2011 with market prices of agency mortgage-backed securities generally reflecting the increased institutional demand for such securities.

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. Inasmuch as such market conditions fluctuate over time, the impairments of value arising from these changing market conditions are both "noncredit-related" and "temporary" in nature.

The Company has the stated ability and intent to "hold to maturity" those securities so designated. Moreover, the Company has both the ability and intent, as of the periods presented, to hold the temporarily impaired available for sale securities until the fair value of the securities recovers to a level equal to or greater than the Company's amortized cost. As such, the Company has not decided to sell the securities as of September 30, 2010 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. Moreover, the Company purchased these securities at either par or nominal premiums. Accordingly, the Company expects that the securities will not be settled for a price less than its amortized cost.

In light of the factors noted above, the Company does not consider its U.S. agency mortgage-backed securities with unrealized losses at September 30, 2010 to be "other-than-temporarily" impaired as of that date.

Non-agency Mortgage-backed Securities. The carrying value of the Company's non-agency mortgage-backed securities totaled $299,000 at September 30, 2010 and comprised less than one percent of total investments and total assets as of that date.

Unlike agency 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 Company monitors the general level of credit risk for each of its non-agency mortgage-backed securities based upon the ratings assigned to its specific tranches by one or more credit rating agencies. 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. For example, all impaired non-agency mortgage-backed securities that are rated below investment grade are reviewed individually to determine if such impairment is other-than-temporary.

Additional factors considered by the Company in identifying its other-than-temporarily impaired securities include, but are not limited to, the severity and duration of the impairment, the payment performance of the underlying mortgage loans and trends relating thereto, the original terms of the underlying loans regarding credit quality (ex. Prime, Alt-A), the geographic distribution of the real estate collateral supporting those loans and any current or anticipated declines in associated collateral values, as well as the degree of protection against credit losses afforded to the Company's security through the structural characteristics of the larger investment vehicle as noted above. Based upon these additional factors, the impairment of certain investment grade securities may also be reviewed for other-than-temporary impairment.

Securities determined to be potentially other-than-temporarily impaired are individually analyzed to determine the "credit-related" and "noncredit-related" portions of the impairment. As noted earlier, a credit-related impairment generally represents the amount by which the present value of the cash flows that are expected to be collected on an other-than-temporarily impaired security fall below its amortized cost. Projected cash flows for the Company's non-agency mortgage-backed securities are modeled using an automated securities analytics system that is commonly used by institutional investors and the broker/dealer community. The system generates an individual tranche's projected cash flows based upon several input assumptions regarding the payment performance of the mortgage loans underlying the larger investment vehicle of which the Company's tranche is a part. Such assumptions include, but may not be limited to, loan prepayment rates, loan default rates, and the severity of actual losses on defaulting loans. The Company generally bases the input values for these assumptions on historical data reported by the analytics system. The Company then calculates the present value of those cash flows based upon the appropriate discount rate required by the applicable accounting guidance.

The impairments of those securities whose cash flows, when present valued, fall below the Company's amortized cost due to expected principal losses are identified as other-than-temporary. The amount by which the present value of the expected cash flows falls below the Company's amortized cost of the security is identified as the credit-related portion of the other-than-temporary impairment. The remaining portion, where applicable, is identified as noncredit-related, other-than-temporary impairment.

The impairments of those individually analyzed securities whose cash flows, when present valued, exceed the Company's amortized cost or otherwise reflect no expected principal losses, are generally identified as temporary. Similarly, the impairments associated with those securities that have generally retained their investment-grade credit rating and whose additional factors, as noted above, are not characterized by potentially adverse attributes, are also generally identified as temporary. In such cases, the Company attributes the unrealized losses to the same fluctuating market-related factors as those affecting agency mortgage-backed securities, noting, in particular, the comparatively greater temporary adverse effect on fair value arising from the general illiquidity of non-agency, investment grade

mortgage-backed securities in the marketplace compared to agency-guaranteed mortgage-backed securities. In light of these factors, the related impairments are defined as “temporary”.

The classification of impairment as “temporary” is generally reinforced by the Company’s stated intent and ability to “hold to maturity” all of its non-agency mortgage-backed securities which allows for an adequate timeframe during which the fair values of the impaired securities are expected to recover to the level of their amortized cost. However, in the event of a severe deterioration of a security’s credit characteristics – including, but not limited to, a reduction in credit rating from investment grade to below investment grade and/or the recognition of credit-related impairment resulting from actual or expected deterioration of cash flows - the Company may re-evaluate and restate its intent to hold an impaired security until the expected recovery of its amortized cost.

For example, during the fourth quarter of fiscal 2010, the Company re-evaluated its intent regarding the retention or sale of its impaired, nonagency collateralized mortgage obligations whose credit-ratings had fallen below investment grade. The Company considered the combined effects of the severe deterioration of the securities’ credit-ratings since their acquisition as investment grade securities and the actual and anticipated cash flow losses that characterized most of the securities. Based on these factors, the Company modified its intent regarding these impaired securities during the quarter ended June 30, 2010 from “hold to recovery of amortized cost” to “sell” and sold such securities prior to the end of that same quarter.

At September 30, 2010, the Company's remaining portfolio of non-agency CMOs totaled 20 held-to-maturity securities all of which are rated as investment grade at September 30, 2010. As such, the Company has not decided to sell the securities as of September 30, 2010 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 above, the Company does not consider its balance of non-agency mortgage-backed securities with unrealized losses at September 30, 2010 to be “other-than-temporarily” impaired as of that date.

U.S. Agency Securities. The carrying value of the Company’s U.S. agency debt securities totaled $233.4 million at September 30, 2010 and comprised 21.1% of total investments and 9.8% of total assets as of that date. Such securities are comprised of $230.0 million of U.S. agency debentures and $3.4 million of securitized pools of loans issued and fully guaranteed by the Small Business Administration (“SBA”), a U.S. government sponsored entity.

At September 30, 2010, the fair value of the Company’s SBA securities included a combination of unrealized gains and losses. As of that same date, the fair value of the Company’s portfolio of U.S. agency debentures reflected no unrealized losses. 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 debt securities are due largely 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 supply and demand.

With regard to interest rates, the Company’s SBA securities are variable rate investments whose interest coupons are generally based on the Prime index minus a margin. Based upon the historically low level of short term market interest rates, of which the Prime index is one measure, the current yields on these securities are comparatively low. Consequently, the fair value of the SBA securities, as determined based upon the market price of these securities, reflects the adverse effects of the historically low short term, market interest rates at September 30, 2010.

Like the mortgage-backed securities described earlier, the currently diminished fair value of the Company's SBA securities also reflects the extended average lives of the underlying loans resulting from loan prepayment prohibitions that may be embedded in the underlying loans coupled with the generally reduced availability of credit in the marketplace reducing borrower refinancing opportunities. Such influences extend the timeframe over which an investor would anticipate holding the security at a "below market" yield. Similarly, the price of securitized SBA loan pools also reflects fluctuating supply and demand in the marketplace attributable to similar factors as those applying to mortgage-backed securities, as presented above.

Unlike its SBA securities, the Company's U.S. agency debentures are fixed rate investments whose fair values over time reflect movements in comparatively longer term market interest rates. While there were no unrealized losses in the agency debenture portfolio at September 30, 2010, fluctuation in the fair value of such securities are generally attributable to movements in longer term market interest rates since their acquisition by the Company.

In sum, the factors influencing the fair value of the Company's U.S. agency 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. Inasmuch as such market conditions fluctuate over time, the "noncredit-related" impairments of value arising from these changing market conditions are "temporary" in nature.

The Company has the stated ability and intent to "hold to maturity" those securities so designated. Moreover, the Company has both the ability and intent, as of the periods presented, to hold the temporarily impaired available for sale securities until the fair value of the securities recovers to a level equal to or greater than the Company's amortized cost. As such, the Company has not decided to sell the securities as of September 30, 2010 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. Moreover, the Company purchased these securities at either par or nominal premiums. Accordingly, the Company expects that the securities will not be settled for a price less than its amortized cost.

In light of the factors noted above, the Company does not consider its balance of U.S. agency securities with unrealized losses at September 30, 2010 to be "other-than-temporarily" impaired as of that date.

Trust Preferred Securities. The outstanding balance of the Company's trust preferred securities totaled $6.7 million at September 30, 2010 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 September 30, 2010, 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.

The Company generally evaluates the level of credit risk for each of its trust preferred securities based upon ratings assigned by one or more credit rating agencies where such ratings are available. For those trust preferred securities that are impaired, the Company uses such ratings as a practical expedient to identify those securities whose impairments are potentially "credit-related" versus "noncredit-related".

Specifically, impairments associated with investment-grade trust preferred securities are generally categorized as "noncredit-related" given the nominal level of credit losses that would be expected based upon such ratings. At September 30, 2010, the Company owned two securities at an amortized cost of

$2.9 million that were consistently rated as investment grade by Moody's and Standard & Poor's Financial Services ("S&P"). 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 September 30, 2010.

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 sum, the factors influencing the fair value of the Company's investment-grade trust preferred 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. Inasmuch as such market conditions fluctuate over time, the "noncredit-related" impairments of value arising from these changing market conditions are "temporary" in nature.

The impairments of the Company's trust preferred securities with one or more non-investment grade ratings are further evaluated to determine if such impairments are "credit-related". Factors considered in this evaluation include, but may not be limited to, 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.

At September 30, 2010, the Company owned two securities at an amortized cost of $4.9 million that were rated as investment grade by Moody's, but below investment grade by S&P. 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.

In evaluating the impairment associated with these securities, 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. The Company also noted the disparity between investment-grade and non-investment grade ratings for the securities among rating companies which demonstrates the current level of uncertainty regarding credit-risk 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.

While all of its trust preferred securities are classified as available for sale, the Company has both the ability and intent, as of the periods presented, to hold the impaired securities until their fair values recover to a level equal to or greater than the Company's amortized cost. As such, the Company has not decided to sell the securities as of September 30, 2010 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. Moreover, the Company purchased these securities at nominal discounts. Accordingly, the Company expects that the securities will not be settled for a price less than its amortized cost.

In light of the factors noted above, the Company does not consider its investments in trust preferred securities with unrealized losses at September 30, 2010 to be "other-than-temporarily" impaired as of that date.

The following table presents roll forwards of OTTI recognized in earnings due to credit-related losses on securities still held at the end of each reporting period.

| | Activity in credit-related other-than-temporary impairment ("OTTI") recognized through earnings | | | | | |
|---|---|---|---|---|---|---|
| | Cumulative balance of credit-related OTTI recognized in earnings - beginning | Additions for newly identified credit-related OTTI | Additions to existing OTTI for further credit-related declines in fair value | Reductions in credit-related OTTI for security sale | Reductions in credit-related OTTI due to accretion of impairment into interest income | Cumulative balance of credit-related OTTI recognized in earnings - ending |
| | (In Thousands) | | | | | |
| Collateralized mortgage obligations: Non-agency securities: | | | | | | |
| Three months ended September 30, 2010 | $ - | $ - | $ - | $ - | $ - | $ - |
| Three months ended September 30, 2009 | $ 434 | $ 7 | $ 90 | $ - | $ 13 | $ 518 |

13. BENEFIT PLANS – COMPONENTS OF NET PERIODIC EXPENSE

The following table sets forth the aggregate net periodic benefit expense for the Bank's Benefit Equalization Plan, Postretirement Welfare Plan and Directors' Consultation and Retirement Plan:

| | Three Months Ended September 30, | |
|---|---|---|
| | 2010 | 2009 |
| | (In Thousands) | |
| Service cost | $ 40 | $ 38 |
| Interest cost | 83 | 90 |
| Amortization of unrecognized past service liability | 18 | 17 |
| Amortization of unrecognized net actuarial (gain) loss | (1) | 18 |
| Net periodic benefit expense | $ 140 | $ 163 |

14. FAIR VALUE OF FINANCIAL INSTRUMENTS

The guidance on fair value measurement establishes a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices in active markets for identical assets or liabilities.

Level 2: Observable inputs other than Level 1 prices, such as quoted for similar assets or liabilities; quoted prices in markets that are not active; or inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

In addition, the guidance requires the Company to disclose the fair value for assets and liabilities on both a recurring and non-recurring basis.

Those assets and liabilities measured at fair value on a recurring basis are summarized below:

| | Fair Value Measurements Using | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance |
| | (In Thousands) | | | |
| At September 30, 2010: | | | | |
| Securities available for sale | $ - | $ 28,382 | $ 1,000 | $ 29,382 |
| Mortgage-backed securities available for sale | - | 844,042 | - | 844,042 |
| At June 30, 2010: | | | | |
| Securities available for sale | $ - | $ 28,497 | $ 1,000 | $ 29,497 |
| Mortgage-backed securities available for sale | - | 703,455 | - | 703,455 |

The fair values of securities available for sale (carried at fair value) or held to maturity (carried at amortized cost) are primarily determined by obtaining matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

The Company holds a trust preferred security with a par value of $1.0 million, a de-facto obligation of Mercantil Commercebank Florida Bancorp, Inc., whose fair value has been determined by using Level 3 inputs. It is a part of a $40.0 million private placement with a coupon of 8.90% issued in 1998 and maturing in 2028. Generally management has been unable to obtain a market quote due to a lack of trading activity for this security. Consequently, the security's fair value as reported at September 30, 2010 and June 30, 2010 is based upon the present value of its expected future cash flows assuming the security continues to meet all its payment obligations and utilizing a discount rate based upon the security's contractual interest rate. For the three months ended September 30, 2010, there were no purchases, sales, issuances, or settlements of assets or liabilities whose fair values are determined based upon Level 3 inputs on a recurring basis.

Those assets and liabilities measured at fair value on a non-recurring basis are summarized below:

| | Fair Value Measurements Using | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance |
| | (In Thousands) | | | |
| At September 30, 2010 | | | | |
| Impaired loans | $ - | $ - | $ 9,969 | $ 9,969 |
| Real estate owned | - | - | 581 | 581 |
| At June 30, 2010 | | | | |
| Impaired loans | $ - | $ - | $ 9,781 | $ 9,781 |
| Real estate owned | - | - | 37 | 37 |

An impaired loan is evaluated and valued at the time the loan is identified as impaired at the lower of cost or market value. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Market value is measured based on the value of the collateral securing the loan and is classified at a Level 3 in the fair value hierarchy. Once a loan is identified as individually impaired, management measures impairment in accordance with the FASB's guidance on accounting by creditors for impairment of a loan with the fair value estimated using the market value of the collateral reduced by estimated disposal costs. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceeds the recorded investments in such loans. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly.

At September 30, 2010, impaired loans valued using Level 3 inputs comprised 29 loans with principal balances totaling $14,953,000 and valuation allowances of $4,984,000 reflecting fair values of $9,969,000. By comparison, at June 30, 2010, impaired loans valued using Level 3 inputs comprised 29 loans with principal balances totaling $14,096,000 and valuation allowances of $4,315,000 reflecting fair values of $9,781,000.

Once a loan is foreclosed, the fair value of real estate owned continues to be evaluated based upon the market value of the repossessed real estate originally securing the loan. At September 30, 2010 real estate owned whose carrying value reflected Level 3 inputs comprised three properties with fair values totaling $581,000. By comparison, at June 30, 2010 real estate owned whose carrying value reflected Level 3 inputs included one property with a fair value totaling $37,000.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments at September 30, 2010 and June 30, 2010:

Cash and Cash Equivalents, Interest Receivable and Interest Payable. The carrying amounts for cash and cash equivalents, interest receivable and interest payable approximate fair value because they mature in three months or less.

Securities. See the discussion presented on Page 26 concerning assets measured at fair value on a recurring basis.

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Loans Receivable. Except for certain impaired loans as previously discussed, the fair value of loans receivable is estimated by discounting the future cash flows, using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, of such loans.

Deposits. The fair value of demand, savings and club accounts is equal to the amount payable on demand at the reporting date. The fair value of certificates of deposit is estimated using rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by deposit liabilities compared to the cost of borrowing funds in the market.

Advances from FHLB. Fair value is estimated using rates currently offered for advances of similar remaining maturities.

Commitments. The fair value of commitments to fund credit lines and originate or participate in loans is estimated using fees currently charged to enter into similar agreements taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed rate loan commitments, fair value also considers the difference between current levels of interest and the committed rates. The carrying value, represented by the net deferred fee arising from the unrecognized commitment, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, is not considered material for disclosure. The contractual amounts of unfunded commitments are presented on Page 41.

The carrying amounts and estimated fair values of financial instruments are as follows:

| | At September 30, 2010 | | At June 30, 2010 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| | (In Thousands) | | | |
| Financial assets: | | | | |
| Cash and cash equivalents | $ 119,084 | $ 119,084 | $ 181,422 | $ 181,422 |
| Securities available for sale | 29,382 | 29,382 | 29,497 | 29,497 |
| Securities held to maturity | 229,976 | 232,063 | 255,000 | 256,914 |
| Loans receivable | 988,367 | 1,007,882 | 1,005,152 | 1,022,873 |
| Mortgage-backed securities available for sale | 844,042 | 844,042 | 703,455 | 703,455 |
| Mortgage-backed securities held to maturity | 1,625 | 1,701 | 1,700 | 1,754 |
| Interest receivable | 8,298 | 8,298 | 8,338 | 8,338 |
| Financial liabilities: | | | | |
| Deposits (A) | 1,663,388 | 1,661,874 | 1,623,562 | 1,632,209 |
| Advances from FHLB | 210,000 | 244,977 | 210,000 | 245,491 |
| Interest payable on FHLB advances | 1,067 | 1,067 | 1,054 | 1,054 |

(A) Includes accrued interest payable on deposits of $126,000 and $142,000, respectively, at September 30, 2010 and June 30, 2010.

Limitations. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. Because no market value exists for a significant portion of the financial instrument, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instrument and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The fair value estimates are based on existing on-and-off balance sheet financial instruments without attempting the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial assets and liabilities include premises and equipment, and advances from borrowers for taxes and insurance. In addition, the ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

Finally, reasonable comparability between financial institutions may not be likely due to the wide range of permitted valuation techniques and numerous estimates which must be made given the absence of active secondary markets for many of the financial instruments. This lack of uniform valuation methodologies introduces a greater degree of subjectivity to these estimated fair values.

## ITEM 2.
## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This Form 10-Q may include certain forward-looking statements based on current management expectations. Such forward-looking statements may be identified by reference to a future period or periods or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "estimate," "anticipate," "continue," or similar t variations on those terms, or the negative of those terms. The actual results of the Company could differ materially from those management expectations. Factors that could cause future results to vary from current management expectations include, but are not limited to, general economic conditions, legislative and regulatory changes, monetary and fiscal policies of the federal government, changes in tax policies, rates and regulations of federal, state and local tax authorities. Additional potential factors include changes in interest rates, deposit flows, cost of funds, demand for loan products, demand for financial services, competition, changes in the quality or composition of loan and investment portfolios of the Bank. Other factors that could cause future results to vary from current management expectations include changes in accounting principles, policies or guidelines, and other economic, competitive, governmental and technological factors affecting the Company's operations, markets, products, services and prices. Further description of the risks and uncertainties to the business are included in the Company's other filings with the Securities and Exchange Commission.

Comparison of Financial Condition at September 30, 2010 and June 30, 2010

General. Total assets increased $36.5 million to $2.38 billion at September 30, 2010 from $2.34 billion at June 30, 2010. The increase in total assets was due primarily to an increase in mortgage-backed securities that was partially offset by decreases in cash and cash equivalents, non-mortgage-backed securities and net loans receivable. The overall increase in total assets was complemented by growth in deposits that was partially offset by a decrease in stockholders' equity.

Cash and Cash Equivalents. Cash and cash equivalents, which consist of interest-earning and noninterest-earning deposits in other banks, decreased $62.3 million to $119.1 million at September 30, 2010 from $181.4 million at June 30, 2010. The decline in short term, liquid assets was largely attributable to the continued reinvestment of a portion of the Company's excess liquidity into mortgage-backed securities. Such excess liquidity has generally resulted from the combined effects of deposit growth coupled with net reductions in the loan and non-mortgage-backed security portfolios.

In accordance with the overall goals of its strategic business plan, the Company had deferred the reinvestment of a portion of incoming cash flows resulting in comparatively higher average balances of short term, liquid assets held through June 30, 2010 as a funding source for future loan originations. While the Bank's pipeline of "in process" loans has generally increased compared to one year earlier, overall loan origination volume continues to reflect the significant economic challenges and declining real estate values that characterize the current lending marketplace. Consequently, loan repayments continued to outpace origination volume through the first quarter of fiscal 2011.

The cash inflows from net declines in the loan portfolio, coupled with those arising from deposit growth and non-mortgage-backed security repayments, resulted in the accumulation of excess liquidity during the quarter ended September 30, 2010. In recognition of the growing opportunity cost to near term

earnings resulting from that excess liquidity, a portion of the Company's short term, liquid assets were reinvested into mortgage-backed securities during the quarter.

Securities Available for Sale. Non-mortgage-backed securities classified as available for sale decreased by $115,000 to $29.4 million at September 30, 2010 from $29.5 million at June 30, 2010. The decrease in the portfolio was attributable to principal repayments that were partially offset by an increase in the fair value of the portfolio. At September 30, 2010, the available for sale non-mortgage-backed securities portfolio consisted of $3.4 million of SBA pass-through certificates, $19.2 million of municipal bonds and $6.7 million of single issuer trust preferred securities with amortized costs of $3.5 million, $18.1 million and $8.9 million, respectively. The net unrealized loss for this portfolio was reduced to $1.1 million at September 30, 2010 from $1.5 million at June 30, 2010. Based on its evaluation, management has concluded that no other-than-temporary impairment is present within this segment of the investment portfolio at September 30, 2010. (For additional information refer to Note 4 and Note 6 to consolidated financial statements.)

Securities Held to Maturity. Non-mortgage-backed securities classified as held to maturity decreased to $230.0 million at September 30, 2010 from $255.0 million at June 30, 2010. The net decrease in the portfolio during the quarter was attributable to the full repayment at par of several fixed rate, agency debentures that were called by the issuer prior to maturity and the reinvestment of all but $25.0 million of those proceeds into similar securities. As of September 30, 2010, a total of $160.0 million of these debentures have remaining terms to maturity of five years or less while securities having total balances of $20.0 million and $50.0 million have remaining terms to maturity of five to ten years and greater than ten years, respectively. Based on its evaluation, management has concluded that no other-than-temporary impairment is present within this segment of the investment portfolio at September 30, 2010.

Loans Receivable and Real Estate Owned. Loans receivable, net of unamortized premiums, deferred costs and the allowance for loan losses, decreased $16.8 million to $988.4 million at September 30, 2010 from $1.01 billion at June 30, 2010. The decrease in net loans receivable was primarily attributable to net decreases in the balances of residential mortgage loans and the funded portion of construction loans in conjunction with an increase in the allowance for loan losses. These changes were partially offset by net increases in the balance of commercial mortgage loans and commercial business loans.

Residential mortgage loans, in aggregate, decreased by $21.3 million to $755.6 million at September 30, 2010 from $776.8 million at June 30, 2010. The components of the aggregate decrease included a net reduction in the balance of one-to-four family first mortgage loans of $15.8 million to $648.0 million at September 30, 2010 coupled with net declines in the balances of home equity loans and home equity lines of credit of $5.0 million and $429,000, respectively, whose ending balances at September 30, 2010 were $96.6 million and $10.9 million, respectively. The reduction in the balance of residential mortgage loans reflects the effects of diminished loan demand in the marketplace arising from challenging economic conditions and declining real estate values which have adversely impacted residential real estate purchase and refinancing activity. In total, residential mortgage loan origination volume for the three months ended September 30, 2010 was $26.0 million comprising originations of one-to-four family first mortgage loans totaling $21.5 million and funding of home equity loans and home equity lines of credit totaling $4.5 million.

Commercial loans, in aggregate, increased by $7.8 million to $225.2 million at September 30, 2010 from $217.4 million at June 30, 2010. The components of the aggregate increase included growth in multi-family mortgage loans of $4.8 million, nonresidential mortgage loans of $2.3 million and commercial business loans of $745,000. The ending balances of multifamily mortgage loans,

nonresidential mortgage loans and commercial business loans at September 30, 2010 were $30.0 million, $180.2 million and $15.1 million, respectively. The overall growth in commercial loans reflects the Company's long-term expanded strategic emphasis in commercial lending coupled with a continuing favorable pricing environment for these loans. In total, commercial loan origination volume for the three months ended September 30, 2010 was $10.7 million comprising originations of multi-family mortgage loans of $5.4 million, nonresidential mortgage loans of $4.7 million and commercial business loans of $662,000.

The outstanding balance of construction loans, net of loans-in-process, decreased by $2.3 million to $12.4 million at September 30, 2010. The decrease in construction loans resulted from principal repayments net of additional disbursements. Construction loan disbursements for the three months ended September 30, 2010 totaled $1.1 million.

Finally, other loans, primarily comprising account loans and deposit account overdraft lines of credit, decreased $84,000 to $4.2 million at September 30, 2010. Other loan originations for the three months ended September 30, 2010 totaled $427,000.

At September 30, 2010, non-performing assets totaled $25.4 million or 1.07% of total assets and comprised 62 nonperforming loans totaling $24.8 million, or 2.49% of total loans, plus three REO properties totaling $581,000. By comparison, at June 30, 2010 non-performing assets totaled $21.7 million or 0.93% of total assets and comprised 54 nonperforming loans totaling $21.6 million, or 2.13% of total loans, plus two REO properties totaling $146,000.

The number and outstanding balance of loans reported as nonperforming at September 30, 2010 include 47 one-to-four family loans totaling $16.9 million, three construction loans totaling $468,000, eight multi-family loans totaling $2.5 million, two nonresidential mortgage loans totaling $2.7 million, and two commercial business loans totaling $2.3 million.

One-to-four family loans reported as non-performing at September 30, 2010 include 31 mortgage loans totaling $14.1 million on residential properties located in New Jersey originally acquired from Countrywide Home Loans, Inc. ("Countrywide"). As of that date, the allowance for loan loss includes valuation allowances totaling $3.1 million attributable to specific impairments identified on the Countrywide nonperforming loans. At September 30, 2010, the Bank owned a total of 164 residential mortgage loans with an aggregate outstanding balance of $81.3 million that were originally acquired from Countrywide and continue to be serviced by their acquirer, Bank of America through its subsidiary, BAC Home Loans Servicing, LP. Of these loans, an additional six loans totaling $2.4 million are 30-89 days past due and are in various stages of collection.

The remaining 16 nonperforming one-to-four family mortgage with an aggregate balance of $2.8 million were internally originated and include a total of 11 first mortgages, four home equity loans and one home equity line of credit. The Bank has identified no impairments requiring the establishment of a specific valuation allowance relating to these loans through September 30, 2010.

Construction loans reported as nonperforming at September 30, 2010 include two internally originated loans and one participation acquired through TICIC, a subsidiary of the New Jersey Bankers Association. As of that date, the allowance for loan loss includes a specific valuation allowance totaling $105,000 attributable to the impairment identified on this TICIC participation. The Bank has identified no impairments requiring the establishment of a specific valuation allowance relating to the two remaining internally originated, nonperforming construction loans.

Seven of the eight multi-family loans totaling $2.0 million that were reported as nonperforming at September 30, 2010 represent participations acquired through TICIC while one internally originated multi-family loan with a balance of $449,000 was reported as nonperforming as of that date. The allowance for loan loss includes specific valuation allowances totaling $1.5 million attributable to impairments identified on the TICIC multi-family loan participations.

The two nonresidential mortgage loans reported as nonperforming at September 30, 2010 represent internally originated loans for which the Bank has identified no impairments requiring the establishment of a specific valuation allowance as of that date. The larger of the two loans has an outstanding balance of $2.7 million and is fully secured by a catering facility in Monmouth County, NJ and remains in foreclosure at September 30, 2010.

Finally, the two commercial business loans reported as nonperforming at September 30, 2010 also represent internally originated loans for which the Bank has identified no impairments requiring the establishment of a specific valuation allowance as of that date. The larger of the two loans has an outstanding balance of $2.2 million and is secured by land with approvals for residential development. The loan was placed on nonaccrual at June 30, 2010 based upon its past due status. The borrower was unsuccessful at selling the underlying property based on a contract for the sale that was originally expected to close during the current quarter. Consequently, collection efforts continue on the loan at September 30, 2010.

In addition to impairments identified on the nonperforming loans noted above, the allowance for loan loss also contains a specific valuation allowance totaling $193,000 relating to one internally originated, multi-family mortgage loan that is impaired, but is reported as performing due to its accrual and payment status.

Charge offs, net of recoveries, against the allowance for loan loss during the current quarter ended September 30, 2010 totaled $435,000. The allowance for loan losses as a percentage of total loans outstanding was 0.94% at September 30, 2010 compared with 0.84% at June 30, 2010 reflecting total allowances of $9.4 million and $8.6 million, respectively. At September 30, 2010, the allowance was comprised of $5.0 million of specific valuation allowances attributable to identified impairments on individual loans while the remaining $4.4 million represented general valuation allowances based upon the historical and environmental loss factors utilized by the Bank’s allowance for loan loss methodology. By comparison, as of June 30, 2010, the specific and general valuation allowances included in the allowance for loan loss totaled $4.3 million and $4.3 million, respectively.

Mortgage-backed Securities Available for Sale. Mortgage-backed securities available for sale, all of which are government agency pass-through certificates, increased $140.6 million to $844.0 million at September 30, 2010 from $703.5 million at June 30, 2010. The net increase reflected security purchases totaling $186.4 million which were partially offset by principal repayments totaling approximately $43.7 million and a decline in the unrealized gain within the portfolio of $1.7 million to $28.3 million at September 30, 2010 from $30.0 million at June 30, 2010. The securities purchased were predominantly fixed rate securities with original maturities of 10 and 15 years. Additionally, the Bank purchased $4.4 million of 30 year, fixed rate issues that are eligible to meet the Community Reinvestment Act investment test. Based on its evaluation, management concluded that no other-than-temporary impairment was present within this segment of the investment portfolio at September 30, 2010. (For additional information refer to Note 4 and Note 6 to consolidated financial statements.)

Mortgage-backed Securities Held to Maturity. Mortgage-backed securities held to maturity decreased $75,000 to $1.6 million at September 30, 2010 from $1.7 million at June 30, 2010 attributable to principal repayments during the quarter. At September 30, 2010, the balance of mortgage-backed securities held to maturity includes both pass-through certificates and collateralized mortgage obligations ("CMOs"). As of that date, the Company's portfolio of non-agency CMOs totaled 20 securities with a total book value of approximately $299,000 while the remainder of the held to maturity mortgage-backed securities portfolio was comprised of government agency mortgage pass-through securities and collateralized mortgage obligations. Based on its evaluation, management concluded that no other-than-temporary impairment was present within this segment of the investment portfolio at September 30, 2010. (For additional information refer to Notes 5 and 6 to consolidated financial statements.)

Other Assets. The aggregate balance of the Company's remaining asset categories, including premises and equipment, Federal Home Loan Bank stock, accrued interest receivable, goodwill, bank owned life insurance, net deferred income tax assets, where applicable, and other assets, reflected nominal changes at September 30, 2010 from June 30, 2010.

Deposits. Deposits increased $39.8 million to $1.66 billion at September 30, 2010 from $1.62 billion at June 30, 2010. Growth was reported across all categories of interest-bearing deposits. For the quarter ended September 30, 2010, interest-bearing demand deposits increased $30.1 million to $286.3 million, savings deposits increased $1.8 million to $336.0 million and certificates of deposit increased $11.8 million to $991.4 million. Non-interest-bearing demand deposits decreased $3.9 million to $49.8 million during the current quarter.

The growth in interest-bearing checking accounts continues to reflect the promotion of the Bank's "High Yield Checking" product which is designed to attract core deposits in the form of customers' primary checking accounts through interest rate and fee reimbursement incentives to qualifying customers. The explicit increase in interest expense associated with the "High Yield Checking" product is expected to be partially offset by an associated increase in transaction fee income.

Depositors have generally been lengthening the maturities of their time deposits, particularly by transferring maturing certificates of deposit to accounts with new maturities of greater than 12 months to improve yield. Certificates of deposit with maturities of greater than 12 months increased by $42.5 million to $305.7 million at September 30, 2010 from $263.2 million at June 30, 2010 with such balances representing 30.8% and 26.9% of total certificates of deposit at the close of each period, respectively.

Advances from FHLB. As a result of the Bank's strong liquidity position, there were no additional borrowings drawn during the quarter ended September 30, 2010. Moreover, no borrowings matured during those same periods. Consequently, the balance of FHLB advances remained unchanged at $210.0 million at September 30, 2010 and June 30, 2010.

Stockholders' Equity. During the quarter ended September 30, 2010, stockholders' equity decreased $1.9 million to $484.0 million from $485.9 million at June 30, 2010. The decrease was attributable, in part, to a $3.3 million increase in treasury stock resulting from the repurchase of 368,800 shares of the Company's common stock as well as an $800,000 cash dividend to minority shareholders. Partially offsetting these factors was quarterly net income of $1.3 million, increases to paid-in-capital totaling $1.2 million attributable primarily to benefit plan related adjustments and $363,000 of ESOP shares earned. The change in stockholders' equity also reflects a $784,000 decline in accumulated other comprehensive income resulting primarily from reductions in the unrealized gain on the available for sale securities portfolios.

Comparison of Operating Results for the Three Months Ended September 30, 2010 and September 30, 2009

General. Net income for the three months ended September 30, 2010 was $1.3 million, or $0.02 per diluted share; an increase of $240,000 compared to $1.1 million, or $0.02 per diluted share for the three months ended September 30, 2009. The increase in net income between periods resulted primarily from increases in net interest income and non-interest income which were partly offset by increases in the provision for loan losses and non-interest expense. In total, these factors resulted in an overall increase in pre-tax income and the provision for income taxes.

Net Interest Income. Net interest income for the three months ended September 30, 2010 was $14.5 million, an increase of $1.3 million from $13.3 million for the three months ended September 30, 2009. The increase in net interest income between the comparative periods resulted from a decrease in interest expense that outpaced the concurrent decrease in interest income. In general, the decrease in interest expense reflected a continued decline in the cost of deposits. Such declines resulted from the downward re-pricing of certificates of deposit as well as reductions in the rates paid on non-maturity deposits. The decline in the rates paid more than offset the additional interest expense resulting from an increase in the average balance of interest-bearing deposits. The decrease in interest income was primarily attributable to declines in the yields across most categories of interest-earning assets coupled with an increase in the average balance of lower yielding investment securities in relation to the decline in the average balance of comparatively higher yielding loans.

As a result of these factors, the Company’s net interest rate spread increased 11 basis points to 2.43% for the three months ended September 30, 2010 from 2.32% for the three months ended September 30, 2009. The increase in the net interest rate spread reflected a decrease in the cost of interest-bearing liabilities of 60 basis points to 1.87% from 2.47% which was partially offset by a decrease in the yield on earning assets of 49 basis points to 4.30% from 4.79% for the same comparative periods. A discussion of the factors contributing to the overall change in yield on earning assets and cost of interest-bearing liabilities is presented in the separate discussion and analysis of interest income and interest expense below.

The factors contributing to the increase in net interest income and net interest rate spread were also reflected in the Company’s net interest margin. However, their effects were more than offset by other factors that resulted in the Company’s net interest margin decreasing by one basis point to 2.73% for the three months ended September 30, 2010 from 2.74% for the three months ended September 30, 2009. In particular, the decline in net interest margin compared to the improvement in net interest spread reflects the opportunity cost of the earning assets used to fund the Company’s share repurchase programs, prepayment of the Bank’s FDIC insurance premium and the net reduction in noninterest-bearing checking accounts between the comparative periods. For the three months ended September 30, 2010, the average balance of treasury stock increased $9.5 million to $56.3 million from $46.7 million for the three months ended September 30, 2009. For those same comparative periods, the Company’s average balance of prepaid expenses increased by $4.2 million attributable largely to the prepayment of the Bank’s FDIC deposit insurance premium. The decline in the average balance of noninterest-bearing checking accounts of $2.2 million between comparative periods was also a contributing factor to the decline in net interest margin.

Interest Income. Total interest income decreased $213,000 to $22.9 million for the three months ended September 30, 2010 from $23.2 million for the three months ended September 30, 2009. As noted above, the decrease in interest income reflected a decrease in the average yield on earning assets which declined 49 basis points to 4.30% for the three months ended September 30, 2010 from 4.79% for the three months ended September 30, 2009. The decrease in the average yield was partially offset by an increase in the average balance of interest-earning assets which increased $198.6 million to $2.13 billion from $1.94 billion for the same comparative period.

Interest income from loans decreased $1.1 million to $13.8 million for the three months ended September 30, 2010 from $14.9 million for the three months ended September 30, 2009. The decrease in interest income on loans was partly attributable to a decrease in the average balance of loans between the comparative periods which declined by $44.7 million to $1.01 billion for the three months ended September 30, 2010 from $1.05 billion for the three months ended September 30, 2009.

Within the reported decline in the average balance of loans, the Company reported a $46.9 million reduction in the average balance of residential mortgage loans to $767.7 million for the three months ended September 30, 2010 from $814.7 million for the three months ended September 30, 2009. The Company's residential mortgages generally comprise one-to-four family first mortgage loans, home equity loans and home equity lines of credit. As noted earlier, the decline reflected the continued diminished residential loan demand by qualified borrowers coupled with the Company's disciplined pricing for such loans in the face of aggressive pricing in the marketplace for certain loan products.

By contrast, the Company reported a net increase of $2.2 million in the average aggregate balance of commercial loans to $219.7 million from $217.5 million for those same comparative periods. The Company's commercial loans generally comprise multi-family and nonresidential mortgage loans as well as secured and unsecured business loans. The increase generally reflects the Company's long-term expanded strategic emphasis in commercial lending. However, the modest level of that increase continues to reflect the challenges to originating high quality, commercial loans that have resulted from the weakened economy and the related deterioration of real estate values and borrower creditworthiness.

The overall decrease in interest income on loans also reflects a decrease in their average yields which declined 18 basis points to 5.49% for the three months ended September 30, 2010 from 5.67% for the three months ended September 30, 2009. The reduction in the overall yield on the Company's loan portfolio generally reflects the effect of lower market interest rates which provides "rate reduction" refinancing incentive to borrowers while also contributing to the downward re-pricing of adjustable rate loans. However, because the Company's commercial loans generally comprise comparatively higher yielding multi-family mortgages, nonresidential mortgage loans and business loans, the continued reallocation within the loan portfolio from residential mortgages into commercial loans diminished the adverse impact of lower market interest rates on the overall yield of the loan portfolio between the comparative periods.

Interest income from mortgage-backed securities decreased $431,000 to $7.4 million for the three months ended September 30, 2010 from $7.8 million for the three months ended September 30, 2009. The decrease in interest income reflected a decrease in the average yield on mortgage-backed securities that was partially offset by an increase in their average balance. The average yield on mortgage-backed securities declined 77 basis points to 4.01% for the three months ended September 30, 2010 from 4.78% for the three months ended September 30, 2009. For those same comparative periods, the average balance of the securities increased $81.6 million to $737.4 million from $655.8 million.

The reduction in the overall yield of the mortgage-backed securities portfolio is attributable to many of the same factors affecting the yield on the Company's loan portfolio. That is, lower market interest rates have continued to provide a "rate reduction" refinancing incentive to mortgagors resulting in the pay off of comparatively higher rate mortgage loans underlying the Company's mortgage-backed securities. Simultaneously, lower market interest rates have resulted in the downward re-pricing of loans underlying the Company's adjustable rate mortgage-backed securities. The increase in the average balance of mortgage-backed securities reflects security purchases resulting, in part, from the reinvestment

of excess liquidity discussed earlier, that have outpaced the level of principal repayments and security sales.

Interest income from non-mortgage-backed securities increased $1.3 million to $1.6 million for the three months ended September 30, 2010 from $218,000 for the three months ended September 30, 2009. The increase in interest income reflected an increase in the average balance of non-mortgage-backed securities partially offset by a decline in their average yield. The average balance of these securities increased $243.5 million to $275.7 million for the three months ended September 30, 2010 from $32.2 million for the three months ended September 30, 2009. For those same comparative periods, the average yield on non-mortgage-backed securities decreased by 44 basis point to 2.27% from 2.71%.

The increase in the average balance of non-mortgage backed securities was primarily attributable to a $243.5 million increase in the average balance of taxable securities to $257.5 million during the three months ended September 30, 2010 from $14.0 million for the three months ended September 30, 2009. For those same comparative periods, the average balance of tax-exempt securities declined nominally to $18.1 million from $18.2 million. The net change in the average yield on non-mortgage backed securities reflected an increase of 49 basis points in the yield of taxable securities to 2.19% during the three months ended September 30, 2010 from 1.70% during the three months ended September 30, 2009 while the average yield on tax-exempt securities declined one basis point to 3.47% from 3.48%.

Interest income from other interest-earning assets decreased $51,000 to $179,000 for the three months ended September 30, 2010 from $230,000 for the three months ended September 30, 2009. The decrease in interest income was primarily attributable to a decline in the average balance of other interest-earning assets that was partially offset by an increase in their average yield. The average balance of other interest-earning assets decreased $81.8 million to $115.0 million for the three months ended September 30, 2010 from $196.9 million for the three months ended September 30. 2009. For those same comparative periods, the average yield on other interest-earning assets increased 16 basis points to 0.62% from 0.47%.

The decline in the average balance of other interest-earning assets was primarily attributable to the reinvestment of short term, liquid assets into mortgage-backed securities during the more recent quarter as described earlier. The increase in the average yield reflected day-to-day fluctuations in the level of earnings on such assets coupled with a decline in the average balance of the comparatively lower yielding components within that category of interest-earning assets.

Interest Expense. Total interest expense decreased $1.5 million to $8.4 million for the three months ended September 30, 2010 from $9.9 million for the three months ended September 30, 2009. As noted earlier, the decrease in interest expense reflected a decrease in the average cost of interest-bearing liabilities which declined 60 basis points to 1.87% for the three months ended September 30, 2010 from 2.47% for the three months ended September 30, 2009. The decrease in the average cost was partially offset by an increase in the average balance of interest-bearing liabilities of $194.0 million to $1.80 billion from $1.60 billion for the same comparative periods.

Interest expense attributed to deposits decreased $1.5 million to $6.3 million for the three months ended September 30, 2010 from $7.8 million for the three months ended September 30, 2009. The decrease resulted primarily from a 66 basis point decrease in the average cost of interest-bearing deposits to 1.59% for the three months ended September 30, 2010 from 2.25% for the three months ended September 30, 2009. The reported decrease in the average cost was reflected in the average cost of savings and certificates of deposit and was primarily attributable to the overall declines in market interest rates. For those comparative periods, the average cost of savings accounts decreased 17 basis points to 0.87% from 1.04% while the average cost of certificates of deposit declined 89 basis points to 1.97%

from 2.86%. The average cost of interest-bearing checking accounts remained unchanged at 1.13% between comparative periods.

The decrease in the average cost was partially offset by a $194.0 million increase in the average balance of interest-bearing deposits to $1.59 billion for the three months ended September 30, 2010 from $1.39 billion for the three months ended September 30, 2009. The reported increase in the average balance was represented across all categories of interest-bearing deposits and reflected the Company's strategic efforts to increase its deposit base coupled with consumer demand for the safety of FDIC insurance given the recent volatility in the financial markets for uninsured investment products. For those same comparative periods, the average balance of interest-bearing checking accounts increased $102.4 million to $273.5 million from $171.1 million, the average balance of savings accounts increased $32.1 million to $336.4 million from $304.2 million and the average balance of certificates of deposit increased $59.4 million to $976.8 million from $917.4 million. As of September 30, 2010, approximately $685.6 million or 69.2% of certificates of deposit, with a weighted average cost of 1.60%, mature within one year. Because the Bank's offering rates for CDs maturing in one year or less are generally lower than 1.60% at September 30, 2010, the majority of these certificates may re-price downward to the extent they are reinvested with the Bank at maturity into accounts with similar terms.

Interest expense attributed to FHLB advances was $2.1 million for each of the periods ended September 30, 2010 and September 30, 2009 reflecting consistent average balances and average costs of $210.0 million and 3.95%, respectively, for both comparative periods.

Provision for Loan Losses. The provision for loan losses increased $393,000 to $1.3 million for the three months ended September 30, 2010 from $858,000 for the three months ended September 30, 2009. The provision in the current period reflected required net increases to the allowance for additional specific losses on several impaired mortgage loans on residential properties located in New Jersey as well as one out-of-state residential mortgage loan. All 1-4 family residential mortgage loans with specific losses recognized during the quarter were originated by other lending institutions, including Countrywide Home Loans, Inc. ("Countrywide"), and purchased by the Bank during prior years. The provision also reflected net increases to balances of general valuation allowances attributable to the application of historical and environmental loss factors to the remaining non-impaired portion of the loan portfolio in accordance with the Company's allowance for loan loss calculation methodology.

Non-Interest Income. Total non-interest income increased $111,000 to $631,000 for the three months ended September 30, 2010 from $520,000 for the three months ended September 30, 2010. Excluding sale gains and losses and impairments of securities, non-interest income increased $13,000 to $631,000 during the three months ended September 30, 2010 compared to $618,000 during the three months ended September 30, 2009. On that basis, the comparative increase in non-interest income reflected an increase in income from bank owned life insurance and ATM interchange fees that was partially offset by a comparative increase in net expenses recognized through REO operations and net declines in deposit and branch-related fees and charges.

The net increase in noninterest income noted above was augmented by the absence in the current period of other-than-temporary impairment charges totaling $98,000 relating to the Company's prior balance non-investment grade, non-agency collateralized mortgage obligations ("CMOs") that were recorded during the earlier comparative quarter. All securities relating to those impairment charges were sold in the fourth quarter of the prior fiscal year ended June 30, 2010.

Non-Interest Expenses. Non-interest expense increased $627,000 to $11.6 million for the three months ended September 30, 2010 from $11.0 million for the three months ended September 30, 2009. The increase in non-interest expense resulted from increases in several categories of non-interest expense

including salaries and employee benefits, occupancy, equipment and systems, advertising and marketing, federal deposit insurance and merger-related expenses that were partially offset by declines in miscellaneous expense.

For the comparative periods noted, salaries and employee benefits increased $271,000 which was generally attributable to year-over-year increases in employees' wages and salaries as well as increases in actuarial pension costs and health benefit expenses. Premises occupancy expenses increased by $32,000 between those same periods reflecting increases in both property taxes and depreciation expense.

Equipment and systems expense increased $105,000 which resulted from increases in service provider expenses associated with core processing, network administration as well as data processing and support costs associated with the Bank's "High Yield Checking" product which had not yet been implemented during the earlier comparative quarter. Likewise, the comparative increase in advertising and marketing expense totaling $32,000 also reflects the absence of promotional expenses for the "High Yield Checking" product during the earlier comparative period.

The increase in cost of FDIC deposit insurance between year-over-year periods reflects the combined effects of several factors including the continued growth in the Bank's balance of insurable deposits coupled with a comparative increase in the premium rates charged by the FDIC per dollar of insurable deposit. Additionally, the expense in the earlier comparative period reflected an adjustment resulting from actual deposit insurance premium rates being lower than the rates at which the expense had been accrued in earlier periods.

Finally, the year-over-year increase in non-interest expenses reflects $40,000 in merger-related expenditures during the current quarter for which no such expense was recorded during the earlier comparative period.

Partially offsetting these increases in noninterest expense was a $146,000 decline in miscellaneous non-interest expense. The net decline primarily reflects reductions in loan expenses and various general and administrative expenses including correspondent bank charges that were partially offset by increases in professional services expenses for legal and accounting services.

Provision for Income Taxes. The provision for income taxes increased $143,000 to $946,000 for the three months ended September 30, 2010 from $803,000 for the three months ended September 30, 2009. The increase in income taxes between the comparative periods was primarily attributable to an increase in pre-tax income. The Company's effective tax rates during the three months ended September 30, 2010 and September 30, 2009 were 41.5% and 42.3%, respectively.

Liquidity and Capital Resources

Our liquidity, represented by cash and cash equivalents, is a product of our operating, investing and financing activities. Our primary sources of funds are deposits, amortization, prepayments and maturities of mortgage-backed securities and outstanding loans, maturities and calls of non-mortgage-backed securities and funds provided from operations. In addition, we invest excess funds in short-term interest-earning assets such as overnight deposits or U.S. agency securities, which provide liquidity to meet lending requirements. While scheduled payments from the amortization of loans and mortgage-backed securities and maturing securities and short-term investments are relatively predictable sources of funds, general interest rates, economic conditions and competition greatly influence deposit flows and prepayments on loans and mortgage-backed securities.

The Bank is required to have enough investments that qualify as liquid assets in order to maintain sufficient liquidity to ensure a safe operation. Management generally invests in cash and cash equivalents for this purpose. Investments that qualify as liquid assets are supplemented by those securities classified as available for sale at September 30, 2010, which included $844.0 million of mortgage-backed securities and $29.4 million of non-mortgage-backed securities that can readily be sold if necessary.

In accordance with the overall goals of its strategic business plan, the Company may, at times, defer the reinvestment of excess liquidity into the investment portfolio in favor of retaining comparatively higher average balances of short term, liquid assets as a funding source for future loan originations. Toward that end, the Bank's pipeline of "in process" loans has generally increased compared to one year earlier due, in part, to continued expansion of the Bank's commercial loan origination staff. Moreover, the Bank continues to evaluate various pricing strategies to expand the origination of certain loan types in select markets.

Despite these efforts to bolster loan growth, incoming cash flows from loan repayments have generally outpaced origination volume. As noted earlier, the Bank continued to experience a reduction in the aggregate outstanding balance of residential first mortgages, home equity loans and home equity lines of credit during the quarter ended September 30, 2010 due largely to the combined effects of significantly reduced levels of residential real estate purchase activity and a highly competitive market for the refinancing of existing credits.

The overall decline in the balance of residential mortgages has been partially offset by the increase in the aggregate balance of commercial loans, including non-residential mortgages, multi-family mortgages and commercial business loans attributable, in part, to the factors noted above. However, during the quarter ended September 30, 2010, the utilization of liquidity to fund the net growth in the commercial loan portfolio was significantly outpaced by the incoming cash flows arising from net deposit growth, security repayments and the overall decline in the residential loan portfolio.

In light of the opportunity cost to near term earnings resulting from the accumulation of short term, liquid assets, the Bank redeployed a portion of its excess liquidity into mortgage-backed securities during the quarter ended September 30, 2010. Total mortgage-backed securities increased by $140.5 million to $845.7 million at September 30, 2010 from $705.2 million at June 30, 2010. The increase in mortgage-backed securities was funded, in part, by a reduction in cash and equivalents which decreased by $62.3 million to $119.1 million from $181.4 million over that same comparative period. The remaining growth in mortgage-backed securities was largely funded by net deposit growth of $39.8 million in conjunction with net reductions in non-mortgage-backed securities and net loans receivable totaling $25.1 million and $16.8 million, respectively, between those same comparative periods.

Management will continue to monitor the opportunity cost to near term earnings resulting from the accumulation of short term, liquid assets in relation to the expected need for such liquidity to fund the Company's strategic initiatives including the upcoming acquisition of Central Jersey Bancorp which is expected to close during the quarter ending December 31, 2010. The Company may continue to redeploy a portion of its liquidity into higher yielding investments based upon the timing and relative success of those initiatives.

At September 30, 2010, the Bank had outstanding commitments to originate loans of $31.6 million compared to $28.0 million at June 30, 2010. Construction loans in process and unused lines of credit were $4.0 million and $25.1 million, respectively, at September 30, 2010 compared to $4.7 million and $25.9 million, respectively, at June 30, 2010. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee by

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the customer. Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. We use the same credit policies in making commitments and conditional obligations as we do for on-balance-sheet instruments. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

At September 30, 2010, the Bank had agreements to fund the purchase of loans on a flow basis of $1.9 million compared to $1.0 million at June 30, 2010. The Bank periodically enters into purchase agreements with a limited number of smaller, local mortgage companies to supplement the Bank’s loan origination pipeline. These agreements call for the purchase, on a flow basis, of mortgage loans with servicing released to the Bank.

As noted earlier, deposits increased $39.8 million to $1.66 billion at September 30, 2010, from $1.62 billion at June 30, 2010 despite the Bank continuing to reduce deposit rates across most interest-bearing deposit categories. In reaction to lower deposit interest rates in the marketplace, certificate of deposit holders have generally been lengthening the maturities of their time deposits, particularly by transferring maturing certificates of deposit to accounts with new maturities of greater than 12 months to improve yield. Certificates of deposit with maturities of greater than 12 months increased by $42.5 million to $305.7 million at September 30, 2010 from $263.2 million at June 30, 2010 with such balances representing 30.8% and 26.9% of total certificates of deposit at the close of each period, respectively.

Borrowings from the FHLB of New York are available to supplement the Bank’s liquidity position and, to the extent that maturing deposits do not remain with the Bank, management may replace such funds with advances. The Bank has the capacity to borrow additional funds from the FHLB, through an overnight line of credit of $200.0 million or by taking additional short-term or long-term advances. Given the excess liquidity position of the Bank, there was no need to borrow additional funds during the three months ended September 30, 2010. Additional borrowings are an option available to management if funding needs change or to lengthen liabilities. Most of the Bank’s mortgage-backed and non-mortgage-backed securities are held in safekeeping at the FHLB of New York and available as collateral if necessary.

We are a party to financial instruments with off-balance-sheet risk in the normal course of our business of investing in loans and securities as well as in the normal course of maintaining and improving the Bank’s facilities. These financial instruments include significant purchase commitments, such as commitments related to capital expenditure plans and commitments to purchase securities or mortgage-backed securities and commitments to extend credit to meet the financing needs of our customers. At September 30, 2010, we had no significant off-balance sheet commitments to purchase securities or for capital expenditures.

Consistent with its goals to operate a sound and profitable financial organization, the Bank actively seeks to maintain its status as a well-capitalized institution in accordance with regulatory standards. As of September 30, 2010, the Bank exceeded all capital requirements of the OTS.

The following table sets forth the Bank's capital position at September 30, 2010, as compared to the minimum regulatory capital requirements:

| | At September 30, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | (Dollars in Thousands) | | | | | |
| Total Capital (to risk-weighted assets) | $ 370,931 | 38.08% | $ 77,929 | 8.00% | $ 97,411 | 10.00% |
| Tier 1 Capital (to risk-weighted assets) | $ 366,538 | 37.63% | $ 38,964 | 4.00% | $ 58,446 | 6.00% |
| Core (Tier 1) Capital (to adjusted total assets) | $ 366,538 | 16.24% | $ 90,300 | 4.00% | $112,875 | 5.00% |
| Tangible Capital (to adjusted total assets) | $ 366,538 | 16.24% | $ 33,862 | 1.50% | $ - | - |

Recent Accounting Pronouncements

For a discussion of the expected impact of recently issued accounting pronouncements that have yet to be adopted by the Company, please refer to Note 7 of the Notes to the Consolidated Financial Statements.

ITEM 3.
QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Qualitative Analysis. The majority of our assets and liabilities are sensitive to changes in interest rates. Consequently, interest rate risk is a significant form of business risk that must be managed by the Company. Interest rate risk is generally defined in regulatory nomenclature as the risk to the Company's earnings or capital arising from the movement of interest rates. It arises from several risk factors including: the differences between the timing of rate changes and the timing of cash flows (re-pricing risk); the changing rate relationships among different yield curves that affect bank activities (basis risk); the changing rate relationships across the spectrum of maturities (yield curve risk); and the interest-rate-related options embedded in bank products (option risk).

Regarding the risk to the Company's earnings, movements in interest rates significantly influence the amount of net interest income recognized by the Company. Net interest income is the difference between:

- the interest income recorded on our earning assets, such as loans, securities and other interest-earning assets; and,

- the interest expense recorded on our costing liabilities, such as interest-bearing deposits and borrowings.

Net interest income is, by far, the Company's largest revenue source to which the Company adds its noninterest income and from which it deducts its noninterest expense and income taxes to calculate net income. Movements in market interest rates, and the effect of such movements on the risk factors noted above, significantly influence the "spread" between the interest earned by the Company on its loans, securities and other interest-earning assets and the interest paid on its deposits and borrowings. Movements in interest rates that increase, or "widen", that net interest spread enhance the Company's net income. Conversely, movements in interest rates that reduce, or "tighten", that net interest spread adversely impact the Company's net income.

For any given movement in interest rates, the resulting degree of movement in an institution's yield on interest earning assets compared with that of its cost of interest-bearing liabilities determines if an institution is deemed "asset sensitive" or "liability sensitive". An asset sensitive institution is one whose yield on interest-earning assets reacts more quickly to movements in interest rates than its cost of interest-bearing liabilities. In general, the earnings of asset sensitive institutions are enhanced by upward movements in interest rates through which the yield on its earning assets increases faster than its cost of interest-bearing liabilities resulting in a widening of its net interest spread. Conversely, the earnings of asset sensitive institutions are adversely impacted by downward movements in interest rates through which the yield on its earning assets decreases faster than its cost of interest-bearing liabilities resulting in a tightening of its net interest spread.

In contrast, a liability sensitive institution is one whose cost of interest-bearing liabilities reacts more quickly to movements in interest rates than its yield on interest-earning assets. In general, the earnings of liability sensitive institutions are enhanced by downward movements in interest rates through which the cost of interest-bearing liabilities decreases faster than its yield on its earning assets resulting in a widening of its net interest spread. Conversely, the earnings of liability sensitive institutions are adversely impacted by upward movements in interest rates through which the cost of interest-bearing liabilities increases faster than its yield on its earning assets resulting in a tightening of its net interest spread.

The degree of an institution's asset or liability sensitivity is traditionally represented by its "gap position". In general, gap is a measurement that describes the net mismatch between the balance of an institution's earning assets that are maturing and/or re-pricing over a selected period of time compared to that of its costing liabilities. Positive gaps represent the greater dollar amount of earning assets maturing or re-pricing over the selected period of time than costing liabilities. Conversely, negative gaps represent the greater dollar amount of costing liabilities maturing or re-pricing over the selected period of time than earning assets. The degree to which an institution is asset or liability sensitive is reported as a negative or positive percentage of assets, respectively. The industry commonly focuses on cumulative one-year and three-year gap percentages as fundamental indicators of interest rate risk sensitivity.

Based upon the findings of the Company's internal interest rate risk analysis, which are corroborated by the independent analysis performed by its primary regulator as described below, the Company is considered to be liability sensitive. Liability sensitivity characterizes the balance sheets of many thrift institutions and is generally attributable to the comparatively shorter contractual maturity and/or re-pricing characteristics of the institution's deposits and borrowings versus those of its loans and investment securities.

With respect to the maturity and re-pricing of its interest-bearing liabilities, at September 30, 2010, $685.6 million or 69.2% of our certificates of deposit mature within one year with an additional $199.5 million or 20.1% maturing in greater than one year but less than or equal to two years. Based on current market interest rates, the majority of these certificates are projected to re-price downward to the extent they remain with the Bank at maturity. Of the $210.0 million of FHLB borrowings at September 30, 2010, all have fixed interest rates with $200.0 million maturing during fiscal 2018, but callable on a quarterly basis prior to maturity. Given current market interest rates, the call options are not currently expected to be exercised by the FHLB. The remaining $10.0 million of FHLB borrowings are non-callable and mature during the third fiscal quarter ending March 31, 2011.

With respect to the maturity and re-pricing of the Company's interest-earning assets, at September 30, 2010, $20.8 million, or 2.1% of our total loans will reach their contractual maturity dates within one year with the remaining $976.6 million, or 97.9% of total loans having remaining terms to contractual maturity in excess of one year. Of loans maturing after one year, $873.9 million or 87.6% had fixed rates of interest while the remaining $102.7 million or 10.3% had adjustable rates of interest.

Regarding investment securities, including mortgage-backed and non-mortgage-backed securities, at September 30, 2010 only $4.7 million or 0.4% of our securities will reach their contractual maturity dates within one year with the remaining $1.1 billion, or 99.6% of total securities, having remaining terms to contractual maturity in excess of one year. Of the latter category, $931.7 million comprising 84.3% of our total securities had fixed rates of interest while the remaining $168.6 million comprising 15.3% of our total securities had adjustable or floating rates of interest.

At September 30, 2010, mortgage-related assets, including mortgage loans and mortgage-backed securities, total $1.78 billion and comprise 82.5% of total earning assets. In addition to remaining term to maturity and interest rate type as discussed above, other factors contribute significantly to the level of interest rate risk associated with mortgage-related assets. In particular, the scheduled amortization of principal and the borrower's option to prepay any or all of a mortgage loan's principal balance, where applicable, has a significant effect on the average lives of such assets and, therefore, the interest rate risk associated with them. In general, the prepayment rate on lower yielding assets tends to slow as interest rates rise due to the reduced financial incentive for borrowers to refinance their loans. By contrast, the prepayment rate of higher yielding assets tends to accelerate as interest rates decline due to the increased financial incentive for borrowers to prepay or refinance their loans to comparatively lower interest rates.

These characteristics tend to diminish the benefits of falling interest rates to liability sensitive institutions while exacerbating the adverse impact of rising interest rates.

The Company retained its overall liability sensitivity during first three months of fiscal 2011 while the degree of that sensitivity, as measured internally by the institution's one-year and three-year gap percentages, changed nominally during that period. Specifically, the Company's cumulative one-year gap percentage widened from +0.91% at June 30, 2010 to +2.50% at September 30, 2010 indicting a modest increase in the proportion of earning assets repricing within one year in relation to costing liabilities repricing within that same timeframe. In contrast, however, the Company's cumulative three-year gap percentage decreased from +9.00% to +7.45% indicating a modest decline in the proportion of earning assets repricing within three years in relation to costing liabilities repricing within that same timeframe.

As a liability sensitive institution, the Company's net interest spread is generally expected to benefit from overall reductions in market interest rates. Conversely, its net interest spread is generally expected to be adversely impacted by overall increases in market interest rates. However, the general effects of movements in market interest rates can be diminished or exacerbated by “nonparallel” movements in interest rates across a yield curve. Nonparallel movements in interest rates generally occur when shorter term and longer term interest rates move disproportionately in a directionally consistent manner. For example, shorter term interest rates may decrease faster than longer term interest rates which would generally result in a “steeper” yield curve. Alternately, nonparallel movements in interest rates may also occur when shorter term and longer term interest rates move in a directionally inconsistent manner. For example, shorter term interest rates may rise while longer term interest rates remain steady or decline which would generally result in a “flatter” yield curve.

At its extreme, a yield curve may become “inverted” for a period of time during which shorter term interest rates exceed longer term interest rates. While inverted yield curves do occasionally occur, they are generally considered a “temporary” phenomenon portending a change in economic conditions that will restore the yield curve to its normal, positively sloped shape.

In general, the interest rates paid on the Company's deposits tend to be determined based upon the level of shorter term interest rates. By contrast, the interest rates earned on the Company's loans and investment securities tend to be based upon the level of longer term interest rates. As such, the overall “spread” between shorter term and longer interest rates when earning assets and costing liabilities re-price greatly influences the Company's overall net interest spread over time. In general, a wider spread between shorter term and longer term interest rates, implying a “steeper” yield curve, is beneficial to the Company's net interest spread. By contrast, a narrower spread between shorter term and longer term interest rates, implying a “flatter” yield curve, or a negative spread between those measures, implying an inverted yield curve, adversely impacts the Company's net interest spread.

The effects of interest rate risk on the Company's earnings are best demonstrated through a review of changes in market interest rates over the past several years and their impact on the Company's net interest spread. Following a period of historically low interest rates, the Federal Reserve Board of Governors steadily increased its target federal funds rate by 425 basis points from 1.00% in June 2004 to 5.25% in June 2007. During that three-year period, federal funds rate and other shorter term market interest rates increased by a far greater degree than longer term market interest rates. For example, the market yield on the one-year U.S. Treasury increased 282 basis points from 2.07% at June 30, 2004 to 4.91% at June 30, 2007. By comparison, the market yield on the 10-year U.S. Treasury increased by only 41 basis points from 4.62% to 5.03% over those same time periods. The flattening yield curve during that three year period had an adverse impact on the Company's net interest spread which decreased 67 basis points from 2.37% for the year ended June 30, 2004 to 1.70% for the year ended June 30, 2007.

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The upward trend in shorter term interest rates was reversed in September 2007 as the Federal Reserve began to lower the target rate for federal funds in reaction to the threat of a looming recession triggered by growing volatility and instability in the housing and credit markets. The effects of those isolated crises rapidly grew to threaten the viability of the domestic and international financial markets as a whole. In reaction to that larger threat, the Federal Reserve reduced the target federal funds rate by a total of over 500 basis points from 5.25% at June 2007 to a range between 0.00% and 0.25% which remained in effect at June 30, 2010. During that three-year period, federal funds rate and other shorter term market interest rates decreased by a far greater degree than longer term market interest rates. For example, the market yield on the one-year U.S. Treasury decreased 369 basis points from 4.01% at June 30, 2007 to 0.32% at June 30, 2010. By comparison, the market yield on the 10-year U.S. Treasury decreased by only 206 basis points from 5.03% to 2.97% over those same time periods. The steepening yield curve during that three year period had a beneficial impact on the Company's net interest spread which increased 75 basis points from 1.70% for the year ended June 30, 2007 to 2.45% for the year ended June 30, 2010.

During the most recent quarter ended September 30, 2010, the yield curve flattened with the one-year U.S. Treasury decreasing five basis points to 0.27% from 0.32% at June 30, 2010 while the market yield on the 10-year U.S. Treasury decreased by 44 basis points to 2.53% from 2.97% over those same time periods. The flattening of the yield curve during the first three months of fiscal 2011 had a nominal impact on the Company's net interest spread which decreased by two basis points to 2.43% during the first three months of fiscal 2011 compared to 2.45% for all of fiscal 2010. Between the linked quarters ended September 30, 2010 and June 30, 2010, the Company's net interest spread remained unchanged at 2.43%.

The Board of Directors has established an Interest Rate Risk Management Committee which is responsible for monitoring the Company's interest rate risk. At September 30, 2010, the membership of the committee included Directors Hopkins, Regan, Aanensen, Mazza and Parow while our Chief Financial Officer and Chief Investment Officer also participate as management's liaison to the committee. The committee meets quarterly to address management of our assets and liabilities, including review of our short term liquidity position; loan and deposit pricing and production volumes and alternative funding sources; current investments; average lives, durations and re-pricing frequencies of loans and securities; and a variety of other asset and liability management topics. The results of the committee's quarterly review are reported to the full Board, which adjusts the investment policy and strategies, as it considers necessary and appropriate.

Quantitative Analysis. Management utilizes a combination of internal and external analyses to quantitatively model, measure and monitor the Company's exposure to interest rate risk. The external quantitative analysis is based upon the OTS interest rate risk model which utilizes data submitted on the Bank's quarterly Thrift Financial Reports. The model estimates the change in the Bank's net portfolio value ("NPV") ratio throughout a series of interest rate scenarios. NPV, sometimes referred to as the economic value of equity, represents the present value of the expected cash flows from the Bank's assets less the present value of the expected cash flows arising from its liabilities adjusted for the value of off-balance sheet contracts. The NPV ratio represents the dollar amount of the Bank's NPV divided by the present value of its total assets for a given interest rate scenario. In essence, NPV attempts to quantify the economic value of the Bank using a discounted cash flow methodology while the NPV ratio reflects that value as a form of capital ratio. The degree to which the NPV ratio changes for any hypothetical interest rate scenario from its "base case" measurement is a reflection of an institution's sensitivity to interest rate risk.

The internal quantitative analysis utilized by management measures interest rate risk from both a capital and earnings perspective. Like the OTS model noted above, the Bank's internal interest rate risk analysis calculates sensitivity of the Bank's NPV ratio to movements in interest rates. Both the OTS and internal models measure the Bank's NPV ratio in a "base case" scenario that assumes no change in interest rates as of the measurement date. Both models measure the change in the NPV ratio throughout a series of interest rate scenarios representing immediate and permanent, parallel shifts in the yield curve up and down 100, 200 and 300 basis points. Both models generally require that interest rates remain positive for all points along the yield curve for each rate scenario which may preclude the modeling of certain "down rate" scenarios during periods of lower market interest rates. The Bank's interest rate risk management policy establishes acceptable floors for the NPV ratio and caps for the maximum change in the NPV ratio throughout the scenarios modeled.

As illustrated in the tables below, the Bank's NPV would be negatively impacted by an increase in interest rates. This result is expected given the Bank's liability sensitivity noted earlier. Specifically, based upon the comparatively shorter maturity and/or re-pricing characteristics of its interest-bearing liabilities compared with that of the Bank's interest-earning assets, an upward movement in interest rates would have a disproportionately adverse impact on the present value of the Bank's assets compared to the beneficial impact arising from the reduced present value of its liabilities. Hence, the Bank's NPV and NPV ratio decline in the increasing interest rate scenarios. Historically low interest rates at September 30, 2010 preclude the modeling of certain scenarios as parallel downward shifts in the yield curve of 100 basis points or more would result in negative interest rates for many points along that curve.

The following tables present the results of the Bank's internal NPV analysis as of September 30, 2010 and June 30, 2010, respectively.

At September 30, 2010

| | Net Portfolio Value | | | Net Portfolio Value as % of Present Value of Assets | |
|---|---|---|---|---|---|
| Changes in Rates (1) | $ Amount | $ Change | % Change | Net Portfolio Value Ratio | Basis Point Change |
| | (In Thousands) | | | | |
| +300 bps | 175,676 | -113,760 | -29% | 13.08% | -367 bps |
| +200 bps | 329,185 | -60,251 | -15% | 15.04% | -172 bps |
| +100 bps | 370,864 | -18,572 | -5% | 16.36% | -39 bps |
| 0 bps | 389,436 | - | - | 16.75% | - |

At June 30, 2010

| | Net Portfolio Value | | | Net Portfolio Value as % of Present Value of Assets | |
|---|---|---|---|---|---|
| Changes in Rates (1) | $ Amount | $ Change | % Change | Net Portfolio Value Ratio | Basis Point Change |
| | (In Thousands) | | | | |
| +300 bps | 264,675 | -115,353 | -30% | 12.85% | -387 bps |
| +200 bps | 320,458 | -59,569 | -16% | 14.97% | -175 bps |
| +100 bps | 358,461 | -21,566 | -6% | 16.19% | -52 bps |
| 0 bps | 380,028 | - | - | 16.71% | - |

(1) The -100 bp, -200 bp and -300 bp scenarios are not shown due to the low prevailing interest rate environment.

A comparative industry benchmark regarding interest rate risk is the "sensitivity measure" which is generally defined by bank regulators as the change in an institution's NPV ratio, measured in basis points, in an immediate and permanent, adverse parallel shift in interest rates of plus or minus 200 basis points. Based upon the tables above, the Bank's sensitivity measure decreased slightly by three basis points from -175 basis points at June 30, 2010 to -172 basis points at September 30, 2010 which indicates a nominal change in the Bank's sensitivity to movements in interest rates from period to period.

There are numerous internal and external factors that may contribute to changes in an institution's sensitivity measure. Internally, changes in the composition and allocation of an institution's balance sheet and the interest rate risk characteristics of its components can significantly alter the exposure to interest rate risk as quantified by the changes in the sensitivity measure. However, changes to certain external factors, most notably changes in the level of market interest rates and overall shape of the yield curve, can significantly alter the projected cash flows of the institution's interest-earning assets and interest-costing liabilities and the associated present values thereof. Changes in internal and external factors from period to period can complement one another's effects to reduce overall sensitivity, partly or wholly offset one another's effects, or exacerbate one another's adverse effects and thereby increase the institution's exposure to interest rate risk as quantified by the sensitivity measure.

Several offsetting internal and external factors working in concert resulted in the nominal change in the Bank's sensitivity measure. For example, the Bank increased its balance of mortgage-backed securities which were funded through the reinvestment of short term, liquid assets and incoming cash flows from growth in deposits. Funding for the growth in mortgage-backed securities was also provided through net reductions in loan and non-mortgage-backed securities portfolios.

More specifically, the Company's mortgage-backed securities portfolio increased by $140.5 million to $845.7 million at September 30, 2010 from $705.2 million at June 30, 2010. The funding for that growth was provided, in part, by a net decrease in the Company's cash and cash equivalents of $62.3 million from $181.4 million or 7.8% of total assets at June 30, 2010 to $119.1 million or 5.0% of total assets at September 30, 2010. The reinvestment of short term liquid assets, which are re-priced on a day-to-day basis to reflect current market interest rates, into comparatively longer duration mortgage-backed securities had the effect of contributing to an increase in the sensitivity measure.

Funding for the increase in investments was also provided by the growth in deposits which increased by $39.8 million from June 30, 2010 to September 30, 2010. A portion of the growth in deposits was reflected in certificates of deposit that, in aggregate, re-price more frequently than the investments into which such funds were deployed which also had the effect of contributing to an increase in interest rate sensitivity.

Several factors substantially offset the increases in interest-rate sensitivity arising from the factors noted above. Specifically, the $16.0 million decline in loans receivable between comparative periods, excluding changes in the allowance for loan losses, also contributed to the funding for the growth in the comparatively shorter duration investment securities. Such funding was also provided through the growth in the Bank's non-maturity deposits which are generally assumed to be less interest-rate sensitive than certificates of deposit. Finally, a comparatively lower level of market interest rates has resulted in an expectation for accelerating loan prepayments effecting both the mortgage loan and mortgage-backed securities portfolios while increasing the likelihood of non-mortgage-backed securities being called prior to maturity.

Taken together, these changes in balance sheet allocation and underlying modeling assumptions substantially offset one another resulting in the nominal change in sensitivity to interest rate risk as quantified by the Bank's sensitivity measure.

Because the Bank's sensitivity measure and NPV ratio in the +200 bps scenario exceeded the thresholds established by its primary regulator, the Bank's "TB 13a Level of Risk" was rated as "Minimal" based upon the results of the OTS interest rate risk model as of September 30, 2010 and June

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30, 2010. TB-13a is the OTS's primary regulatory guidance concerning the management of interest rate risk.

The results of the Bank's internal "NPV-based" analysis are generally consistent with those of the external analysis prepared by OTS. As noted earlier, the Bank's internal interest rate risk analysis also includes an "earnings-based" component. A quantitative, earnings-based approach to measuring interest rate risk is strongly encouraged by bank regulators as a complement to the "NPV-based" methodology. Notwithstanding, there is currently no external "earnings-based" interest rate risk analysis prepared by OTS for the institutions within its oversight. As such, institutions must utilize internal models and analysis to gauge the sensitivity of their earnings to movements in interest rates. Regarding such internal modeling, however, there are no commonly accepted "industry best practices" that specify the manner in which "earnings-based" interest rate risk analysis should be performed with regard to certain key modeling variables. Such variables include, but are not limited to, those relating to rate scenarios (e.g., immediate and permanent rate "shocks" versus gradual rate change "ramps", "parallel" versus "nonparallel" yield curve changes) measurement periods (e.g., one year versus two year, cumulative versus noncumulative), measurement criteria (e.g., net interest income versus net income) and balance sheet composition and allocation ("static" balance sheet, reflecting reinvestment of cash flows into like instruments, versus "dynamic" balance sheet, reflecting internal budget and planning assumptions).

The Company is aware that the absence of an industry-standard, external analysis to measure interest rate risk from an earnings perspective or, at a minimum, a commonly shared set of analysis criteria and assumptions on which to base an internal analysis, could result in inconsistent or misinterpreted disclosure concerning an institution's level of interest rate risk. Consequently, the Company limits the presentation of its earnings-based interest rate risk analysis to the internally modeled scenarios presented in the table below. Consistent with the NPV analysis above, such scenarios utilize immediate and permanent rate "shocks" that result in parallel shifts in the yield curve. For each scenario, projected net interest income is measured over a one year period utilizing a static balance sheet assumption through which incoming and outgoing asset and liability cash flows are reinvested into the same instruments. Product pricing and earning asset prepayment speeds are appropriately adjusted for each rate scenario.

As illustrated in the tables below, the Bank's net interest income would be negatively impacted by an increase in interest rates. Like the NPV results presented earlier, this result is expected given the Bank's liability sensitivity noted earlier. The tables below also reflect an increase in sensitivity to movements in interest rates between the comparative periods resulting from the changes in balance sheet allocation and market interest rates discussed earlier.

At September 30, 2010

| Rate Change Type | Yield Curve Shift | Balance Sheet Composition & Allocation | Changes in Rates | Measurement Period | Net Interest Income | Change in Net Interest Income | Change in Net Interest Income |
|---|---|---|---|---|---|---|---|
| | | | | | (In Thousands) | | |
| Base case (No change) | - | Static | 0 bps | One Year | $ 58,015 | $ - | -% |
| Immediate and permanent | Parallel | Static | +100 bps | One Year | 57,767 | -248 | -0.43 |
| Immediate and permanent | Parallel | Static | +200 bps | One Year | 55,911 | -2,104 | -3.63 |
| Immediate and permanent | Parallel | Static | +300 bps | One Year | 53,046 | -4,970 | -8.57 |

At June 30, 2010

| Rate Change Type | Yield Curve Shift | Balance |
|---|---|---|