

Kearny Financial Corp.  
Form 10-K  
September 13, 2010

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the Fiscal Year Ended June 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: 0-51093

KEARNY FINANCIAL CORP.

(Exact name of Registrant as specified in its Charter)

United States  
(State or Other Jurisdiction of  
Incorporation or Organization)

22-3803741  
(I.R.S. Employer  
Identification No.)

120 Passaic Avenue, Fairfield, New  
Jersey  
(Address of Principal Executive Offices)

07004  
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$0.10 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§229.405 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

(Do not check if a smaller reporting company)

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant on December 31, 2009 (the last business day of the Registrant's most recently completed second fiscal quarter) was \$152.1 million. Solely for purposes of this calculation, shares held by directors, executive officers and greater than 10% stockholders are treated as shares held by affiliates.

As of September 3, 2010 there were outstanding 68,000,777 shares of the Registrant's Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the definitive Proxy Statement for the Registrant's 2010 Annual Meeting of Stockholders. (Part III)

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KEARNY FINANCIAL CORP.  
ANNUAL REPORT ON FORM 10-K  
For the Fiscal Year Ended June 30, 2010

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## Forward-Looking Statements

Kearny Financial Corp. (the “Company” or the “Registrant”) may from time to time make written or oral “forward-looking statements”, including statements contained in the Company’s filings with the Securities and Exchange Commission (including this Annual Report on Form 10-K and the exhibits thereto), in its reports to stockholders and in other communications by the Company, which are made in good faith by the Company pursuant to the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements involve risks and uncertainties, such as statements of the Company’s plans, objectives, expectations, estimates and intentions that are subject to change based on various important factors (some of which are beyond the Company’s control). In addition to the factors described under Item 1A. Risk Factors, the following factors, among others, could cause the Company’s financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements:

- the strength of the United States economy in general and the strength of the local economy in which the Company conducts operations,
- the effects of and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System, inflation, interest rates, market and monetary fluctuations,
- the impact of changes in financial services laws and regulations (including laws concerning taxation, banking, securities and insurance),
- changes in accounting policies and practices, as may be adopted by regulatory agencies, the Financial Accounting Standards Board (“FASB”) or the Public Company Accounting Oversight Board,
  - technological changes.
  - competition among financial services providers and,
- the success of the Company at managing the risks involved in the foregoing and managing its business.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

## PART I

### Item 1. Business

#### General

The Company is a federally-chartered corporation that was organized on March 30, 2001 for the purpose of being a holding company for Kearny Federal Savings Bank (the "Bank"), a federally-chartered stock savings bank. On February 23, 2005, the Company completed a minority stock offering in which it sold 21,821,250 shares, representing 30% of its outstanding common stock upon completion of the offering. The remaining 70% of the outstanding common stock, totaling 50,916,250 shares, were retained by Kearny MHC (the "MHC"). The MHC is a federally-chartered mutual holding company and so long as the MHC is in existence, it will at all time own a majority of the outstanding common stock of the Company. The stock repurchase programs conducted by the Company since the offering have reduced the total number of shares outstanding. The 50,916,250 shares held by the MHC represented 74.5% of the 68,344,277 total shares outstanding as of the Company's June 30, 2010 fiscal year end. The MHC and the Company are chartered and regulated by the Office of Thrift Supervision ("OTS").

The Company is a unitary savings and loan holding company and conducts no significant business or operations of its own. References in this Annual Report on Form 10-K to the Company or Registrant generally refer to the Company and the Bank, unless the context indicates otherwise. References to "we", "us", or "our" refer to the Bank or Company, or both, as the context indicates.

The Bank was originally founded in 1884 as a New Jersey mutual building and loan association. It obtained federal insurance of accounts in 1939 and received a federal charter in 1941. The Bank's deposits are federally insured by the Deposit Insurance Fund as administered by the Federal Deposit Insurance Corporation ("the FDIC") and the Bank is regulated by the OTS and the FDIC.

The Company's primary business is the ownership and operation of the Bank. The Bank is principally engaged in the business of attracting deposits from the general public in New Jersey and using these deposits, together with other funds, to originate or purchase loans for its portfolio and invest in securities. Loans originated or purchased by the Bank generally include loans collateralized by residential and commercial real estate augmented by secured and unsecured loans to businesses and consumers. The investment securities purchased by the Bank generally include U.S. agency mortgage-backed securities, U.S. government and agency debentures and bank-qualified municipal obligations. The Bank maintains a small balance of single issuer trust preferred securities and non-agency mortgage-backed securities which were acquired through the Company's purchase of other institutions and does not actively purchase such securities. At June 30, 2010, net loans receivable comprised 43.0% of our total assets while investment securities, including mortgage-backed and non-mortgage-backed securities, comprised 42.3% of our total assets. By comparison, at June 30, 2009, net loans receivable comprised 48.9% of our total assets while securities comprised 33.7% of our total assets.

The loan portfolio's decline on both a dollar and percentage of total assets basis during fiscal 2010 reflected an accelerated level of loan prepayments compared to fiscal 2009 that outpaced the year-over-year increase in the Company's volume of new loan acquisitions. The increase in loan acquisitions during fiscal 2010 included an increase in internally originated loans partially offset by declines in purchased loans. Despite the year-to-year increase in loan acquisition volume, the level of loan originations and purchases during fiscal 2010 continued to reflect the challenges of declining real estate values and high levels of unemployment that have characterized the regional and national economy since the financial crisis of 2008-2009. Notwithstanding these near-term challenges, our strategic business plan



continues to call for increasing the balance of our loan portfolio relative to the size of our securities portfolio over the next several years.

We operate from an administrative headquarters in Fairfield, New Jersey and had 27 branch offices as of June 30, 2010. We also operate an Internet website at [www.kearnyfederalsavings.com](http://www.kearnyfederalsavings.com) through which copies of our periodic reports are available free of charge as soon as reasonably practicable after they are filed with the Securities and Exchange Commission.

**Market Area.** At June 30, 2010, our primary market area consists of the New Jersey counties in which we currently operate branches: Bergen, Essex, Hudson, Middlesex, Morris, Ocean, Passaic and Union Counties. While we have also considered Monmouth County, New Jersey to be part of our market area in the past, we expect this market to grow in strategic significance due to our proposed acquisition of Central Jersey Bancorp (NASDAQ: CJBK), headquartered in Monmouth County, NJ, as discussed below. Our lending is concentrated in these nine counties and our predominant sources of deposits are the communities in which our offices are located as well as the neighboring communities.

Our primary market area is largely urban and suburban with a broad economic base as is typical within the New York metropolitan area. Service jobs represent the largest employment sector followed by wholesale/retail trade. Our business of attracting deposits and making loans is generally conducted within our primary market area. A downturn in the local economy could reduce the amount of funds available for deposit and the ability of borrowers to repay their loans which would adversely affect our profitability.

**Competition.** We operate in a market area with a high concentration of banking and financial institutions and we face substantial competition in attracting deposits and in originating loans. A number of our competitors are significantly larger institutions with greater financial and managerial resources and lending limits. Our ability to compete successfully is a significant factor affecting our growth potential and profitability.

Our competition for deposits and loans historically has come from other insured financial institutions such as local and regional commercial banks, savings institutions and credit unions located in our primary market area. We also compete with mortgage banking and finance companies for real estate loans and with commercial banks and savings institutions for consumer loans. We also face competition for attracting funds from providers of alternative investment products such as equity and fixed income investments such as corporate, agency and government securities as well as the mutual funds that invest in these instruments.

There are large retail banking competitors operating throughout our primary market area, including Bank of America, Citibank, Hudson City Savings Bank, JP Morgan Chase Bank, PNC Bank, TD Bank, and Wells Fargo Bank and we face strong competition from other community-based financial institutions. Based on data compiled by the FDIC as of June 30, 2009, the latest date for which such data is available, Kearny Federal Savings Bank was ranked 17th of 115 depository institutions operating in the eight counties in which it has branches with 0.92% of total FDIC-insured deposits.

**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 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 June 30, 2010, Central





Jersey Bank had \$576.8 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.

The Merger Agreement contains (a) customary representations and warranties of Central Jersey and the Company, including, among others, with respect to corporate organization, capitalization, corporate authority, third party and governmental consents and approvals, financial statements, and compliance with applicable laws, (b) covenants of Central Jersey to conduct its business in the ordinary course until the Merger is completed; (c) covenants of Central Jersey not to take certain actions during such period. Central Jersey has also agreed not to (i) solicit proposals relating to alternative business combination transactions or (ii) subject to certain exceptions, enter into discussions concerning, or provide confidential information in connection with, any proposals for alternative business combination transactions.

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 Merger Agreement also contains certain termination rights for the Company and Central Jersey, as the case may be, applicable upon the occurrence or non-occurrence of certain events, including: final, non-appealable denial of required regulatory approvals required for consummation of the Merger; failure of Central Jersey shareholders to approve the Merger; if, subject to certain conditions, the Merger has not been completed by March 31, 2011; a breach by the other party that is not or cannot be cured within 30 days after written notice if such breach would result in a failure of the conditions to closing set forth in the Merger Agreement; entry by the Board of Directors of Central Jersey into an alternative business combination transaction; or the failure by the Board of Directors of Central Jersey to hold the meeting of shareholders to vote on the Merger Agreement or to recommend the Merger to its shareholders. If the Merger is not consummated under certain circumstances, Central Jersey has agreed to pay the Company a termination fee of up to \$2.8 million.

The representations and warranties of each party set forth in the Merger Agreement have been made solely for the benefit of the other party to the Merger Agreement. In addition, such representations and warranties (a) are subject to materiality qualifications contained in the Merger Agreement which may differ from what may be viewed as material by investors, (b) were made only as of the date of the Merger

Agreement or such other date as is specified in the Merger Agreement, and (c) may have been included in the Merger Agreement for the purpose of allocating risk between the Company and Central Jersey rather than establishing matters as facts. Accordingly, the Merger Agreement is included with this filing only to provide investors with information regarding the terms of the Merger Agreement, and not to provide investors with any other factual information regarding the parties or their respective businesses.

### Lending Activities

General. We have traditionally focused on the origination of one-to-four family first mortgage loans, which comprise a significant majority of our total loan portfolio. Our next largest category of loans comprises commercial mortgages, including loans secured by multi-family, mixed-use and nonresidential properties. Our commercial loan offerings also include secured and unsecured business loans most of which are secured by real estate. Our consumer loan offerings primarily include home equity loans and home equity lines of credit as well as account loans and overdraft lines of credit. We also offer construction loans to builders/developers as well as individual homeowners. Substantially all of our borrowers are residents of our primary market area and would be expected to be similarly affected by economic and other conditions in that area. Since May 2007, we have been purchasing out-of-state one-to-four family first mortgage loans to supplement our in-house originations, as discussed on Page 13.

	2010		2009		At June 30, 2008		2007		2006	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
(Dollars in Thousands)										
Real estate mortgage:										
One-to-four family	\$ 663,850	65.52%	\$ 689,317	65.97%	\$ 687,679	66.99%	\$ 559,306	64.66%	\$ 465,822	65.8
Multi-family and nonresidential	203,013	20.04	197,379	18.89	178,588	17.40	159,147	18.40	107,111	15.1
Commercial business	14,352	1.42	14,812	1.42	8,735	0.85	4,205	0.48	3,208	0.4
Consumer:										
Home equity loans	101,659	10.03	113,387	10.85	123,978	12.08	113,624	13.14	93,639	13.2
Home equity lines of credit	11,320	1.12	12,116	1.16	11,478	1.12	12,748	1.47	12,988	1.8
Passbook or certificate	2,703	0.27	2,922	0.28	2,662	0.26	3,250	0.38	2,884	0.4
Other	1,545	0.15	1,585	0.15	1,332	0.13	1,391	0.16	247	0.0
Construction	14,707	1.45	13,367	1.28	12,062	1.17	11,360	1.31	22,078	3.1
Total loans	1,013,149	100.00%	1,044,885	100.00%	1,026,514	100.00%	865,031	100.00%	707,977	100.0
Less:										
Allowance for loan losses	8,561		6,434		6,104		6,049		5,451	
Unamortized yield adjustments including net	(564)		(962)		(1,276)		(1,511)		(1,087)	

premiums on purchased loans and net deferred loans costs and fees	7,997	5,472	4,828	4,538	4,364
Total loans, net	\$ 1,005,152	\$ 1,039,413	\$ 1,021,686	\$ 860,493	\$ 703,613

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Loan Maturity Schedule. The following table sets forth the maturities of our loan portfolio at June 30, 2010. Demand loans, loans having no stated maturity and overdrafts are shown as due in one year or less. Loans are stated in the following table at contractual maturity and actual maturities could differ due to prepayments.

	Real estate mortgage: One-to-four family	Real estate mortgage: Multi-family and commercial	Commercial business	Home equity loans	Home equity lines of credit	Passbook or certificate	Other	Construction	Total
	(In Thousands)								
Amounts Due: Within 1 Year	\$ 285	\$ 385	\$ 6,886	\$ 162	\$ 4	\$ 1,287	\$ 103	\$ 11,985	\$ 21,097
After 1 year:									
1 to 3 years	2,548	626	—	2,124	14	46	1	2,722	8,081
3 to 5 years	6,613	504	—	5,402	142	16	8	—	12,685
5 to 10 years	72,078	10,321	84	28,163	4,549	—	—	—	115,195
10 to 15 years	140,772	31,836	1,427	31,615	5,941	—	—	—	211,591
Over 15 years	441,554	159,341	5,955	34,193	670	1,354	1,433	—	644,500
Total due after one year	663,565	202,628	7,466	101,497	11,316	1,416	1,442	2,722	992,052
Total amount due	\$ 663,850	\$ 203,013	\$ 14,352	\$ 101,659	\$ 11,320	\$ 2,703	\$ 1,545	\$ 14,707	\$ 1,013,149

The following table shows the dollar amount of loans as of June 30, 2010 due after June 30, 2011 according to rate type and loan category.

	Fixed Rates	Floating or Adjustable Rates (In Thousands)	Total
Real estate mortgage:			
One-to-four family	\$ 604,612	\$ 58,953	\$ 663,565
Multi-family and commercial	172,428	30,200	202,628
Commercial business	4,527	2,939	7,466
Consumer:			
Home equity loans	101,497	—	101,497
Home equity lines of credit	2,650	8,666	11,316
Passbook or certificate	—	1,416	1,416
Other	297	1,145	1,442
Construction	—	2,722	2,722
Total	\$ 886,011	\$ 106,041	\$ 992,052

**One-to-Four Family Mortgage Loans.** Our primary lending activity has traditionally consisted of the origination of one-to-four family first mortgage loans, of which approximately \$570.7 million or 86.0% are secured by properties located within New Jersey as of June 30, 2010. By comparison, at June 30, 2009 approximately \$583.5 million or 84.7% of loans were secured by New Jersey properties. During the year ended June 30, 2010, the Bank originated \$102.1 million of one-to-four family first mortgage loans within New Jersey compared to \$79.4 million in the year ended June 30, 2009. Despite the year-to-year increase in loan origination volume, the overall level of loan originations during fiscal 2010 continued to reflect the challenges of declining real estate values and high levels of unemployment that have characterized the regional and national economy since the financial crisis of 2008-2009. The volume of loan originations for fiscal 2010 also reflected management's decision to maintain its conservative underwriting standards coupled with a disciplined pricing policy which may have caused some potential borrowers to seek financing with more aggressive lenders. To supplement originations, we also purchased one-to-four family first mortgages totaling \$31.2 million during the year ended June 30, 2010, compared to \$67.7 million during the year ended June 30, 2009. An acceleration of one-to-four family mortgage loan prepayments during fiscal 2010 outpaced the corresponding increase in loan acquisition volume resulting in the reported decline in the outstanding balance of this segment of the loan portfolio for fiscal 2010.

We will originate a one-to-four family mortgage loan on an owner-occupied property with a principal amount of up to 95% of the lesser of the appraised value or the purchase price of the property, with private mortgage insurance required if the loan-to-value ratio exceeds 80%. Our loan-to-value limit on a non-owner-occupied property is 75%. Loans in excess of \$1.0 million are handled on a case-by-case basis and are subject to lower loan-to-value limits, generally no more than 50%.

Our fixed-rate and adjustable-rate residential mortgage loans on owner-occupied properties have terms of ten to 30 years. Residential mortgage loans on non-owner-occupied properties have terms of up to 15 years for fixed-rate loans and terms of up to 20 years for adjustable-rate loans. We also offer ten-year balloon mortgages with a thirty-year amortization schedule on owner-occupied properties and a twenty-year amortization schedule on non-owner-occupied properties.



Our adjustable-rate loan products provide for an interest rate that is tied to the one-year Constant Maturity U.S. Treasury index and have terms of up to 30 years with initial fixed-rate periods of one, three, five, seven, or ten years according to the terms of the loan and annual rate adjustment thereafter. We also offer an adjustable-rate loan with a term of up to 30 years with a rate that adjusts every five years to the five-year Constant Maturity U.S. Treasury index. There is a 200 basis point limit on the rate adjustment in any adjustment period and the rate adjustment limit over the life of the loan is 600 basis points.

We offer a first-time homebuyer program for persons who have not previously owned real estate and are purchasing a one-to-four family property in Bergen, Passaic, Morris, Essex, Hudson, Middlesex, Monmouth, Ocean and Union Counties, New Jersey for use as a primary residence. This program is also available outside these areas, but only to persons who are existing deposit or loan customers of Kearny Federal Savings Bank and/or members of their immediate families. The financial incentives offered under this program are a one-eighth of one percentage point rate reduction on all first mortgage loan types and the refund of the application fee at closing.

The fixed-rate mortgage loans that we originate generally meet the secondary mortgage market standards of the Federal Home Loan Mortgage Corporation (“Freddie Mac”). However, as our business plan continues to call for increasing loans on both a dollar and percentage of assets basis, we generally do not sell loans in the secondary market and do not currently expect to do so in any large capacity in the near future. Toward that end, there were no residential mortgage loan sales in the secondary market during the last three fiscal years.

Substantially all of our residential mortgages include “due on sale” clauses, which give us the right to declare a loan immediately payable if the borrower sells or otherwise transfers an interest in the property to a third party. Property appraisals on real estate securing our one-to-four family first mortgage loans are made by state certified or licensed independent appraisers approved by the Bank’s Board of Directors. Appraisals are performed in accordance with applicable regulations and policies. We require title insurance policies on all first mortgage real estate loans originated. Homeowners, liability and fire insurance and, if applicable, flood insurance, are also required.

**Multi-Family and Nonresidential Real Estate Mortgage Loans.** We also originate commercial mortgage loans on multi-family and nonresidential properties, including loans on apartment buildings, retail/service properties and other income-producing properties, such as mixed-use properties combining residential and commercial space. The factors noted above that impacted residential loan origination volume during fiscal 2010 also adversely impacted the origination volume of commercial mortgages. Consequently, the Bank originated \$31.0 million of multi-family and commercial real estate mortgages during the year ended June 30, 2010, compared to \$36.7 million during the year ended June 30, 2009. Despite the year-over-year decrease in loan origination volume, the outstanding balance of the portfolio grew modestly during fiscal 2010. The Company’s business plan continues to call for growing strategic emphasis on the origination of commercial mortgages and increasing that portfolio on both a dollar and percentage of assets basis.

We generally require no less than a 25% down payment or equity position for mortgage loans on multi-family and nonresidential properties. For such loans, we generally require personal guarantees. Currently, these loans are made with a maturity of up to 25 years. We also offer a five-year balloon loan with a twenty five-year amortization schedule. Our commercial mortgage loans are secured by properties located in New Jersey.

Commercial mortgage loans generally are considered to entail significantly greater risk than that which is involved with one-to-four family, owner-occupied real estate lending. The repayment of these





loans typically is dependent on the successful operations and income stream of the borrower and the real estate securing the loan as collateral. These risks can be significantly affected by economic conditions. In addition, commercial mortgage loans generally carry larger balances to single borrowers or related groups of borrowers than one-to-four family mortgage loans. Consequently, such loans typically require substantially greater evaluation and oversight efforts compared to residential real estate lending.

**Commercial Business Loans.** We also originate commercial term loans and lines of credit to a variety of professionals, sole proprietorships and small businesses in our market area. As above, the factors noted earlier that impacted mortgage loan origination volume during fiscal 2010 also adversely impacted the origination volume of commercial business loans. Consequently, during the year ended June 30, 2010, the Bank originated \$3.5 million of commercial business loans compared to \$8.0 million during the year ended June 30, 2009. Despite the year-over-year decrease in loan origination volume, the outstanding balance of the portfolio declined only modestly during fiscal 2010. The Company's business plan continues to call for increased emphasis on originating commercial business loans as part of its strategic focus on commercial lending.

Our commercial business loans are normally secured by real estate and we require personal guarantees on all commercial loans. Approximately \$9.2 million or 63.9% of our commercial business loans are secured by one-to-four family properties and approximately \$5.2 million or 36.0% are secured by commercial real estate and other forms of collateral. Only \$18,000 or less than one percent of the loans are unsecured. Marketable securities may also be accepted as collateral on lines of credit, but with a loan to value limit of 50%. The loan to value limit on secured commercial lines of credit and term loans is otherwise generally limited to 70%. We also make unsecured commercial loans in the form of overdraft checking authorization up to \$25,000 and unsecured lines of credit up to \$25,000.

Our commercial term loans generally have terms of up to 20 years and are mostly fixed-rate loans. Our commercial lines of credit have terms of up to two years and are generally adjustable-rate loans. We also offer a one-year, interest-only commercial line of credit with a balloon payment.

Unlike single-family, owner-occupied residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment and other income and which are secured by real property whose value tends to be more easily ascertainable, commercial business loans typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself and the general economic environment. Commercial business loans, therefore, have greater credit risk than residential mortgage loans. In addition, commercial loans may carry larger balances to single borrowers or related groups of borrowers than one-to-four family first mortgage loans. As such, commercial business lending requires substantially greater evaluation and oversight efforts compared to residential or commercial real estate lending.

**Home Equity Loans and Lines of Credit.** Our home equity loans are fixed-rate loans for terms of generally up to 20 years. We also offer fixed-rate and adjustable-rate home equity lines of credit with terms of up to 15 years. The factors noted above that impacted one-to-four family loan origination volume during fiscal 2010 also adversely impacted the origination volume of home equity loans and lines of credit. During the year ended June 30, 2010, the Bank originated \$30.6 million of home equity loans and home equity lines of credit compared to \$31.0 million in the year ended June 30, 2009. Consistent with the one-to-four family first mortgage loans, prepayment activity on home equity loans and lines of credit outpaced loan origination volume resulting in the reported decline in the outstanding balance of this segment of the loan portfolio for fiscal 2010.



Collateral value is determined through an automated valuation module, specifically, Freddie Mac's Home Valuation Explorer, or property value analysis report provided by a state certified or licensed independent appraiser. In some cases, we determine collateral value by a full appraisal performed by a state certified or licensed independent appraiser. Home equity loans and lines of credit do not require title insurance but do require homeowner, liability and fire insurance and, if applicable, flood insurance.

Home equity loans and fixed-rate home equity lines of credit are generally originated in our market area and are generally made in amounts of up to 80% of value on term loans and of up to 75% of value on home equity adjustable-rate lines of credit. We originate home equity loans secured by either a first lien or a second lien on the property.

**Other Consumer Loans.** In addition to home equity loans and lines of credit, our consumer loan portfolio primarily includes loans secured by savings accounts and certificates of deposit on deposit with the Bank and unsecured personal overdraft loans. We will generally lend up to 90% of the account balance on a loan secured by a savings account or certificate of deposit.

Consumer loans entail greater risks than residential mortgage loans, particularly consumer loans that are unsecured. Consumer loan repayment is dependent on the borrower's continuing financial stability and is more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. The application of various federal laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on consumer loans in the event of a default.

Our underwriting standards for consumer loans include a determination of the applicant's credit history and an assessment of the applicant's ability to meet existing obligations and payments on the proposed loan. The stability of the applicant's monthly income may be determined by verification of gross monthly income from primary employment and any additional verifiable secondary income.

**Construction Lending.** Our construction lending includes loans to individuals for construction of one-to-four family residences or for major renovations or improvements to an existing dwelling. Our construction lending also includes loans to builders and developers for multi-unit buildings or multi-house projects. All of our construction lending is in New Jersey. During the year ended June 30, 2010, construction loan disbursements were \$7.1 million compared to \$5.4 million during the year ended June 30, 2009. The level of construction loan disbursements continues to reflect reduced origination volume attributable to many of the same factors that have adversely impacted the origination volume of other loan categories during fiscal 2010.

Construction borrowers must hold title to the land free and clear of any liens. Financing for construction loans is limited to 80% of the anticipated appraised value of the completed property. Disbursements are made in accordance with inspection reports by our approved appraisal firms. Terms of financing are limited to one year with an interest rate tied to the prime rate published in the Wall Street Journal and may include a premium of one or more points. In some cases, we convert a construction loan to a permanent mortgage loan upon completion of construction.

We have no formal limits as to the number of projects a builder has under construction or development and make a case-by-case determination on loans to builders and developers who have multiple projects under development. The Board of Directors reviews the Bank's business relationship with a builder or developer prior to accepting a loan application for processing. We generally do not make construction loans to builders on a speculative basis. There must be a contract for sale in place. Financing is provided for up to two houses at a time in a multi-house project, requiring a contract on one of the two houses before financing for the next house may be obtained.



Construction lending is generally considered to involve a higher degree of credit risk than mortgage lending. If the initial estimate of construction cost proves to be inaccurate, we may be compelled to advance additional funds to complete the construction with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If we are forced to foreclose on a project prior to completion, there is no assurance that we will be able to recover the entire unpaid portion of the loan. In addition, we may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period.

Loans to One Borrower. Federal law generally limits the amount that a savings institution may lend to one borrower to the greater of \$500,000 or 15% of the institution's unimpaired capital and surplus. Accordingly, as of June 30, 2010, our loans-to-one-borrower limit was approximately \$54.7 million.

At June 30, 2010, our largest single borrower had an aggregate loan balance of approximately \$14.1 million, representing four mortgage loans secured by commercial real estate. Our second largest single borrower had an aggregate loan balance of approximately \$10.0 million, representing ten loans secured by commercial real estate, two residential construction loans and one residential loan. Our third largest borrower had an aggregate loan balance of approximately \$9.7 million, representing two loans secured by commercial real estate. At June 30, 2010, all of these lending relationships were current and performing in accordance with the terms of their loan agreements. By comparison, at June 30, 2009, loans outstanding to the Bank's three largest borrowers totaled approximately \$14.0 million, \$11.0 million and \$10.0 million, respectively.

Loan Originations, Purchases, Sales, Solicitation and Processing. The following table shows total loans originated, purchased and repaid during the periods indicated.

	For the Years Ended June 30,		
	2010	2009	2008
	(In Thousands)		
Loan originations and purchases:			
Loan originations:			
Real estate mortgage:			
One-to-four family	\$ 102,116	\$ 79,413	\$ 99,113
Multi-family and commercial	31,002	36,700	44,854
Commercial business	3,457	8,002	7,622
Construction	7,081	5,374	5,569
Consumer:			
Home equity loans and lines of credit	30,622	31,034	44,992
Passbook or certificate	843	1,506	1,504
Other	469	792	334
Total loan originations	175,590	162,821	203,988
Loan purchases:			
Real estate mortgage:			
One-to-four family	31,216	67,698	102,228
Total loan purchases	31,216	67,698	102,228
Loan principal repayments	(239,697)	(213,131)	(145,959)
(Decrease) increase due to other items	(1,370)	339	936
Net (decrease) increase in loan portfolio	\$ (34,261)	\$ 17,727	\$ 161,193



Our customary sources of loan applications include loan originated by our commercial and residential loan officers, repeat customers, referrals from realtors and other professionals and “walk-in” customers. These sources are supported in varying degrees by our newspaper and electronic advertising and marketing strategies.

The Bank maintains loan purchase and servicing agreements with three large nationwide lenders, in order to supplement the Bank’s loan production pipeline. The original agreements called for the purchase of loan pools that contain mortgages on residential properties in our lending area. Subsequently, we expanded our loan purchase and servicing agreements with the same nationwide lenders to include mortgage loans secured by residential real estate located outside of New Jersey. We have procedures in place for purchasing these mortgages such that the underwriting guidelines are consistent with those used in our in-house loan origination process. The evaluation and approval process ensures that the purchased loans generally conform to our normal underwriting guidelines. Our due diligence process includes full credit reviews and an examination of the title policy and associated legal instruments. We recalculate debt service and loan-to-value ratios for accuracy and review appraisals for reasonableness. All loan packages presented to the Bank must meet the Bank’s underwriting requirements as outlined in the purchase and servicing agreements and are subject to the same review process outlined above. Furthermore, there are stricter underwriting guidelines in place for out-of-state mortgages, including higher minimum credit scores. During the year ended June 30, 2010, we purchased a total of \$11.0 million and \$3.9 million of fixed-rate and adjustable rate loans, respectively, from these sellers.

Once we purchase the loans, we continually monitor the seller’s performance by thoroughly reviewing portfolio balancing reports, remittance reports, delinquency reports and other data supplied to us on a monthly basis. We also review the seller’s financial statements and documentation as to their compliance with the servicing standards established by the Mortgage Bankers Association of America.

Since May 2007, we have occasionally purchased out-of-state one-to-four family first mortgage loans to supplement our in-house originations. As of June 30, 2010, our portfolio of out-of-state loans included mortgages in 28 states and totaled \$93.2 million. The states with the two largest concentrations of loans at June 30, 2010 were Texas and Washington with outstanding principal balances totaling \$9.7 million and \$9.5 million, respectively. The aggregate outstanding balances of loans in each of the remaining 26 states comprise less than 10% of the total balance of out-of-state loans.

The Bank also enters into purchase agreements with a limited number of mortgage originators to supplement the Bank’s loan production pipeline. These agreements call for the purchase, on a flow basis, of one-to-four family first mortgage loans with servicing released to the Bank. During the year ended June 30, 2010, we purchased a total of \$15.6 million and \$661,000 of fixed-rate and adjustable rate loans, respectively, from these sellers.

In addition to purchasing one-to-four family loans, we also occasionally purchase participations in loans originated by other banks and through the Thrift Institutions Community Investment Corporation of New Jersey (“TICIC”), a subsidiary of the New Jersey Bankers Association. Our TICIC participations generally include multi-family and commercial real estate properties. The aggregate balance of TICIC participations at June 30, 2010 was \$7.4 million and the average balance of a single participation was approximately \$246,000. Both were virtually unchanged from June 30 2009, with additional loan disbursements generally offset by principal repayments. At June 30, 2010, we had four non-TICIC participations with an aggregate balance of \$8.6 million, consisting of loans on commercial real estate properties, including a medical center, a self-storage facility, a shopping plaza and commercial buildings with a combination of retail and office space and a construction loan to build townhouses. By comparison, at June 30, 2009 non-TICIC participations totaled \$11.3 million. During the year ended June 30, 2010, the Bank did not purchase any loan participations originated by other banks.





**Loan Approval Procedures and Authority.** Senior management recommends and the Board of Directors approves our lending policies and loan approval limits. Our Chief Lending Officer may approve loans up to \$750,000. Loan department personnel of the Bank serving in the following positions may approve loans as follows: mortgage loan managers, mortgage loans up to \$500,000; mortgage loan underwriters, mortgage loans up to \$250,000; consumer loan managers, consumer loans up to \$250,000; and consumer loan underwriters, consumer loans up to \$150,000. In addition to these principal amount limits, there are established limits for different levels of approval authority as to minimum credit scores and maximum loan to value ratios and debt ratios. Our Chief Executive Officer, Chief Financial Officer and Chief Investment Officer have authorization to countersign loans for amounts that exceed \$750,000 up to a limit of \$1.0 million. Our Chief Lending Officer must approve loans between \$750,000 and \$1.0 million along with one of these designated officers. Non-conforming mortgage loans and loans over \$1.0 million require the approval of the Board of Directors.

#### Asset Quality

**Loan Delinquencies and Collection Procedures.** The Company regularly monitors the payment status of all loans within its portfolio and promptly initiates collections efforts on past due loans in accordance with applicable policies and procedures. Delinquent borrowers are notified by both mail and telephone when a loan is 30 days past due. If the delinquency continues, subsequent efforts are made to contact the delinquent borrower and additional collection notices and letters are sent. All reasonable attempts are made to collect from borrowers prior to referral to an attorney for collection. However, when a loan is 90 days delinquent, it is our general practice to refer it to an attorney for repossession, foreclosure or other form of collection action, as appropriate. In certain instances, we may modify the loan or grant a limited moratorium on loan payments to enable the borrower to reorganize his or her financial affairs and we attempt to work with the borrower to establish a repayment schedule to cure the delinquency.

As to mortgage loans, if a foreclosure action is taken and the loan is not reinstated, paid in full or refinanced, the property is sold at judicial sale at which we may be the buyer if there are no adequate offers to satisfy the debt. Any property acquired as the result of foreclosure or by deed in lieu of foreclosure is classified as real estate owned until it is sold or otherwise disposed of. When real estate owned is acquired, it is recorded at its fair market value less estimated selling costs. The initial write-down of the property, if necessary, is charged to the allowance for loan losses. Adjustments to the carrying value of the properties that result from subsequent declines in value are charged to operations in the period in which the declines are identified. At June 30, 2010, we held real estate owned totaling \$146,000, consisting of two properties acquire through foreclosure.

Loans are generally placed on non-accrual status when they are more than 90 days delinquent, with the exception of passbook loans. When a passbook loan becomes 120 days delinquent, we collect the outstanding balance of the loan from the related passbook account along with accrued interest (and a penalty is charged if the account securing the loan is a certificate of deposit). Loans may be placed on a non-accrual status at any time if, in the opinion of management, repayment of the loan in accordance with its stated terms is doubtful. Interest accrued and unpaid at the time a loan is placed on non-accrual status is charged against interest income. Subsequent payments are applied in accordance with the promissory note. At June 30, 2010, we had approximately \$9.2 million of loans that were held on a non-accrual basis compared to \$8.1 million at June 30, 2009.

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Non-Performing Assets. The following table provides information regarding the Bank's non-performing loans and real estate owned.

	2010	2009	At June 30, 2008	2007	2006
	(Dollars in Thousands)				
Loans accounted for on a non-accrual basis:					
Real estate mortgage:					
One- to four-family	\$ 1,867	\$ 2,120	\$ 530	\$ 472	\$ 329
Multi-family and nonresidential	4,358	5,626	1,012	1,017	592
Commercial business	2,298	—	—	—	—
Consumer:					
Home equity loans	250	27	31	—	21
Home equity lines of credit	—	—	—	—	—
Other	1	—	—	—	—
Construction	468	362	—	—	—
Total	9,242	8,135	1,573	1,489	942
Accruing loans which are contractually past due 90 days or more:					
Real estate mortgage:					
One- to four-family	12,321	5,017	—	—	—
Multi-family and commercial	—	—	—	—	—
Commercial business	—	—	—	—	—
Consumer:					
Home equity loans and lines of credit	—	—	—	—	—
Passbook or certificate	—	—	—	—	—
Other	—	—	—	—	—
Construction	—	—	—	—	—
Total	12,321	5,017	—	—	—
Total non-performing loans	\$ 21,563	\$ 13,152	\$ 1,573	\$ 1,489	\$ 942
Real estate owned	\$ 146	\$ 109	\$ 109	\$ 109	\$ 109
Other non-performing assets	\$ —	\$ —	\$ —	\$ —	\$ —
Total non-performing assets	\$ 21,709	\$ 13,261	\$ 1,682	\$ 1,598	\$ 1,051
Total non-performing loans to total loans	2.13%	1.26%	0.15%	0.17%	0.13%
Total non-performing loans to total assets	0.92%	0.62%	0.08%	0.08%	0.05%
Total non-performing assets to total assets	0.93%	0.62%	0.08%	0.08%	0.05%

Non-performing assets increased by \$8.4 million to \$21.7 million at June 30, 2010 from \$13.3 million at June 30, 2009. The increase comprised a net increase in non-accrual loans of \$1.1 million plus the addition of \$7.3 million of loans 90 days or more past due and still accruing. For those same comparative periods, the number of nonaccrual loans increased from 21 to 26 loans while the number of loans 90 days or more past due and still accruing increased

from 12 to 28 loans.

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The \$2,117,000 of nonaccrual one-to-four family mortgage loans and home equity loans include a total of 11 originated loans with outstanding principal balances ranging from \$7,000 to \$470,000 at June 30, 2010. The loans are in various stages of collection, workout or foreclosure and are secured by New Jersey properties whose values at June 30, 2010 are estimated to equal or exceed the outstanding balances of the loans at that date.

The \$4,358,000 of nonaccrual multifamily and nonresidential mortgage loans includes a total of seven loans with outstanding principal balances ranging from \$70,000 to \$2.7 million at June 30, 2010. Five of the seven loans with combined balances of \$1,632,000 were acquired through TICIC. Based upon updated collateral valuations, the Bank has established specific valuation allowances of \$1,551,000 for the identified impairment attributable to four of these five loans at June 30, 2010. The remaining loans represent two originated nonresidential mortgage loans with combined balances of \$2,726,000. The loans are secured by New Jersey properties whose values at June 30, 2010 are estimated to equal or exceed the outstanding balances of the loans at that date.

The \$2,298,000 of nonaccrual commercial business loans include a total of three loans with outstanding principal balances ranging from \$4,800 to \$2.2 million at June 30, 2010. The largest of these three loans represents one loan with an outstanding balance of \$2.2 million loan which 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. However, no specific valuation allowance for impairment was required to be established against the loan as of that date based upon the adequacy of the Bank's collateral as well as an existing contract for the sale of the underlying property which is expected to close in the quarter ending September 30, 2010. The remaining two nonaccrual commercial business loans have combined balances of \$99,600 with a specific valuation allowance of \$4,800 established in the allowance for loan loss for the identified impairment attributable to one of these two loans.

The balance of nonaccrual loans also includes \$468,000 attributable to three construction loans secured by properties in New Jersey with outstanding principal balances ranging from \$106,000 to \$213,000 at June 30, 2010. Based upon updated collateral valuations, the Bank has established a specific valuation allowance of \$106,000 at June 30, 2010 for the identified impairment attributable to one of the three loans while the values of the collateral securing the remaining two properties are estimated to equal or exceed the outstanding balances of the loans at that date.

Nonperforming loans also include 28 accruing loans totaling \$12,321,000 reported as 90 days or more past due. Of these 28 loans, 27 represent residential mortgage loans secured by New Jersey properties while one loan is secured by a residential property located in Alabama. The loans were purchased from nationwide mortgage loan originators and continue to be serviced by those organizations. In accordance with our agreements, the servicers advance scheduled principal and interest payments to the Bank when such payments are not made by the borrower. The timely receipt of principal and interest from the servicer ensures the continued accrual status of the Bank's loan. However, the delinquency status reported for these nonperforming loans reflects the borrower's actual delinquency irrespective of the Bank's receipt of advances which will be recouped by the servicer from the Bank in the event the borrower does not reinstate the loan. Based upon updated collateral valuations, the Bank has established specific valuation allowances of \$2,433,000 for the identified impairment attributable to 22 of these 28 loans at June 30, 2010.

During the years ended June 30, 2010, 2009 and 2008, gross interest income of \$629,000, \$591,000 and \$105,000, respectively, would have been recognized on loans accounted for on a non-accrual basis if those loans had been current. Interest income recognized on such loans of \$233,000, \$134,000 and \$47,000 was included in income for the years ended June 30, 2010, 2009 and 2008, respectively.

In addition to the non-performing assets included in the table above, the Bank had two loans with combined outstanding balances totaling \$945,000 reported as troubled debt restructurings at June 30, 2010. No loans were reported as troubled debt restructurings at June 30, 2009, 2008, 2007 or 2006.

During the year ended June 30, 2010, gross interest income of \$63,000 would have been recognized on loans reported as troubled debt restructurings under their original terms prior to restructuring. Actual interest income of \$46,000 was recognized on such loans for the year ended June 30, 2010 reflecting the interest received under the revised terms of those restructured loans.

**Loan Review System.** The Company maintains a loan review system consisting of several related functions including, but not limited to, classification of assets, calculation of the allowance for loan losses, independent credit file review as well as internal audit and lending compliance reviews. The Company utilizes both internal and external resources, where appropriate, to perform the various loan review functions. For example, the Company has engaged the services of a third party firm specializing in loan review and analysis to perform several loan review functions. This firm reviews the loan portfolio in accordance with the scope and frequency determined by senior management and the Asset Quality Committee of the Board of Directors. The third party loan review firm assists senior management and the board of directors in identifying potential credit weaknesses; in appropriately grading or adversely classifying loans; in identifying relevant trends that affect the collectability of the portfolio and identify segments of the portfolio that are potential problem areas; in verifying the appropriateness of the allowance for loan losses; in evaluating the activities of lending personnel including compliance with lending policies and the quality of their loan approval, monitoring and risk assessment; and by providing an objective assessment of the overall quality of the loan portfolio. Currently, independent loan reviews are being conducted quarterly and include non-performing loans as well as samples of performing loans of varying types within the Company's portfolio.

The Company's loan review system also includes the internal audit and compliance functions, which operate in accordance with a scope determined by the Audit and Compliance Committees of the Board of Directors. Internal audit resources assess the adequacy of, and adherence to, internal credit policies and loan administration procedures. Similarly, the Company's compliance resources monitor adherence to relevant lending-related and consumer protection-related laws and regulations. The loan review system is structured in such a way that the internal audit function maintains the ability to independently audit other risk monitoring functions without impairing its independence with respect to these other functions.

As noted, the loan review system also comprises the Company's policies and procedures relating to the regulatory classification of assets and the allowance for loan loss functions each of which are described in greater detail below.

**Classification of Assets.** In compliance with the OTS guidelines, management maintains an internal loan review program, whereby certain loans exhibiting adverse credit quality characteristics are classified "Special Mention", "Substandard", "Doubtful" or "Loss". It is our policy to review the loan portfolio in accordance with regulatory classification procedures, generally on a monthly basis. Management evaluates loans classified as substandard or doubtful for impairment in accordance with applicable accounting requirements. Management classifies the impaired portion of a loan as "Loss" through which a specific valuation allowance equal to 100% of the impairment is established.

An asset is classified as "Substandard" if it is inadequately protected by the paying capacity and net worth of the obligor or the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not



corrected. Assets classified as “Doubtful” have all of the weaknesses inherent in those classified as “Substandard”, with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions and values. Assets, or portions thereof, classified as “Loss” are considered uncollectible or of so little value that their continuance as assets is not warranted. Assets classified as “Loss” are either charged off directly against the allowance for loan loss or a specific valuation allowance equal to 100% of the loss is established as noted above.

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

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

The following table discloses our designation of certain loans as special mention or adversely classified during each of the five years presented. See Page 32 for a discussion on classified securities.

	2010	2009	At June 30, 2008 (In Thousands)	2007	2006
Special Mention	\$ 10,353	\$ 3,506	\$ —	\$ 736	\$ 236
Substandard	18,697	14,891	749	1,470	1,448
Doubtful	—	817	1,871	1,881	2,001
Loss	—	—	—	—	—
Total	\$ 29,050	\$ 19,214	\$ 2,620	\$ 4,087	\$ 3,685

The balance of “Special Mention” loans at June 30, 2010 included a total of 19 loans whose entire outstanding balances were classified in that manner. The balance of “Substandard” loans included a total of 52 loans at June 30, 2010. Of these “Substandard” loans, the entire balances of 29 loans totaling \$8,915,000 were classified in that manner. The remaining 23 loans had total outstanding balances of \$12,434,000 of which \$9,782,000 was classified as “Substandard” with the remaining \$2,652,000 classified as “Loss”.

In addition to the 23 “Substandard” loans with portions of their balances classified as “Loss”, the entire balances of six additional loans totaling \$1,663,000 were fully classified as “Loss”. In total, the outstanding balance of loans, or portions thereof, classified as “Loss” totaled \$4,315,000 at June 30, 2010. As seen on Page 25, specific valuation allowances have been established against 100% of these estimated losses in accordance with the Company’s allowance for loan loss methodology. Consistent with regulatory reporting requirements, the balance of classified assets are reported in the table above net of





any applicable specific valuation allowances resulting in the zero net balance for assets classified as “Loss”.

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

In accordance with generally accepted accounting principles and supporting regulatory guidelines, the balance of our allowance for loan losses generally comprises two components. The first represents specific valuation allowances that we have established for identified losses on certain loans that have been individually reviewed for impairment. The second component represents the general valuation allowances that we have established for estimated losses on homogenous groups of loans sharing similar risk characteristics. The following narrative describes the specific manner in which the Company calculates and records its allowance for loan losses within the framework of its integrated loan review system.

The Company’s allowance for loan loss calculation methodology utilizes a “two-tier” loss measurement process that is performed monthly. Based upon the results of the classification of assets and credit file review processes described earlier, the Company first identifies the loans that must be reviewed individually for impairment. Loans eligible for individual impairment review generally represent the Company’s larger and/or more complex loans including commercial mortgage loans, comprising multi-family, nonresidential real estate and construction loans, as well as the Company’s commercial business loans. However, the Company may also evaluate certain individual one-to-four family mortgage loans, home equity loans and home equity lines of credit for impairment based upon certain risk factors. Factors considered in identifying individual loans to be reviewed include, but may not be limited to, delinquency status, size of loan, type and condition of collateral and the financial condition of the borrower.

A reviewed loan is deemed to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Once a loan is determined to be impaired, management measures the amount of impairment associated with that loan. Impairment is generally defined as the difference between the carrying value and fair value of a loan where former exceeds the latter. For the collateral dependent mortgage loans that comprise the large majority of the Company’s portfolio, the fair value of the real estate collateralizing the loan serves as a practical expedient for that of the impaired loan itself. Such values are generally determined based upon a discounted market value obtained through an automated valuation module or prepared by a qualified, independent real estate appraiser. As supported by the accounting and regulatory guidance, the fair value of the collateral is further reduced by estimated selling costs when such costs are expected to reduce the cash flows available to repay the loan.

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

The second tier of the loss measurement process involves estimating the probable and estimable losses which addresses loans not otherwise reviewed individually for impairment. Such loans generally



comprise large groups of smaller-balance homogeneous loans, such as one-to-four family mortgage loans, home equity loans and home equity lines of credit and consumer loans, that may generally be excluded from individual impairment analysis and instead collectively evaluated for impairment. Such loans also include the remaining non-impaired loans of the larger and/or more complex types, such as the Company's commercial mortgage and business loans, which were not individually reviewed for impairment.

Valuation allowances established through the second tier of the loss measurement process utilize historical and environmental loss factors to collectively estimate the level of probable losses within defined segments of the Company's loan portfolio. These segments aggregate homogeneous subsets of loans with similar risk characteristics based upon loan type. For allowance for loan loss calculation and reporting purposes, the Company currently stratifies its loan portfolio into six primary categories: residential mortgage loans, multi-family mortgage loans, nonresidential mortgage loans, construction loans, commercial business loans and consumer loans. Within these broad categories, the Company defines certain segments. For example, the residential mortgage loan category comprises four primary segments including one-to-four family originated mortgage loans, one-to-four family purchased loans, home equity loans and home equity lines of credit. Commercial real estate loans, comprising the multi-family and nonresidential mortgage loan categories are each grouped into TICIC participations and other (non-TICIC) loans. Construction loans segments also differentiate between TICIC participations and other (non-TICIC) loans while also grouping loans by underlying property types such as one-to-four family, multi-family and nonresidential construction loans. Commercial business loans are generally grouped by collateral type while consumer loans are broken into segments based on both collateral type and/or purpose.

In regard to historical loss factors, the Company's allowance for loan loss calculation calls for an analysis of historical charge-offs and recoveries for each of the defined segments within the loan portfolio. The Company currently utilizes a two-year moving average of annual net charge-off rates (charge-offs net of recoveries) by loan segment, where available, to calculate its actual, historical loss experience. During earlier fiscal years, the Company had generally utilized a five-year "look-back" period to determine the average charge-off history used in the calculation of historical loss factors. The Company reduced that "look-back" period to two years during fiscal 2010 to better reflect the level of actual losses incurred during the current credit cycle in the calculation of its historical loss factors. The outstanding principal balance of each loan segment is multiplied by the applicable historical loss factor to estimate the level of probable losses based upon the Company's historical loss experience.

As noted, the Company's allowance for loan loss calculation also utilizes environment loss factors to estimate the probable losses within the loan portfolio. Environmental loss factors are based upon specific qualitative criteria representing key sources of risk within the loan portfolio. Such risk criteria includes the level of and trends in delinquencies and non-accrual loans; the effects of changes in credit policy; the experience, ability and depth of the lending function's management and staff; national and local economic trends and conditions; credit risk concentrations and changes in local and regional real estate values. For each segment of the loan portfolio, a level of risk, developed from a number of internal and external resources, is assigned to each of the qualitative criteria utilizing a scale ranging from zero (negligible risk) to 15 (high risk). The sum of the risk values, expressed as a whole number, is multiplied by .01% to arrive at an overall environmental loss factor, expressed in basis points, for each segment. The outstanding principal balance of each loan segment is multiplied by the applicable environmental loss factor to estimate the level of probable losses based upon the qualitative risk criteria.

The sum of the probable and estimable loan losses calculated through the first and second tiers of the loss measurement processes as described above, represents the total targeted balance for the Company's allowance for loan losses at the end of a fiscal period. As noted earlier, the Company



establishes all additional specific valuation allowances in the fiscal period during which additional loan impairments are identified. This step is generally performed by transferring the required additions to specific valuation allowances on impaired loans from the balance of Company's general valuation allowances. After establishing all specific valuation allowances relating to impaired loans, the Company then compares the remaining actual balance of its general valuation allowance to the targeted balance calculated at the end of the fiscal period. The Company adjusts its balance of general valuation allowances through the provision for loan losses as required to ensure that the balance of the allowance for loan losses reflects all probable and estimable loans losses at the close of the fiscal period. Any balance of general valuation allowances in excess of the targeted balance is reported as unallocated with such balances attributable to probable losses within the loan portfolio relating to environmental factors within one or more non-specified loan segments. Notwithstanding calculation methodology and the noted distinction between specific and general valuation allowances, the Company's entire allowance for loan losses is available to cover all charge-offs that arise from the loan portfolio.

Finally, the labels "specific" and "general" used herein to define and distinguish the Company's valuation allowances have substantially the same meaning as those used in the regulatory nomenclature applicable to the valuation allowances of insured financial institutions. As such, the portion of the allowance for loan losses categorized herein as "general valuation allowance" is considered "supplemental capital" for the regulatory capital calculations applicable to the Company and its wholly owned bank subsidiary. By contrast, the Company's "specific valuation allowance" maintained against impaired loans is excluded from all forms of regulatory capital and is instead netted against the balance of the applicable assets for regulatory reporting purposes.

Our focus has consistently been to maintain an allowance for loan losses that represents our best estimate of probable losses within the Company's loan portfolio given current facts and economic circumstances as of the evaluation date. For fiscal years ended June 30, 2007 and prior, the Company had utilized a loan classification-based methodology to estimate the allowance for loan losses. The loan classification methodology utilized benchmarks to establish the allowance for loan losses based upon their classification within the Company's classification of assets process described earlier. For example, the prior methodology generally required that the Company maintain a minimum level of general valuation allowances ranging from 0.30% to 1.00% of the outstanding principal balance of loans graded as "Pass" or "Watch". Similarly, general valuation allowances of 5%, 25% and 50%, respectively, were also established and maintained against the outstanding balance of all classified loans rated as "Special Mention", "Substandard" and "Doubtful". Where appropriate, additional general valuation allowance percentages were established and maintained against certain categories of commercial loans. The prior methodology also required that the Company maintain a specific valuation allowance in the amount of 100% of the outstanding balance of all loans, or portions thereof, classified as Loss which is consistent with the current allowance calculation methodology and regulatory requirements.

Like the current allowance for loan loss calculation methodology, the Company's prior practice also allowed for the balance of the allowance to be maintained within a reasonable threshold of the balance targeted by the calculation methodology in place at that time. Calculation methodology notwithstanding, the Company consistently determined that the overall balance of the allowance for loan losses at the close of each reporting period was being maintained within a range consistent with that required by GAAP.

During the fiscal year ended June 30, 2008, the Company revised its allowance for loan loss calculation methodology to that described in the preceding discussion. Doing so resulted in a more precise measurement of estimated probable losses consistent with the Interagency Policy Statement on the Allowance for Loan and Lease Losses that had been recently updated by bank regulators. Through this policy statement, bank regulators clarified the applicable regulatory guidance regarding the allowance for



loan loss and emphasized the requirement that insured institutions adhere to the applicable accounting standards in calculating the appropriate level for the allowance for loan loss.

As discussed in greater detail below, the use of this new methodology did not result in a material change in the overall level of the allowance for loan losses. Moreover, the provision recorded during the year ended June 30, 2008, which was determined based on the newly implemented methodology, was not materially different, on an overall basis, from what would have been required under the prior methodology. However, the change in methodology did increase the precision of the calculation supporting the component balances of the Company's allowance for loan losses while resulting in a noteworthy reallocation between loan segments and the general and specific valuation allowances applicable to each. In particular, eliminating the use of loan classification benchmarks to estimate the allowance for loan losses corrected a tendency to overweight the allocation towards multi-family and commercial mortgages during prior periods in favor of a greater allocation toward one-to-four family mortgage loans. Moreover, the change in underlying methodology converted what had been general valuation allowances, previously established and maintained on certain TICIC participations based upon their adverse loan classification, into more precisely defined specific and general valuation allowances attributable to those same loans, albeit in a lesser aggregate amount. The remainder was largely reallocated toward the general valuation allowances required by the historical and environmental loss factors utilized in the revised calculation.



The following table sets forth information with respect to activity in the allowance for loan losses for the periods indicated.

	For the Years Ended June 30,				
	2010	2009	2008	2007	2006
	(Dollars in Thousands)				
Allowance balance (at beginning of period)	\$ 6,434	\$ 6,104	\$ 6,049	\$ 5,451	\$ 5,416
Provision for loan losses	2,616	317	94	571	72
Charge-offs:					
One-to-four family mortgage	202	2	30	—	—
Home equity loan	16	—	—	—	—
Commercial mortgage	322	—	—	—	—
Commercial business	—	—	—	—	30
Other	1	3	9	—	12
Total charge-offs	541	5	39	—	42
Recoveries:					
One-to-four family mortgage	10	—	—	—	—
Commercial mortgage	42	—	—	—	—
Commercial business	—	18	—	27	5
Total recoveries	52	18	—	27	5
Net (charge-offs) recoveries	(489)	13	(39)	27	(37)
Allowance balance (at end of period)	\$ 8,561	\$ 6,434	\$ 6,104	\$ 6,049	\$ 5,451
Total loans outstanding	\$ 1,013,149	\$ 1,044,885	\$ 1,026,514	\$ 865,031	\$ 707,977
Average loans outstanding	\$ 1,030,287	\$ 1,064,019	\$ 951,019	\$ 785,210	\$ 633,758
Allowance for loan losses as a percent					
of total loans outstanding	0.84%	0.62%	0.59%	0.70%	0.77%
Net loan charge-offs as a percent					
of average loans outstanding	0.05%	0.00%	0.00%	0.00%	0.01%
Allowance for loan losses to non-performing loans	39.70%	48.92%	388.05%	406.25%	578.66%

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Allocation of Allowance for Loan Losses. The following table sets forth the allocation of the total allowance for loan losses by loan category and segment and the percent of loans in each category's segment to total net loans receivable at the dates indicated. The portion of the loan loss allowance allocated to each loan segment does not represent the total available for future losses which may occur within a particular loan segment since the total loan loss allowance is a valuation reserve applicable to the entire loan portfolio.

	2010		2009		At June 30, 2008		2007		2006	
	Amount	Percent of Loans to Total	Amount	Percent of Loans to Total	Amount	Percent of Loans to Total	Amount	Percent of Loans to Total	Amount	Percent of Loans to Total
At end of period allocated to:										
Real estate mortgage:										
One-to-four family	\$ 4,302	65.52%	\$ 3,254	65.97%	\$ 2,979	66.99%	\$ 1,854	64.66%	\$ 1,582	65.80%
Multi-family and commercial	3,315	20.04	2,181	18.89	1,841	17.40	3,602	18.40	3,133	15.13
Commercial business	108	1.42	73	1.42	44	0.85	27	0.48	34	0.45
Consumer:										
Home equity loans	313	10.03	510	10.85	719	12.08	356	13.14	286	13.23
Home equity lines of credit	34	1.12	55	1.16	67	1.12	46	1.47	39	1.83
Passbook or certificate	7	0.27	—	0.28	—	0.26	—	0.38	—	0.41
Other	6	0.15	24	0.15	41	0.13	34	0.16	27	0.03
Construction	245	1.45	106	1.28	118	1.17	130	1.31	350	3.12
	8,330		6,203		5,809		6,049		5,451	
Unallocated	231		231		295		—		—	
Total	\$ 8,561	100.00%	\$ 6,434	100.00%	\$ 6,104	100.00%	\$ 6,049	100.00%	\$ 5,451	100.00%

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The following table sets forth the allocation of the allowance for loan losses by loan category and segment within each valuation allowance category at the dates indicated. The valuation allowance categories presented reflect the allowance for loan loss calculation methodology in effect at the time.

	2010	2009	At June 30, 2008		2007	2006
			(Dollars in Thousands)			
Specific valuation allowance:						
Real estate mortgage:						
One-to-four family	\$ 2,433	\$ 150	\$ —	\$ —	\$ —	\$ —
Multi-family and commercial (TICIC Participations)	1,551	1,046	1,160	—	—	—
Multi-family and commercial (Non-TICIC)	220	232	—	—	—	—
Commercial business	5	2	3	—	—	—
Construction	106	—	—	—	—	—
Total specific valuation allowance	4,315	1,430	1,163	—	—	—
General valuation allowance (Factors based):						
Historical loss factors	199	30	33	—	—	—
Environmental loss factors:						
Real estate mortgage:						
One-to-four family	1,784	3,098	2,972	—	—	—
Multi-family and commercial	1,443	901	679	—	—	—
Commercial business	103	71	41	—	—	—
Consumer:						
Home equity loans	305	510	719	—	—	—
Home equity lines of credit	34	55	67	—	—	—
Other	8	8	23	—	—	—
Construction	139	100	112	—	—	—
Total environmental loss factors	3,816	4,743	4,613	—	—	—
Total (Factors based)	4,015	4,773	4,646	—	—	—
General valuation allowance (Loan classifications based):						
Real estate mortgage:						
One-to-four family	—	—	—	1,854	1,582	—
Multi-family and commercial (TICIC Participations)	—	—	—	2,014	2,105	—
Multi-family and commercial (Non-TICIC)	—	—	—	1,588	1,028	—
Commercial business	—	—	—	27	34	—
Consumer:						
Home equity loans	—	—	—	356	286	—
Home equity lines of credit	—	—	—	46	39	—
Other	—	—	—	34	27	—
Construction	—	—	—	130	350	—

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Total (Loan classifications based)	—	—	—	6,049	5,451
Unallocated general valuation allowance	231	231	295	—	—
Total allowance for loan losses	\$ 8,561	\$ 6,434	\$ 6,104	\$ 6,049	\$ 5,451

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As reported in the tables above, the balance of the allowance for loan losses increased by approximately \$2.1 million to \$8.6 million at June 30, 2010 from \$6.4 million at June 30, 2009. The increase resulted from additional provisions of \$2.6 million combined with net charge offs of \$489,000 during fiscal 2010. The increase reflects net additions to specific valuation allowances of approximately \$2.9 million relating to impaired loans partially offset by net reductions of general valuation allowances, including unallocated amounts, of approximately \$758,000 arising from the application of the historical and environmental loss factors to the outstanding balance of the remaining, non-impaired loans within the Company's portfolio which declined during the year.

With regard to the reported net additions to specific valuation allowances at June 30, 2010, the Company reported a total of 39 impaired loans with a total outstanding balance of \$20.5 million compared to a total of 19 impaired loans with a total outstanding balance of \$11.1 million at June 30, 2009. As of June 30, 2010, the portion of the total allowance for loan losses specifically attributable to impaired loans totaled \$4.3 million representing the specific valuation allowances on 29 impaired loans with a total outstanding balance of \$14.1 million. The remaining 10 impaired loans with a total outstanding balance of \$6.4 million did not require specific impairment allowances at June 30, 2010. By comparison, as of June 30, 2009, the portion of the total allowance for loan losses specifically attributable to impaired loans totaled approximately \$1.4 million representing specific valuation allowances attributable to ten impaired loans with a total outstanding balance of \$5.4 million. The remaining nine impaired loans with a total outstanding balance of \$5.7 million did not require specific impairment allowances at June 30, 2009. The increases in specific valuation allowances reported in fiscal 2010 generally resulted from reductions in the fair value of the real estate securing the collateral dependent loans that were individually evaluated for impairment in accordance with the Company's allowance for loan loss calculation methodology described earlier.

The balance of the Company's general valuation allowances, including unallocated amounts, decreased \$758,000 from \$5.0 million at June 30, 2009 to \$4.2 million at June 30, 2010. The reported net change in general valuation allowances during fiscal 2010 was attributable to the application of the Company's historical and environment loss factors to the "non-impaired" portion of the loan portfolio during the year.

With regard to historical loss factors, the Company's loan portfolio experienced a net annual charge-off rate of 5 basis points during fiscal 2010 while such losses were limited to one basis point or less during fiscal 2006-2009. As a result, the Company's general valuation allowances are derived largely from environmental loss factors with a significantly lesser portion of the allowance attributable to historical loss factors. Of the balance of general valuation allowances reported at June 30, 2010 and June 30, 2009, \$199,000 and \$30,000, respectively, were attributable to historical loss factors. Notwithstanding its low level of historical charge-offs, however, there can be no assurance that the Company's net charge-off rate will remain at these levels given the current downturn in the economy and its potential effect on the future performance of the Company's loan portfolio. In particular, the Company has established specific valuation allowances of approximately \$4.3 million at June 30, 2010 that represent identified impairments on nonperforming loans which are ultimately expected to result in additional charge offs in future periods as such loans work through the resolution process.

At June 30, 2010 and June 30, 2009, the portion of the Company's general valuation allowances attributable to environmental factors totaled \$3.8 million and \$4.7 million, respectively. The net decrease in this portion of the general valuation allowance reflects the level of environmental loss factors applied to the Company's "non-impaired" loan portfolio whose outstanding balances declined during the year. Specifically, loans receivable, excluding the allowance for loan loss, decreased \$32.1 million from \$1.05 billion at June 30, 2009 to \$1.01 billion at June 30, 2010. Along with this decline, impaired loans increased \$9.4 million from \$11.1 million at June 30, 2009 to \$20.5 million at June 30, 2010. Therefore,



the net decline in the “non-impaired” loan portfolio totaled approximately \$41.5 million for the year ended June 30, 2010. Additionally, management’s review and update of the historical and environmental loss factors during fiscal 2010 also resulted in modifications to the Company’s environmental factors from June 30, 2009 to June 30, 2010. The result of such modifications increased the environmental loss factors applied to the Company’s riskier assets while reducing those factors applicable to those loans that are generally characterized by less credit risk. The net result of these changes, in conjunction with the overall declines in the outstanding balance of the “non-impaired” loan portfolio, resulted in an overall reduction in the level of general valuation allowances attributable to environmental factors during the year.

Finally, the general valuation allowances included a balance of the unallocated allowance totaling \$231,000 at both June 30, 2010 and June 30, 2009. As noted earlier, the balance of the unallocated general allowance represents the amount established and maintained for probable losses attributable to environmental factors within one or more non-specified segments within the loan portfolio. In accordance with the Company’s allowance for loan loss methodology, changes in the targeted balance of general valuation allowances attributable to modifications in environmental loss factors may, in whole or in part, be transferred to and from the unallocated allowance subject to the thresholds outlined in the earlier discussion concerning allowance for loan loss calculation methodology.

The balance of the allowance for loan losses included in the tables above for the two years ended June 30, 2006 and June 30, 2007 reflect the Company’s prior calculation methodology described in the earlier section. As noted in that discussion, prior to the fiscal year ended June 30, 2008, the Company had utilized a loan classification-based methodology to estimate the allowance for loan losses. This prior methodology utilized benchmarks to establish the allowance for loan losses based upon the Company’s classification of assets process.

During those two fiscal years, the balance of the Company’s allowance for loan losses comprised general valuation allowances only. The Company maintained no specific valuation allowances on loans, or portions thereof, resulting from its classification of assets process. This was consistent with the Company’s reporting of no impaired loans during those same years.

As noted earlier, loan classification-based methodology in use by the Company during that time resulted in a total balance of the allowance that was within a range consistent with that required by GAAP. However, the balance of the Company’s allowance fluctuated within that acceptable range based upon the methodology and its application given certain corporate events affecting the loan portfolio.

Specifically, the Company acquired two banks, one in October 2002 and the other in July 2003. The Bank’s allowance for loan losses, when combined with the allowance for loan losses from each of the acquisitions, as required by GAAP at the time, resulted in an allowance for loan losses that generally reflected a margin for imprecision and uncertainty that is inherent in estimates of probable credit losses. Included in the loan portfolios of both acquired institutions were several loan participations of questionable credit quality originated by TICIC. TICIC enables financial institutions to pool their individual resources into a single facility designed to provide long-term financing for affordable and senior housing in New Jersey while supporting the participating institutions’ Community Reinvestment Act (“CRA”) lending objectives. Based upon the Company’s understanding of the facts, economic circumstances and probable loss exposure relating to the TICIC loans following the acquisitions, the Company increased the applicable general valuation allowances to approximately \$2.0 million in accordance with the loan classification-based allowance methodology in use during that time. As described in the table above, the Company maintained the balance of the general valuation allowances attributable to the TICIC loans within a range of \$2.0 million to \$2.1 million during the two years ended June 30, 2006 and June 30, 2007 based upon their adverse classification during those years.





Loan loss provisions were minimal during the fiscal year ended June 30, 2006 due largely to targeted additions to valuation allowances attributable to net loan growth during those periods being largely offset by reductions in required valuation allowances on diminishing balances of classified assets. Specifically, total loans outstanding increased \$145.4 million from \$562.6 million at June 30, 2005 to \$708.0 million at June 30, 2006. During that same timeframe, total classified assets declined by \$3.7 million from \$7.4 million to \$3.7 million, respectively. Based upon the allowance calculation methodology in use during that time, the balance of the Company's valuation allowances was \$5.4 million at both June 30, 2005 and June 20, 2006 reflecting the partially offsetting effects of net loan growth and net reductions in classified assets. In total, net growth in the Company's loan portfolio outpaced that of the allowance for loan losses during those periods. Consequently, the ratio of allowance for loan losses to total loans decreased from 0.96% at June 30, 2005 to 0.77% at June 30, 2006.

By the fiscal year ended June 30, 2007, net growth in the loan portfolio necessitated a comparatively larger provision of \$571,000 to increase the allowance to the level targeted by the Company's allowance calculation methodology. The net growth in the allowance during fiscal 2007 also reflected a modest increase in the balance of classified assets. Specifically, total loans outstanding increased by \$157.0 million from \$708.0 million at June 30, 2006 to \$865.0 million at June 30, 2007. During that same timeframe, total classified assets increased by \$402,000 from \$3.7 million to \$4.1 million, respectively. Based upon the allowance calculation methodology in use during that time, the balance of the Company's valuation allowances increased by \$598,000 from \$5.4 million at June 30, 2006 to \$6.0 million at June 30, 2007 reflecting the combined effects of net loan growth and an increase in the balance of classified assets. As in prior years, the overall growth in the loan portfolio during fiscal 2007 outpaced that of the allowance. Consequently, the ratio of the allowance for loan losses to total loans continued to decline to 0.70% at June 30, 2007.

As noted earlier, during the fiscal year ended June 30, 2008, the Company revised its allowance for loan loss calculation to the methodology currently in use. Doing so resulted in a more precise measurement of estimated probable losses that was consistent with the Interagency Policy Statement on the Allowance for Loan and Lease Losses updated by bank regulators and more closely aligned the Company's calculation methodology to that required by the applicable accounting standards.

As supported by the tables above, the change in underlying calculation methodology did not result in a material change in the overall level of the allowance for loan losses from year to year. Rather, the implementation of the revised methodology largely reallocated what had been the Company's balance of general valuation allowances, calculated in accordance with the prior loan classification-based methodology at June 30, 2007, into more precisely defined specific valuation allowances for individually identified loan impairments and general valuation allowances based upon historical and environmental loss factors, as reported at June 30, 2008.

In total, the balance of the allowance for loan losses increased \$55,000 from \$6.0 million at June 30, 2007 to \$6.1 million at June 30, 2008 reflecting additional provisions of \$94,000 partially offset by net charge-offs of \$39,000 during fiscal 2008. This net provision for fiscal 2008 reflected the Company's implementation of the new allowance for loan loss calculation methodology coupled with the effects of continued net loan growth and a further reduction in the balance of total classified assets. Specifically, total loans outstanding increased \$161.5 million from \$865.0 million at June 30, 2007 to \$1.03 billion at June 30, 2008. The additions to general valuation allowances attributable to this net growth in loans, as calculated by the revised methodology, were largely offset by decreases in the required level of valuation allowances attributable to the TICIC loan participations discussed earlier. Specifically, reviewing the individual TICIC loans for impairment, in accordance with the Company's revised allowance calculation methodology, resulted in a lower, albeit more precise, estimate of probable losses associated with those



loans than had been calculated based upon the Company's prior allowance calculation methodology. At June 30, 2007, the outstanding balance of the Company's TICIC participations totaled \$9.0 million against which the Company maintained general valuation allowances of \$2.0 million based upon the allowance calculation methodology in use by the Company at that time. By comparison, at June 30, 2008, the outstanding balance of the Company's TICIC participations totaled \$8.5 million against which the Company maintained total valuation allowances of \$1.19 million.

The total amount of valuation allowances attributable to the TICIC participations at June 30, 2008 included \$1.16 million of specific valuation allowances attributable to impairments identified on loans that were individually reviewed in accordance with revised allowance calculation methodology implemented by the Company during fiscal 2008. This amount was effectively reallocated from the general valuation allowances that had previously been established and maintained against the TICIC loans in accordance with the prior allowance calculation methodology. The remaining \$33,000 of TICIC valuation allowances at June 30, 2008 represented general valuation allowances arising from the identification of probable losses using the applicable historical and environmental loss factors on the "non-impaired" TICIC participations. This amount was similarly reallocated within the balance of general valuation allowances attributable to the TICIC loan participations.

Having established the required level of specific and general valuation allowances against the TICIC loan participations in accordance with its revised allowance calculation methodology, the Company reallocated the remaining \$821,000 of general valuation allowances previously attributable to the TICIC loan participations to other probable losses identified by that revised methodology including, but not limited to, that required by the net growth in the loan portfolio during fiscal 2008.

The Company's historical loss experience throughout the past twenty years has generally reflected a period of unprecedented and sustained economic expansion that continued through fiscal 2007. The strong economic and real estate market conditions during that time resulted in minimal loan charge-offs through the current year ended June 30, 2010. Accordingly, the Company did not consider the formal validation of the current allowance for loan loss methodology via comparison to our actual charge-off history through June 30, 2010 as necessary or useful. Notwithstanding the Company's low historical charge-off rates, however, economic and market conditions deteriorated significantly from fiscal 2008 through fiscal 2010. As such, the Company expects that probable loan losses estimated by its current allowance for loan loss methodology, particularly those attributable to specific impairments, will be realized through actual charge-offs in the foreseeable future. As such, the Company intends to validate the results of its allowance for loan loss calculations based upon historical data as such data builds in the future. Notwithstanding this future analysis, the Company will continue to regularly update the historical loss factors used to estimate probable losses within its portfolio based upon its actual charge-offs.

Finally, the calculation of probable losses within a loan portfolio and the resulting allowance for loan losses is subject to estimates and assumptions that are susceptible to significant revisions as more information becomes available and as events or conditions effecting individual borrowers and the marketplace as a whole change over time. Future additions to the allowance for loan losses will likely be necessary if economic and market conditions do not improve in the future from those currently prevalent in the marketplace. In addition, the OTS, as an integral part of its examination process, periodically reviews our loan and foreclosed real estate portfolios and the related allowance for loan losses and valuation allowance for foreclosed real estate. The OTS may require the allowance for loan losses or the valuation allowance for foreclosed real estate to be increased based on its review of information available at the time of the examination, which may negatively affect our earnings.



## Securities Portfolio

Our deposits and borrowings have traditionally exceeded our outstanding balance of loans receivable. We generally invest excess funds into investment securities with an emphasis on agency mortgage-backed securities. At June 30, 2010, our securities portfolio totaled \$989.7 million and comprised 42.3% of our total assets. By comparison, at June 30, 2009, our securities portfolio totaled \$716.1 million and comprised 33.7% of our total assets.

In the recent years preceding fiscal 2010, we had increased the balance of our loan portfolio relative to the size of our securities portfolio in order to improve earnings as contemplated in our strategic business plan. However, that trend reversed during fiscal 2010 during which the balance of the securities portfolio grew while aggregate loan balances declined. The increase in the securities portfolio reflected the reinvestment of excess liquidity from deposit growth coupled with additional cash flows attributable to net declines in the loan portfolio as reviewed earlier. Notwithstanding the growth in securities during fiscal 2010, our strategic business plan continues to call for shifting the mix of our earning assets toward greater balances of loans and lesser balances of investment securities over the longer term.

Our investment policy, which is approved by the Board of Directors, is designed to foster earnings and manage cash flows within prudent interest rate risk and credit risk guidelines. Generally, our investment policy is to invest funds in various categories of securities and maturities based upon our liquidity needs, asset/liability management policies, investment quality, and marketability and performance objectives. Our Chief Executive Officer, Chief Financial Officer and Chief Investment Officer are designated by the Board of Directors as the officers responsible for securities investment transactions and all transactions require the approval of at least two of these designated officers. The Interest Rate Risk Management Committee, currently composed of Directors Hopkins, Regan, Aanensen, Mazza and Parow, with our Chief Investment Officer and Chief Financial Officer participating as management's liaison to the committee, is responsible for oversight of the securities portfolio. This committee meets quarterly to review the securities portfolio. 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.

Federally chartered savings banks have the authority to invest in various types of liquid assets. The investments authorized under the investment policy approved by our Board of Directors include U.S. government and government agency obligations, municipal securities (consisting of bank qualified municipal bond obligations of state and local governments) and mortgage-backed securities of various U.S. government agencies or government-sponsored entities. On a short-term basis, our investment policy authorizes investment in securities purchased under agreements to resell, federal funds, certificates of deposits of insured banks and savings institutions and FHLB term deposits.

As of June 30, 2010, mortgage-backed securities represented approximately 71.3% of our total investment in securities, compared to 96.1% as of June 30, 2009. Mortgage-backed securities generally include mortgage pass-through securities and collateralized mortgage obligations which are typically issued with stated principal amounts and backed by pools of mortgage loans. Collateralized mortgage obligations represented less than 1.0% of total mortgage-backed securities at both June 30, 2010 and 2009. Mortgage originators use intermediaries (generally government agencies and government-sponsored enterprises, but also a variety of non-agency corporate issuers) to pool and package mortgage loans into mortgage-backed securities. The cash flow and re-pricing characteristics of a mortgage pass-through security generally approximate those of the underlying mortgages. By comparison, the cash flow and re-pricing characteristics of collateralized mortgage obligations are determined by those assigned to an individual security, or "tranche", within the terms of a larger investment vehicle which allocates cash

flows to its component tranches based upon a predetermined structure as payments are received from the underlying mortgagors.

We generally invest in mortgage-backed securities issued by U.S. government agencies or government-sponsored entities, such as the Government National Mortgage Association (“Ginnie Mae”), Freddie Mac and the Federal National Mortgage Association (“Fannie Mae”). Mortgage-backed securities issued or sponsored by U.S. government agencies and government-sponsored entities are guaranteed as to the payment of principal and interest to investors. Mortgage-backed securities generally yield less than the mortgage loans underlying such securities because of the costs of servicing and of their payment guarantees or credit enhancements which minimize the level of credit risk to the security holder.

In addition to our investments in agency mortgage-backed securities, we formerly had an investment in the AMF Ultra Short Mortgage Fund (“AMF Fund”), a mutual fund acquired during 2002 as the result of a merger, which invested primarily in agency and non-agency mortgage-backed securities of short duration. The housing and credit crises negatively impacted the market value of certain securities in the fund’s portfolio resulting in a continuing decline in the net asset value of this fund. In addition, the fund’s manager instituted a temporary prohibition against cash redemptions to protect shareholders against the possibility that the fund might be forced to liquidate securities at distressed price levels to satisfy redemption requests. In light of these factors, the Company recognized an impairment charge of \$659,000 during the fiscal year ended June 30, 2008 due to other-than-temporary declines in the fund’s net asset value.

Due to a continuing decline in the net asset value of the AMF Fund, the Company elected to withdraw its investment in the fund by invoking a redemption-in-kind option during the first quarter of fiscal 2009 in lieu of cash. The shares redeemed for cash and the shares redeemed for the underlying securities were written down to fair value as of the trade date resulting in an additional pre-tax charge to operations of \$415,000 during the quarter ended September 30, 2008. Through March 31, 2009, the Company recognized an additional \$570,000 of other-than-temporary impairments through earnings attributable to further declines in the value of the non-agency collateralized mortgage obligations acquired through the AMF Fund redemption-in-kind. Effective April 1, 2009, the Company adopted updated guidance relating to the accounting for impairment of investment securities. As a result, that impairment was bifurcated into credit-related and noncredit-related components of \$290,000 and \$280,000, respectively. Further credit-related and noncredit-related other-than-temporary impairments relating to these securities totaling \$144,000 and \$274,000, respectively, were recognized during the fourth quarter of fiscal 2009.

Through the first three quarters of fiscal 2010, the Company recorded additional credit-related and noncredit-related other-than-temporary impairments relating to these securities totaling \$206,000 and \$240,000, respectively. During the fourth quarter ended June 30, 2010, the Company sold the remaining outstanding balance of its non-investment grade, non-agency collateralized mortgage obligations, most of which had been identified as other-than-temporarily impaired (“OTTI”) triggering the recognition of the impairment charges noted above. At June 30, 2010, the Company’s remaining portfolio of non-agency collateralized mortgage obligations totaled 20 securities with an aggregate outstanding balance of approximately \$310,000. These securities, all of which were acquired through the AMF Fund redemption and remain in the held-to-maturity portfolio, were not other-than-temporarily impaired and were rated as investment grade as of that date.

Current accounting standards require that securities be categorized as “held to maturity”, “trading securities” or “available for sale”, based on management’s intent as to the ultimate disposition of each security. These standards allow debt securities to be classified as “held to maturity” and reported in financial statements at amortized cost only if the reporting entity has the positive intent and ability to hold



these securities to maturity. Securities that might be sold in response to changes in market interest rates, changes in the security's prepayment risk, increases in loan demand, or other similar factors cannot be classified as "held to maturity".

We do not currently use or maintain a trading account. Securities not classified as "held to maturity" are classified as "available for sale". These securities are reported at fair value and unrealized gains and losses on the securities are excluded from earnings and reported, net of deferred taxes, as adjustments to Accumulated Other Comprehensive Income, a separate component of equity. As of June 30, 2010, the \$1.7 million remaining balance of all securities originally acquired through the AMF Fund redemption-in-kind, including both agency and non-agency mortgage-backed securities, were classified as held to maturity. Additionally, the Company has classified \$255.0 million of its agency debentures as held-to-maturity. The remainder of Company's portfolio, including all other agency mortgage backed securities, agency debentures; municipal obligations and single issuer trust preferred securities were classified as available for sale at June 30, 2010.

Other than mortgage-backed securities issued or guaranteed by the U.S. government or its agencies, we did not hold securities of any one issuer having an aggregate book value in excess of 10% of our equity at June 30, 2010. All of our securities carry market risk insofar as increases in market rates of interest may cause a decrease in their market value. Purchases of securities are made based on certain considerations, which include the interest rate, tax considerations, volatility, yield, settlement date and maturity of the security, our liquidity position and anticipated cash needs and sources. The effect that the proposed security would have on our credit and interest rate risk and risk-based capital is also considered. We do not currently participate in hedging programs, interest rate caps, floors or swaps, or other activities involving the use of off-balance sheet derivative financial instruments. We do not purchase securities that are rated below investment grade.

During the years ended June 30, 2010, 2009 and 2008, proceeds from sales of securities available for sale totaled \$34.2 million, \$7.3 million and \$48.5 million which resulted in gross gains of \$1,545,000, \$-0- and \$57,000 and gross losses of \$-0-, \$415,000 and \$57,000, respectively. Proceeds from sale of securities held to maturity during the year ended June 30, 2010 totaled \$1.1 million with gross gains and gross losses of \$-0- and \$1,036,000, respectively. There were no sales of held to maturity securities during the years ended June 30, 2009 or June 30, 2008.

As of June 30, 2010, two securities with a combined amortized cost \$4.9 million were classified as "Substandard" for regulatory reporting purposes. The securities represent two single issuer, trust preferred securities whose credit-ratings had fallen below investment grade by one of two rating agencies monitored by the Company.



The following table sets forth the carrying value of our securities portfolio at the dates indicated. Mortgage-backed securities include mortgage pass-through securities and collateralized mortgage obligations.

	2010	2009	At June 30, 2008 (In Thousands)	2007	2006
<b>Securities Available for Sale:</b>					
U.S. agency obligations	\$ 3,942	\$ 4,557	\$ 5,513	\$ 6,864	\$ 8,786
Obligations of states and political subdivisions	18,955	18,340	17,757	65,333	195,661
Mutual funds (1)	—	—	7,545	7,795	7,424
Trust preferred securities	6,600	5,130	7,368	8,877	10,922
Total securities available for sale	29,497	28,027	38,183	88,869	222,793
<b>Securities Held to Maturity:</b>					
U.S. agency obligations	255,000	—	—	—	—
Total securities held to maturity	255,000	—	—	—	—
<b>Mortgage-Backed Securities Available for Sale:</b>					
Government National Mortgage Association	15,628	18,431	21,930	29,540	42,646
Federal Home Loan Mortgage Corporation	273,704	289,468	317,448	252,497	256,036
Federal National Mortgage Association	414,123	375,886	386,645	361,742	371,647
Total mortgage-backed securities available for sale	703,455	683,785	726,023	643,779	670,329
<b>Mortgage-Backed Securities Held to Maturity:</b>					
Federal Home Loan Mortgage Corporation	267	373	—	—	—
Federal National Mortgage Association	1,123	1,439	—	—	—
Non-agency	310	2,509	—	—	—
Total mortgage-backed securities held to maturity	1,700	4,321	—	—	—
<b>Total</b>	<b>\$ 989,652</b>	<b>\$ 716,133</b>	<b>\$ 764,206</b>	<b>\$ 732,648</b>	<b>\$ 893,122</b>

(1) As of June 30, 2008, 2007 and 2006, our mutual fund investment consisted of shares issued by the AMF Fund.

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The following table sets forth certain information regarding the carrying values, weighted average yields and maturities of our securities portfolio at June 30, 2010. This table shows contractual maturities and does not reflect re-pricing or the effect of prepayments. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without prepayment penalties. At June 30, 2010, securities with a carrying value of \$236.6 million are callable within one year.

	At June 30, 2010										
	One Year or Less		One to Five Years		Five to Ten Years		More Than Ten Years		Total Securities		
	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Market Value
	(Dollars in Thousands)										
Trust preferred securities	\$ —	—%	\$ —	—%	\$ —	—%	\$ 6,600	2.32%	\$ 6,600	2.32%	\$ 6,600
U.S. agency obligations	—	—%	200,000	1.82%	40,332	3.98%	18,610	4.15%	258,942	2.32%	260,850
Obligations of states and political subdivisions	—	—%	5,490	3.31%	13,250	3.54%	215	3.60%	18,955	3.47%	18,955
Mortgage-backed securities:											
Pass-through:											
Government National Mortgage Association	4	15.81%	119	12.01%	529	9.32%	14,976	5.42%	15,628	5.61%	15,628
Federal Home Loan Mortgage Corporation	9	7.70%	288	3.56%	35,413	4.69%	238,162	4.01%	273,872	4.10%	273,872
Federal National Mortgage Association	4,763	6.07%	4,857	6.21%	46,366	4.72%	358,493	4.31%	414,479	4.40%	414,480
Collateralized mortgage obligations:											
Federal Home Loan Mortgage Corporation	—	—%	—	—%	—	—%	99	9.48%	99	9.48%	110
Federal National Mortgage Association	—	—%	—	—%	—	—%	767	10.02%	767	10.02%	830
Non-agency	—	—%	—	—%	—	—%	310	4.45%	310	4.45%	260
Total	\$ 4,776	6.08%	\$ 210,754	1.97%	\$ 135,890	4.39%	\$ 638,232	4.20%	\$ 989,652	3.76%	\$ 991,620



## Sources of Funds

General. Deposits are our primary source of funds for lending and other investment purposes. In addition, we derive funds from loan and mortgage-backed securities principal repayments and proceeds from the maturities and calls of non-mortgage-backed securities. Loan and securities payments are a relatively stable source of funds, while deposit inflows are significantly influenced by general interest rates and money market conditions. Borrowings from the FHLB of New York are also used to supplement the funding for loans and investments.

Deposits. Our current deposit products include interest-bearing and non-interest-bearing checking accounts, money market deposit accounts, savings accounts and certificates of deposit accounts ranging in terms from 30 days to five years. Certificates of deposit with terms ranging from one year to five years are available for individual retirement account plans. Deposit account terms, such as interest rate earned, applicability of certain fees and service charges and funds accessibility, will vary based upon several factors including, but not limited to, minimum balance, term to maturity, and transaction frequency and form requirements.

Deposits are obtained primarily from within New Jersey. Traditional methods of advertising are used to attract new customers and deposits, including radio, print media, outdoor advertising, direct mail and inserts included with customer statements. We do not utilize the services of deposit brokers or Internet listing services. Premiums or incentives for opening accounts are sometimes offered. One of our key retail products in recent years has been “Star Banking”, which bundles a number of banking services and products together for those customers with a checking account with direct deposit and combined deposits of \$20,000 or more, including Internet banking, bill pay, telephone banking, reduced rates on home equity loans and a 25 basis point premium on certificates of deposit with a term of at least one year, excluding special promotions. During the latter half of fiscal 2010, we also began to offer “High Yield Checking” which is primarily designed to attract core deposits in the form of customers’ primary checking accounts through interest rate and fee reimbursement incentives to qualifying customers. The comparatively higher interest expense associated with the “High Yield Checking” product in relation to our other checking products is expected to be partially offset by an associated increase in transaction fee income.

We may also offer a 25 basis point premium on certificate of deposit accounts with a term of at least one year, excluding special promotions, to certificate of deposit account holders that have \$200,000 or more on deposit with the Bank. Though certificates of deposit with non-standard maturities are popular in our market, we generally promote certificates of deposit with traditional maturities, including three and six months and one, two, three and five years. During the term of our 17-month and 29-month certificates of deposit, we offer customers a “one-time option” to “step up” the rate paid from the original rate set on the certificate to the current rate being offered by the Bank for certificates of that particular maturity.

The determination of interest rates is based upon a number of factors, including: (1) our need for funds based on loan demand, current maturities of deposits and other cash flow needs; (2) a current survey of a selected group of competitors’ rates for similar products; (3) our current cost of funds, yield on assets and asset/liability position; and (4) the alternate cost of funds on a wholesale basis, in particular the cost of borrowing from the FHLB. Interest rates are reviewed by senior management on a weekly basis.

A large percentage of our deposits are in certificates of deposit, which represented 60.3% and 63.7% of total deposits at June 30, 2010 and June 30, 2009, respectively. Our liquidity could be reduced if a significant amount of certificates of deposit maturing within a short period were not renewed. At June 30, 2010 and June 30, 2009, certificates of deposit maturing within one year were \$716.3 million



and \$740.4 million, respectively. Historically, a significant portion of the certificates of deposit remain with us after they mature and we believe that this will continue. At June 30, 2010, \$333.4 million or 34.0% of our certificates of deposit were certificates of \$100,000 or more compared to \$275.9 million or 30.5% at June 30, 2009. The general level of market interest rates and money market conditions significantly influence deposit inflows and outflows. The effects of these factors are particularly pronounced on deposit accounts with larger balances. In particular, certificates of deposit with balances of \$100,000 or greater are traditionally viewed as being a more volatile source of funding than comparatively lower balance certificates of deposit or non-maturity transaction accounts. In order to retain certificates of deposit with balances of \$100,000 or more, we may have to pay a premium rate, resulting in an increase in our cost of funds. In a rising rate environment, we may be unwilling or unable to pay a competitive rate. To the extent that such deposits do not remain with us, they may need to be replaced with borrowings, which could increase our cost of funds and negatively impact our interest rate spread and our financial condition.

The following table sets forth the distribution of average deposits for the periods indicated and the weighted average nominal interest rates for each period on each category of deposits presented.

	For the Years Ended June 30,								
	2010			2009			2008		
	Average Balance	Percent of Total Deposits	Weighted Average Nominal Rate	Average Balance	Percent of Total Deposits	Weighted Average Nominal Rate	Average Balance	Percent of Total Deposits	Weighted Average Nominal Rate
(Dollars in Thousands)									
Non-interest-bearing demand	\$ 55,436	3.68%	0.00%	\$ 51,132	3.72%	0.00%	\$ 59,169	4.40%	0.00%
Interest-bearing demand	198,623	13.19	1.17	156,883	11.41	1.34	149,871	11.16	1.81
Savings and club	315,715	20.97	1.03	293,483	21.35	1.05	303,818	22.61	1.08
Certificates of deposit	935,684	62.16	2.41	873,257	63.52	3.50	830,726	61.83	4.49
Total deposits	\$ 1,505,458	100.00%	1.87%	\$ 1,374,755	100.00%	2.60%	\$ 1,343,584	100.00%	3.22%

The following table sets forth certificates of deposit classified by interest rate as of the dates indicated.

Interest Rate	At June 30,		
	2010	2009	2008
(In Thousands)			
0.00-0.99%	\$ 9,396	\$ 3,122	\$ -
1.00-1.99%	648,259	187,827	2,235
2.00-2.99%	206,791	182,588	91,937
3.00-3.99%	67,991	417,596	298,819
4.00-4.99%	40,482	106,994	473,649
5.00-5.99%	6,613	6,616	6,969
Total	\$ 979,532	\$ 904,743	\$ 873,609



The following table shows the amount of certificates of deposit of \$100,000 or more by time remaining until maturity as of the date indicated.

	At June 30, 2010 (In Thousands)	
Maturity Period		
Within three months	\$	95,275
Three through six months		58,154
Six through twelve months		77,862
Over twelve months		102,127
	\$	333,418

The following table sets forth the amount and maturities of certificates of deposit at June 30, 2010.

	Amount Due						Total
	Within 1 year	1-2 years	2-3 years	3-4 years	4-5 years	After 5 years	
	(In Thousands)						
0.00-0.99%	\$ 9,396	\$ —	\$ —	\$ —	\$ —	\$ —	9,396
1.00-1.99%	566,892	75,909	5,458	—	—	—	648,259
2.00-2.99%	69,359	80,848	39,411	2,016	15,157	—	206,791
3.00-3.99%	54,631	5,628	3,174	3,514	1,044	—	67,991
4.00-4.99%	16,011	8,981	15,486	—	3	1	40,482
5.00-5.99%	—	1,671	4,942	—	—	—	6,613
Total	\$ 716,289	\$ 173,037	\$ 68,471	\$ 5,530	\$ 16,204	\$ 1	\$ 979,532

**Borrowings.** To supplement our deposits as a source of funds for lending or investment, we borrow funds in the form of advances from the FHLB of New York. We make use of FHLB advances as part of our interest rate risk management, primarily to extend the duration of funding to match the longer-term fixed-rate loans and mortgage-backed securities.

Advances from the FHLB are typically secured by our FHLB capital stock and certain investment securities we choose to utilize as collateral for such borrowings. Additional information regarding our FHLB advances is included under Note 12 to consolidated financial statements.

Short-term FHLB advances generally have original maturities of less than one year. Typically, our short term advances are in the form of overnight borrowings. With no overnight advances drawn at June 30, 2010, our available overnight lines of credit at the FHLB totaled \$200.0 million as of that date.



Long term advances generally include term advances with original maturities of greater than one year. At June 30, 2010, our outstanding balance of long-term FHLB advances totaled \$210.0 million with a weighted average interest rate of 3.87%. Our long term advances mature as follows:

		(In Thousands)	
Maturing in Years Ending June 30,			
2011	\$	10,000	
2018		200,000	
Total	\$	210,000	

#### Subsidiary Activity

Kearny Financial Corp. has two wholly owned subsidiaries: Kearny Federal Savings Bank and Kearny Financial Securities, Inc.

Kearny Financial Securities, Inc. was organized in April 2005 under Delaware law as a Delaware Investment Company primarily to hold securities and mortgage-backed securities. At June 30, 2010, it held assets totaling \$8,081 and was considered inactive.

Kearny Federal Savings Bank has two wholly owned subsidiaries: KFS Financial Services, Inc. and KFS Investment Corp. A third subsidiary, Kearny Federal Investment Corp. was dissolved in fiscal 2008.

KFS Financial Services, Inc. was incorporated as a New Jersey corporation in 1994 under the name of South Bergen Financial Services, Inc., was acquired in Kearny's merger with South Bergen Savings Bank in 1999 and was renamed KFS Financial Services, Inc. in 2000. It is a service corporation subsidiary organized for selling insurance products, including annuities, to Bank customers and the general public through a third party networking arrangement. KFS Financial Services, Inc. is not a licensed insurance agency and it may only offer insurance products through an agreement with a licensed insurance agency. KFS Financial Services, Inc. has entered into an agreement with The Savings Bank Life Insurance Company of Massachusetts, a licensed insurance agency, through which it offers insurance products. At June 30, 2010, it held assets totaling \$311,313.

KFS Investment Corp. was organized in October 2007 under New Jersey law as a New Jersey Investment Company to potentially replace Kearny Federal Investment Corp. At June 30, 2010, KFS Investment Corp. held no assets and was considered inactive.

Kearny Federal Investment Corp. was organized in May 2004 under New Jersey law as a New Jersey Investment Company primarily to hold securities and mortgage-backed securities. In June 2008, Kearny Federal Investment Corp. was formally dissolved and its assets returned to its parent, Kearny Federal Savings Bank.

#### Personnel

As of June 30, 2010, we had 274 full-time employees and 11 part-time employees equating to a total of 280 full time equivalent ("FTE") employees. By comparison, at June 30, 2009, we had 263 full-time employees and 21 part-time employees equating to a total of 274 FTEs. The net increase in FTE's year-over-year was primarily attributable to the Bank's de novo branch opened during the first quarter of fiscal 2010 couple with staffing additions in the commercial lending area. Our employees are not represented by a collective bargaining unit and we consider our relationship with our employees to be good.



## REGULATION

The Bank and the Company operate in a highly regulated industry. This regulation establishes a comprehensive framework of activities in which a savings and loan holding company and federal savings bank may engage and is intended primarily for the protection of the deposit insurance fund and depositors. Set forth below is a brief description of certain laws that relate to the regulation of the Bank and the Company. The description does not purport to be complete and is qualified in its entirety by reference to applicable laws and regulations.

Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of an institution and its holding company, the classification of assets by the institution and the adequacy of an institution's allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, or legislation, including changes in the regulations governing mutual holding companies, could have a material adverse impact on the Company, the Bank and their operations. The adoption of regulations or the enactment of laws that restrict the operations of the Bank and/or the Company or impose burdensome requirements upon one or both of them could reduce their profitability and could impair the value of the Bank's franchise, resulting in negative effects on the trading price of the Company's common stock.

### Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was signed into law. The Dodd-Frank Act is intended to effect a fundamental restructuring of federal banking regulation. Among other things, the Dodd-Frank Act creates a new Financial Stability Oversight Council to identify systemic risks in the financial system and gives federal regulators new authority to take control of and liquidate financial firms. The Dodd-Frank Act eliminates our current primary federal regulator and subjects savings and loan holding companies to greater regulation. The Dodd-Frank Act additionally creates a new independent federal regulator to administer federal consumer protection laws. The Dodd-Frank Act is expected to have a significant impact on our business operations as its provisions take effect. Among the provisions that are likely to affect us are the following:

**Elimination of OTS.** The Dodd-Frank Act calls for the elimination of the OTS, which is our primary federal regulator and the primary federal regulator of the Bank within 12 to 18 months of enactment. At that time, the primary federal regulator of Kearny Financial Corp. will become the Board of Governors of the Federal Reserve System (the "Federal Reserve"), and the primary federal regulator for the Bank will become the Office of the Comptroller of the Currency ("OCC") if we retain our federal savings bank charter. The Federal Reserve and OCC will generally have rulemaking, examination, supervision and oversight authority over our operations and the FDIC will retain secondary authority over the Bank. Prior to the elimination of the OTS, the Federal Reserve and OCC will provide a list of the current regulations issued by the OTS that each will continue to apply. OTS guidance, orders, interpretations, policies and similar items under which we and other savings and loan holding companies and federal savings associations operate will continue to remain in effect until they are superseded by new guidance and policies from the OCC or Federal Reserve.

**New Limits on MHC Dividend Waivers.** Effective as of the date of transfer of OTS's duties, the Dodd-Frank Act will make significant changes in the law governing waivers of dividends by mutual holding companies. After that date, a mutual holding company may only waive the receipt of a dividend from a subsidiary if no insider of the mutual holding company or their associates or tax-qualified or non-tax-qualified employee stock benefit plan holds any shares of the class of stock to which the waiver



would apply, the mutual holding company gives written notice of its intent to waive the dividend at least 30 days prior to the proposed payment date and the Federal Reserve does not object. The Federal Reserve will not object to a dividend waiver if it determines that the waiver would not be detrimental to the safe and sound operation of the savings association, the mutual holding company's board determines that the waiver is consistent with its fiduciary duties and the mutual holding company has waived dividends prior to December 1, 2009. In addition, waived dividends must be taken into account in determining the appropriate exchange ratio for a second-step conversion of a mutual holding company unless the mutual holding company has waived dividends prior to December 1, 2009.

**Holding Company Capital Requirements.** Effective as of the transfer date, the Federal Reserve will be authorized to establish capital requirements for savings and loan holding companies. These capital requirements must be countercyclical so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, consistent with safety and soundness. Savings and loan holding companies will also be required to serve as a source of financial strength for their depository institution subsidiaries. Within five years after enactment, the Dodd-Frank Act requires the Federal Reserve to apply consolidated capital requirements that are no less stringent than those currently applied to depository institutions to depository institution holding companies that were not supervised by the Federal Reserve as of May 19, 2009. Under these standards, trust preferred securities will be excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by a bank or savings and loan holding company with less than \$15 billion in assets.

**Federal Preemption.** A major benefit of the federal thrift charter has been the strong preemptive effect of the Home Owners' Loan Act ("HOLA"), under which we are chartered. Historically, the courts have interpreted the HOLA to "occupy the field" with respect to the operations of federal thrifts, leaving no room for conflicting state regulation. The Dodd-Frank Act, however, amends the HOLA to specifically provide that it does not occupy the field in any area of state law. Henceforth, any preemption determination must be made in accordance with the standards applicable to national banks, which have themselves been scaled back to require case-by-case determinations of whether state consumer protection laws discriminate against national banks or interfere with the exercise of their powers before these laws may be pre-empted.

**Deposit Insurance.** The Dodd-Frank Act permanently increases the maximum deposit insurance amount for banks, savings institutions and credit unions to \$250,000 per depositor, retroactive to January 1, 2009, and extends unlimited deposit insurance to non-interest bearing transaction accounts through December 31, 2013. The Dodd-Frank Act also broadens the base for FDIC insurance assessments. Assessments will now be based on the average consolidated total assets less tangible equity capital of a financial institution. The Dodd-Frank Act requires the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. The Dodd-Frank Act eliminates the federal statutory prohibition against the payment of interest on business checking accounts.

**Qualified Thrift Lender Test.** Under the Dodd-Frank Act, a savings association that fails the qualified thrift lender test will be prohibited from paying dividends, except for dividends that: (i) would be permissible for a national bank; (ii) are necessary to meet obligations of a company that controls the savings association; and (iii) are specifically approved by the OCC and the Federal Reserve. In addition, a savings association that fails the qualified thrift lender test will be deemed to have violated Section 5 of the Home Owners' Loan Act and may become subject to enforcement actions thereunder.



Corporate Governance. The Dodd-Frank Act will require publicly traded companies to give stockholders a non-binding vote on executive compensation at their first annual meeting taking place six months after the date of enactment and at least every three years thereafter and on so-called “golden parachute” payments in connection with approvals of mergers and acquisitions. The new legislation also authorizes the SEC to promulgate rules that would allow stockholders to nominate their own candidates using a company’s proxy materials. Additionally, the Dodd-Frank Act directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of \$1.0 billion, regardless of whether the company is publicly traded or not. The Dodd-Frank Act gives the SEC authority to prohibit broker discretionary voting on elections of directors and executive compensation matters.

Transactions with Affiliates and Insiders. Effective one year from the date of enactment, the Dodd-Frank Act expands the definition of affiliate for purposes of quantitative and qualitative limitations of Section 23A of the Federal Reserve Act to include mutual funds advised by a depository institution or its affiliates. The Dodd-Frank Act will apply Section 23A and Section 22(h) of the Federal Reserve Act (governing transactions with insiders) to derivative transactions, repurchase agreements and securities lending and borrowing transaction that create credit exposure to an affiliate or an insider. Any such transactions with affiliates must be fully secured. The current exemption from Section 23A for transactions with financial subsidiaries will be eliminated. The Dodd-Frank Act will additionally prohibit an insured depository institution from purchasing an asset from or selling an asset to an insider unless the transaction is on market terms and, if representing more than 10% of capital, is approved in advance by the disinterested directors.

Consumer Financial Protection Bureau. The Dodd-Frank Act creates a new, independent federal agency called the Consumer Financial Protection Bureau (“CFPB”), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB will have examination and primary enforcement authority with respect to depository institutions with \$10 billion or more in assets. Smaller institutions will be subject to rules promulgated by the CFPB but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB will have authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower’s ability to repay. In addition, the Dodd-Frank Act will allow borrowers to raise certain defenses to foreclosure if they receive any loan other than a “qualified mortgage” as defined by the CFPB. The Dodd-Frank Act permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations. Federal preemption of state consumer protection law requirements, traditionally an attribute of the federal savings association charter, has also been modified by the Dodd-Frank Act and now requires a case-by-case determination of preemption by the OCC and eliminates preemption for subsidiaries of a bank. Depending on the implementation of this revised federal preemption standard, the operations of the Bank could become subject to additional compliance burdens in the states in which it operates.

#### Regulation of the Bank

General. As a federally chartered, Federal Deposit Insurance Corporation-insured savings bank, the Bank is subject to extensive regulation by the OTS and the FDIC. This regulatory structure gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities





and examination policies, including policies regarding the classification of assets and the level of the allowance for loan losses. The activities of federal savings banks are subject to extensive regulation including restrictions or requirements with respect to loans to one borrower, the percentage of non-mortgage loans or investments to total assets, capital distributions, permissible investments and lending activities, liquidity, transactions with affiliates and community reinvestment. Federal savings banks are also subject to reserve requirements imposed by the Board of Governors of the Federal Reserve System. Both state and federal law regulate a federal savings bank's relationship with its depositors and borrowers, especially in such matters as the ownership of savings accounts and the form and content of the bank's mortgage documents.

The Bank must file reports with the OTS concerning its activities and financial condition and must obtain regulatory approvals prior to entering into certain transactions such as mergers with or acquisitions of other financial institutions. The OTS regularly examines the Bank and prepares reports to the Bank's Board of Directors on deficiencies, if any, found in its operations. The OTS has substantial discretion to impose enforcement action on an institution that fails to comply with applicable regulatory requirements, particularly with respect to its capital requirements. In addition, the FDIC has the authority to recommend to the Director of the OTS to take enforcement action with respect to a particular federally chartered savings bank and, if the Director does not take action, the FDIC has authority to take such action under certain circumstances.

Federal Deposit Insurance. The Bank's deposits are insured to applicable limits by the FDIC. The maximum deposit insurance amount has been permanently increased from \$100,000 to \$250,000 under the Dodd-Frank Wall Street Reform and Consumer Protection Act. On October 13, 2008, the FDIC established a Temporary Liquidity Guarantee Program under which the FDIC fully guarantees all non-interest-bearing transaction accounts until December 31, 2009 (the "Transaction Account Guarantee Program") and all senior unsecured debt of insured depository institutions or their qualified holding companies issued between October 14, 2008 and June 30, 2009, with the FDIC's guarantee expiring by June 30, 2012 (the "Debt Guarantee Program"). Senior unsecured debt would include federal funds purchased and certificates of deposit standing to the credit of the bank. After November 12, 2008, institutions that did not opt out of the Programs by December 5, 2008 were assessed at the rate of ten basis points for transaction account balances in excess of \$250,000 and at a rate between 50 and 100 basis points of the amount of debt issued. In May, 2009, the Debt Guarantee Program issue end date and the guarantee expiration date were both extended, to October 31, 2009 and December 31, 2012, respectively. Participating holding companies that have not issued FDIC-guaranteed debt prior to April 1, 2009 had to apply to remain in the Debt Guarantee Program. Participating institutions will be subject to surcharges for debt issued after that date. Effective October 1, 2009, the Transaction Account Guarantee Program has been extended until December 31, 2010, with an assessment of between 15 and 25 basis points after January 1, 2010. The Company and the Bank did not opt out of the Debt Guarantee Program. The Bank did not opt out of the original Transaction Account Guarantee Program, but did opt out of its extension. The Dodd-Frank Act has extended unlimited deposit insurance to non-interest-bearing transaction accounts until December 31, 2013.

The FDIC has adopted a risk-based premium system that provides for quarterly assessments based on an insured institution's ranking in one of four risk categories based on their examination ratings and capital ratios. Well-capitalized institutions with the CAMELS ratings of 1 or 2 are grouped in Risk Category I and, until 2009, were assessed for deposit insurance at an annual rate of between five and seven basis points with the assessment rate for an individual institution determined according to a formula based on a weighted average of the institution's individual CAMELS component ratings plus either five financial ratios or the average ratings of its long-term debt. Institutions in Risk Categories II, III and IV were assessed at annual rates of 10, 28 and 43 basis points, respectively.

Pursuant to the Federal Deposit Insurance Reform Act of 2005 (the “Reform Act”), the FDIC is authorized to set the reserve ratio for the Deposit Insurance Fund annually at between 1.15% and 1.5% of estimated insured deposits. Due to recent bank failures, the FDIC determined that the reserve ratio was 1.01% as of June 30, 2008. In accordance with the Reform Act, as amended by the Helping Families Save Their Home Act of 2009, the FDIC has established and implemented a plan to restore the reserve ratio to 1.15% within eight years. For the quarter beginning January 1, 2009, the FDIC raised the base annual assessment rate for institutions in Risk Category I to between 12 and 14 basis points while the base annual assessment rates for institutions in Risk Categories II, III and IV were increased to 17, 35 and 50 basis points, respectively. For the quarter beginning April 1, 2009 the FDIC set the base annual assessment rate for institutions in Risk Category I to between 12 and 16 basis points and the base annual assessment rates for institutions in Risk Categories II, III and IV at 22, 32 and 45 basis points, respectively. An institution’s assessment rate could be lowered by as much as five basis points based on the ratio of its long-term unsecured debt to deposits or, for smaller institutions based on the ratio of certain amounts of Tier 1 capital to adjusted assets. The assessment rate may be adjusted for Risk Category I institutions that have a high level of brokered deposits and have experienced higher levels of asset growth (other than through acquisitions) and could be increased by as much as ten basis points for institutions in Risk Categories II, III and IV whose ratio of brokered deposits to deposits exceeds 10%. Reciprocal deposit arrangements like CDARS® were treated as brokered deposits for Risk Category II, III and IV institutions but not for institutions in Risk Category I. An institution’s base assessment rate would also be increased if an institution’s ratio of secured liabilities (including FHLB advances and repurchase agreements) to deposits exceeds 25%. The maximum adjustment for secured liabilities for institutions in Risk Categories I, II, III and IV would be 8, 11, 16 and 22.5 basis points, respectively, provided that the adjustment may not increase an institution’s base assessment rate by more than 50%.

The FDIC imposed a special assessment equal to five basis points of assets less Tier 1 capital as of June 30, 2009, payable on September 30, 2009, and reserved the right to impose additional special assessments. In November, 2009, instead of imposing additional special assessments, the FDIC amended the assessment regulations to require all insured depository institutions to prepay their estimated risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012 on December 30, 2009. For purposes of estimating the future assessments, each institution’s base assessment rate in effect on September 30, 2009 was used, assuming a 5% annual growth rate in the assessment base and a 3 basis point increase in the assessment rate in 2011 and 2012. The prepaid assessment will be applied against actual quarterly assessments until exhausted. Any funds remaining after June 30, 2013 will be returned to the institution. If the prepayment would impair an institution’s liquidity or otherwise create significant hardship, it may apply for an exemption. Requiring this prepaid assessment does not preclude the FDIC from changing assessment rates or from further revising the risk-based assessment system.

In addition, all FDIC-insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation (“FICO”), an agency of the Federal government established to recapitalize the Federal Savings and Loan Insurance Corporation. The FICO assessment rates, which are determined quarterly, averaged .01% of insured deposits on an annualized basis in fiscal year 2010. These assessments will continue until the FICO bonds mature in 2017.

**Regulatory Capital Requirements.** The OTS capital regulations require savings institutions to meet three minimum capital standards: (1) tangible capital equal to 1.5% of total adjusted assets, (2) “Tier 1” or “core” capital equal to at least 4% of total adjusted assets and (3) risk-based capital equal to 8% of total risk-weighted assets. For information on the Bank’s compliance with these regulatory capital standards, see Note 14 to consolidated financial statements. In assessing an institution’s capital adequacy, the OTS takes into consideration not only these numeric factors but also qualitative factors as well and has the authority to establish higher capital requirements for individual institutions where necessary.



In addition, the OTS may require that a savings institution that has a risk-based capital ratio of less than 8%, a ratio of Tier 1 capital to risk-weighted assets of less than 4% or a ratio of Tier 1 capital to total adjusted assets of less than 4% take certain action to increase its capital ratios. If the savings institution's capital is significantly below the minimum required levels of capital or if it is unsuccessful in increasing its capital ratios, the OTS may restrict its activities.

For purposes of the OTS capital regulations, tangible capital is defined as core capital less all intangible assets except for certain mortgage servicing rights. Tier 1 or core capital is defined as common stockholders' equity, non-cumulative perpetual preferred stock and related surplus, minority interests in the equity accounts of consolidated subsidiaries and certain non-withdrawable accounts and pledged deposits of mutual savings banks. The Bank does not have any non-withdrawable accounts or pledged deposits. Tier 1 and core capital are reduced by an institution's intangible assets, with limited exceptions for certain mortgage and non-mortgage servicing rights and purchased credit card relationships. Both core and tangible capital are further reduced by an amount equal to the savings institution's debt and equity investments in "non-includable" subsidiaries engaged in activities not permissible for national banks other than subsidiaries engaged in activities undertaken as agent for customers or in mortgage banking activities and subsidiary depository institutions or their holding companies.

The risk-based capital standard for savings institutions requires the maintenance of total capital of 8% of risk-weighted assets. Total capital equals the sum of core and supplementary capital. The components of supplementary capital include, among other items, cumulative perpetual preferred stock, perpetual subordinated debt, mandatory convertible subordinated debt and intermediate-term preferred stock, the portion of the allowance for loan losses not designated for specific loan losses and up to 45% of unrealized gains on equity securities. The portion of the allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, supplementary capital is limited to 100% of core capital. For purposes of determining total capital, a savings institution's assets are reduced by the amount of capital instruments held by other depository institutions pursuant to reciprocal arrangements and by the amount of the institution's equity investments (other than those deducted from core and tangible capital) and its high loan-to-value ratio land loans and commercial construction loans.

A savings institution's risk-based capital requirement is measured against risk-weighted assets, which equal the sum of each on-balance-sheet asset and the credit-equivalent amount of each off-balance-sheet item after being multiplied by an assigned risk weight. These risk weights generally range from 0% for cash to 100% for delinquent loans, property acquired through foreclosure, commercial loans and certain other assets.

**Dividend and Other Capital Distribution Limitations.** The OTS imposes various restrictions or requirements on the ability of savings institutions to make capital distributions, including cash dividends. A savings institution that is a subsidiary of a savings and loan holding company, such as the Bank, must file an application or a notice with the OTS at least thirty days before making a capital distribution, such as paying a dividend to the Company. A savings institution must file an application for prior approval of a capital distribution if: (i) it is not eligible for expedited treatment under the applications processing rules of the OTS; (ii) the total amount of all capital distributions, including the proposed capital distribution, for the applicable calendar year would exceed an amount equal to the savings institution's net income for that year to date plus the institution's retained net income for the preceding two years; (iii) it would not adequately be capitalized after the capital distribution; or (iv) the distribution would violate an agreement with the OTS or applicable regulations.

The OTS may disapprove a notice or deny an application for a capital distribution if: (i) the savings institution would be undercapitalized following the capital distribution; (ii) the proposed capital distribution raises safety and soundness concerns; or (iii) the capital distribution would violate a prohibition contained in any statute, regulation or agreement.

During the fiscal year ended June 30, 2008, the Bank applied for and received the approval from the OTS to distribute \$19,000,000 to the Company. A cash dividend in that amount was paid by the Bank to the Company in November, 2007. During the fiscal year ended June 30, 2010, a second application for a capital distribution from the Bank to the Company was approved by the OTS in the amount of \$6,000,000. A cash dividend in that amount was paid by the Bank to the Company in December, 2009. During the more recent approval process, the OTS noted that future dividend requests will require closer scrutiny by the OTS due to the deteriorated economic conditions and level of uncertainty that characterize the current marketplace coupled with the Bank's compressed level of earnings in recent years.

**Qualified Thrift Lender Test.** Federal savings institutions must meet a qualified thrift lender test or they become subject to the business activity restrictions and branching rules applicable to national banks. To qualify as a qualified thrift lender, a savings institution must either (i) be deemed a "domestic building and loan association" under the Internal Revenue Code by maintaining at least 60% of its total assets in specified types of assets, including cash, certain government securities, loans secured by and other assets related to residential real property, educational loans and investments in premises of the institution or (ii) satisfy the statutory qualified thrift lender test set forth in the Home Owners' Loan Act by maintaining at least 65% of its portfolio assets in qualified thrift investments (defined to include residential mortgages and related equity investments, certain mortgage-related securities, small business loans, student loans and credit card loans). For purposes of the statutory qualified thrift lender test, portfolio assets are defined as total assets minus goodwill and other intangible assets, the value of property used by the institution in conducting its business and specified liquid assets up to 20% of total assets. A savings institution must maintain its status as a qualified thrift lender on a monthly basis in at least nine out of every twelve months.

A savings bank that fails the qualified thrift lender test and does not convert to a bank charter generally will be prohibited from: (1) engaging in any new activity not permissible for a national bank; (2) paying dividends not permissible under national bank regulations; and (3) establishing any new branch office in a location not permissible for a national bank in the institution's home state. In addition, if the institution does not requalify under the qualified thrift lender test within three years after failing the test, the institution would be prohibited from engaging in any activity not permissible for a national bank and would have to repay any outstanding advances from the FHLB as promptly as possible.

**Community Reinvestment Act.** Under the CRA, every insured depository institution, including the Bank, has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community. The CRA requires the OTS to assess the depository institution's record of meeting the credit needs of its community and to consider such record in its evaluation of certain applications by such institution, such as a merger or the establishment of a branch office by the Bank. The OTS may use an unsatisfactory CRA examination rating as the basis for the denial of an application. The Bank received a satisfactory CRA rating in its most recent CRA examination by the OTS.

**Federal Home Loan Bank System.** The Bank is a member of the FHLB of New York, which is one of twelve regional Federal Home Loan Banks. Each FHLB serves as a reserve or central bank for its



members within its assigned region. It is funded primarily from funds deposited by financial institutions and proceeds derived from the sale of consolidated obligations of the FHLB System. It makes loans to members pursuant to policies and procedures established by the board of directors of the FHLB.

As a member, the Bank is required to purchase and maintain stock in the FHLB of New York in an amount equal to the greater of 1% of our aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year or 5% of our outstanding FHLB advances. The FHLB imposes various limitations on advances such as limiting the amount of certain types of real estate related collateral to 30% of a member's capital and limiting total advances to a member.

The Federal Home Loan Banks are required to provide funds for the resolution of troubled savings institutions and to contribute to affordable housing programs through direct loans or interest subsidies on advances targeted for community investment and low- and moderate-income housing projects. These contributions have adversely affected the level of FHLB dividends paid and could continue to do so in the future. In addition, these requirements could result in the Federal Home Loan Banks imposing a higher rate of interest on advances to their members.

The USA Patriot Act. The Bank is subject to the OTS regulations implementing the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, or the USA Patriot Act. The USA Patriot Act gives the federal government powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. By way of amendments to the Bank Secrecy Act, Title III of the USA Patriot Act takes measures intended to encourage information sharing among bank regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative obligations on a broad range of financial institutions, including banks, thrifts, brokers, dealers, credit unions, money transfer agents and parties registered under the Commodity Exchange Act.

Among other requirements, Title III of the USA Patriot Act and the related regulations of the OTS impose the following requirements with respect to financial institutions:

- Establishment of anti-money laundering programs that include, at minimum: (i) internal policies, procedures and controls; (ii) specific designation of an anti-money laundering compliance officer; (iii) ongoing employee training programs; and (iv) an independent audit function to test the anti-money laundering program.
- Establishment of a program specifying procedures for obtaining identifying information from customers seeking to open new accounts, including verifying the identity of customers within a reasonable period.
- Establishment of appropriate, specific and, where necessary, enhanced due diligence policies, procedures and controls designed to detect and report money laundering.
- Prohibitions on establishing, maintaining, administering or managing correspondent accounts for foreign shell banks (foreign banks that do not have a physical presence in any country) and compliance with certain record keeping obligations with respect to correspondent accounts of foreign banks.

Bank regulators are directed to consider a holding company's effectiveness in combating money laundering when ruling on Federal Reserve Act and Bank Merger Act applications.

## Regulation of the Company

**General.** The Company is a savings and loan holding company within the meaning of Section 10 of the Home Owners' Loan Act. It is required to file reports with the OTS and is subject to regulation and examination by the OTS. The Company must also obtain regulatory approval from the OTS before engaging in certain transactions, such as mergers with or acquisitions of other financial institutions. In addition, the OTS has enforcement authority over the Company and any non-savings institution subsidiaries. This permits the OTS to restrict or prohibit activities that it determines to be a serious risk to the Bank. This regulation is intended primarily for the protection of the depositors and not for the benefit of stockholders of the Company.

**Activities Restrictions.** As a savings and loan holding company and as a subsidiary holding company of a mutual holding company, the Company is subject to statutory and regulatory restrictions on its business activities. The non-banking activities of the Company and its non-savings institution subsidiaries are restricted to certain activities specified by the OTS regulation, which include performing services and holding properties used by a savings institution subsidiary, activities authorized for savings and loan holding companies as of March 5, 1987 and non-banking activities permissible for bank holding companies pursuant to the Bank Holding Company Act of 1956 or authorized for financial holding companies pursuant to the Gramm-Leach-Bliley Act. Before engaging in any non-banking activity or acquiring a company engaged in any such activities, the Company must file with the OTS either a prior notice or (in the case of non-banking activities permissible for bank holding companies) an application regarding its planned activity or acquisition.

**Mergers and Acquisitions.** The Company must obtain approval from the OTS before acquiring, directly or indirectly, more than 5% of the voting stock of another savings institution or savings and loan holding company or acquiring such an institution or holding company by merger, consolidation, or purchase of its assets. Federal law also prohibits a savings and loan holding company from acquiring more than 5% of a company engaged in activities other than those authorized for savings and loan holding companies by federal law; or acquiring or retaining control of a depository institution that is not insured by the FDIC. In evaluating an application for the Company to acquire control of a savings institution, the OTS would consider the financial and managerial resources and future prospects of the Company and the target institution, the effect of the acquisition on the risk to the insurance funds, the convenience and the needs of the community and competitive factors.

On May 25, 2010, the Company announced its proposed acquisition of Central Jersey Bancorp (NASDAQ: CJBK) based in Monmouth County, NJ. The transaction is subject to the approval of both companies' primary regulators as well as the shareholders of Central Jersey Bancorp. Merger applications have been filed with each regulator as of the issuance date of this report and are under review. Subject to the requisite approvals, the transaction is expected to close during the Company's second fiscal quarter ending December 31, 2010.

**Waivers of Dividends by Kearny MHC.** The OTS regulations require the MHC to notify the OTS of any proposed waiver of its receipt of dividends from the Company. The OTS reviews dividend waiver notices on a case-by-case basis and, in general, does not object to any such waiver if: (i) the mutual holding company's board of directors determines that such waiver is consistent with such directors' fiduciary duties to the mutual holding company's members and (ii) the waiver would not be detrimental to the safe and sound operations of the subsidiary savings association.

During the year ended June 30, 2010, the MHC waived its right, upon non-objection from the OTS, to receive cash dividends of \$9.9 million declared during the year.





Conversion of the MHC to Stock Form. The OTS regulations permit the MHC to convert from the mutual form of organization to the capital stock form of organization, commonly referred to as a second step conversion. In a second step conversion a new holding company would be formed as the successor to the Company, the MHC's corporate existence would end and certain depositors of the Bank would receive the right to subscribe for shares of the new holding company. In a second step conversion, each share of common stock held by stockholders other than the MHC would be automatically converted into a number of shares of common stock of the new holding company determined pursuant to an exchange ratio that ensures that the Company's stockholders own the same percentage of common stock in the new holding company as they owned in the Company immediately prior to the second step conversion. Under the OTS regulations, the Company's stockholders would not be diluted because of any dividends waived by the MHC (and waived dividends would not be considered in determining an appropriate exchange ratio), in the event the MHC converts to stock form. The total number of shares held by the Company's stockholders after a second step conversion also would be increased by any purchases by the Company's stockholders in the stock offering of the new holding company conducted as part of the second step conversion.

Acquisition of Control. Under the federal Change in Bank Control Act, a notice must be submitted to the OTS if any person (including a company), or group acting in concert, seeks to acquire "control" of a savings and loan holding company or savings association. An acquisition of "control" can occur upon the acquisition of 10% or more of the voting stock of a savings and loan holding company or savings institution or as otherwise defined by the OTS. Under the Change in Bank Control Act, the OTS has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the anti-trust effects of the acquisition. Any company that so acquires control is then subject to regulation as a savings and loan holding company.

#### Item 1A. Risk Factors

The following is a summary of what management, in its opinion, currently believes to be the material risks related to an investment in the Company's securities.

We may not realize the anticipated benefits from our proposed acquisition of Central Jersey Bancorp.

On May 25, 2010, we 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 immediately thereafter, Central Jersey Bank will merge with and into the Bank. The acquisition of Central Jersey is anticipated to strengthen our market position in Monmouth and Ocean Counties and increase our profitability by increasing our commercial loan portfolio. The success of this transaction, however, will depend on, among other things, our ability to realize anticipated cost savings and to combine the businesses of the Bank and Central Jersey Bank in a manner that permits growth opportunities and does not materially disrupt the existing customer relationships of Central Jersey Bank nor result in decreased revenues resulting from any loss of customers. If we are not able to successfully achieve these objectives, the anticipated benefits of the merger may not be realized fully or at all or may take longer to realize than expected.

Kearny Financial Corp. and Central Jersey have operated and, until the completion of the transactions, will continue to operate, independently. Certain Central Jersey employees may not be employed by us after the transaction. In addition, Central Jersey employees that we wish to retain may elect to terminate their employment as a result of the acquisition, which could delay or disrupt the



integration process. It is possible that the integration process could result in the disruption of Central Jersey's ongoing businesses or inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with customers and employees or to achieve the anticipated benefits of the acquisition.

Recent negative developments in the financial services industry and the domestic and international credit markets may continue to adversely affect our operations and results.

Negative developments in the global credit and securitization markets during the latter half of 2007 and 2008 have resulted in uncertainty and volatility in U.S. financial markets that contributed significantly to the general economic downturn which has continued throughout fiscal 2009 and 2010. Asset quality has deteriorated at many financial institutions resulting in additional loan loss provisions and increased recognition of impairments in securities portfolios. In particular, the continuing decline in the value of real estate collateral supporting many commercial and residential mortgage loans has contributed significantly to these results. The effects of declining real estate values on asset quality has been exacerbated by rising unemployment resulting in increased levels of loan delinquencies, foreclosures and bankruptcies. These factors affecting the general marketplace have had an adverse impact on the Company's earnings and operations through an increase in the level of nonperforming loans and associated provisions to the allowance for loan losses. The Company also recognized other-than-temporary security impairments recorded through earnings and other comprehensive income generally attributable to these same factors. Moreover, the Company has recognized additional FDIC insurance costs resulting from the agency's need to replenish the fund for charges associated with recent bank failures.

In general, thrift and thrift holding company stock prices have been negatively affected, as has their general ability to raise capital or borrow in the debt markets. The potential exists for new federal or state laws and regulations regarding lending and funding practices, liquidity standards, and minimum capital levels.

Continued negative developments in the financial services industry and the domestic and international credit markets, and the impact of new legislation in response to those developments, may negatively impact our operations by restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance. In addition, the adverse economic conditions noted earlier could continue to adversely affect the performance and value of our loan and investment portfolios which would also negatively affect our financial performance.

Changes in interest rates may adversely affect our net interest rate spread and net interest margin, which would hurt our earnings.

We derive our income mainly from the difference or "spread" between the interest earned on loans, securities and other interest-earning assets and interest paid on deposits, borrowings and other interest-bearing liabilities. In general, the larger the spread, the more we earn. When market rates of interest change, the interest we receive on our assets and the interest we pay on our liabilities will fluctuate. This can cause decreases in our spread and can adversely affect our income.

From an interest rate risk perspective, the Company has generally been liability sensitive, which indicates that liabilities generally re-price faster than assets. The timing mismatch of the re-price of interest-earning assets and interest-bearing liabilities is referred to as the gap position. The most common measurement interval is one year. At June 30, 2010, the Company's one-year gap position was +0.91%

and at June 30, 2009 it was -5.17%. During the fiscal year it fluctuated from -8.46% at September 30, 2009 to -4.71% at December 31, 2009 to -4.76% at March 31, 2010. The improvement in the one-year gap position resulted in part, from customers extending the maturities of their certificates of deposit during fiscal 2010. Additionally, the expectation for higher mortgage prepayment speeds associated with the continued reduction of market interest rates has increased the forecasted level of incoming cash flows from loans within the one year time horizon. Together, these factors have improved the "mismatch" between the dollar amount of assets and liabilities that are re-pricing within a one year interval at June 30, 2010 from June 30, 2009.

In response to negative economic developments, the Federal Open Market Committee has steadily reduced its federal funds rate target from 5.25% in September 2007 to between 0.00% and 0.25% currently which has had the effect of reducing our cost of funds. However, the benefits to earnings arising from the reduction in our cost of interest-cost liabilities have been partially offset by reduced yields on the Company's interest-earning assets. Notwithstanding reduced yields on interest-earning assets, the Company's net interest rate spread and margin improved from 2.25% to 2.45% and 2.81% to 2.83%, respectively, year-over-year.

The improvements in the Company's net interest income and the associated net interest spread and margin are indicative of its overall level of liability sensitivity which has generally proven to be beneficial to net interest income during fiscal 2010. However, the Company's liability sensitivity may adversely effect net income and earnings in the future when market interest rates ultimately increase from their historical lows and the its cost of interest-bearing liabilities rises faster than its yield on interest-earning assets.

As of June 30, 2010, \$716.3 million or 73.1% of our certificates of deposit mature within one year. During the year ending June 30, 2011, \$200.0 million of FHLB advances are callable, but based on the interest rate environment as of June 30, 2010 it appears unlikely that they will be called. With respect to re-pricing assets, at June 30, 2010, the Company maintained balances of short term, liquid assets of \$181.4 million. During the year ending June 30, 2011, \$21.1 million of loans will reach their contractual maturity dates. The effect of subsequent interest rate changes will be reflected in the re-pricing of \$106.0 million of loans maturing after June 30, 2011 and mortgage-backed securities and non-mortgage-backed securities with floating or adjustable rates with amortized costs of \$177.1 million.

Interest rates also affect how much money we lend. For example, when interest rates rise, the cost of borrowing increases and loan originations tend to decrease. In addition, changes in interest rates can affect the average life of loans and securities. A reduction in interest rates generally results in increased prepayments of loans and mortgage-backed securities, as borrowers refinance their debt in order to reduce their borrowing cost. This causes reinvestment risk, because we generally are not able to reinvest prepayments at rates that are comparable to the rates we earned on the prepaid loans or securities. Changes in market interest rates could also reduce the value of our financial assets. If we are unsuccessful in managing the effects of changes in interest rates, our financial condition and profitability could suffer.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings will decrease.

We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the required amount of the allowance for loan losses, we evaluate certain loans individually and establish specific loan loss allowances for identified impairments. For all non-impaired loans, including those not individually reviewed, we

estimate losses and establish general loan loss allowances based upon historical and environmental loss factors. If the assumptions used in our calculation methodology are incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in further additions to our allowance. While our allowance for loan losses was 0.84% of total loans at June 30, 2010, significant additions to our allowance could materially decrease our net income.

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

We may be required to record additional impairment charges with respect to our investment securities portfolio.

We review our securities portfolio at the end of each quarter to determine whether the fair value is below the current carrying value. When the fair value of any of our investment securities has declined below its carrying value, we are required to assess whether the impairment is other than temporary. If we conclude that the impairment is other than temporary, we are required to write down the value of that security. The "credit-related" portion of the impairment is recognized through earnings whereas the "noncredit-related" portion is generally recognized through other comprehensive income in the circumstances where the future sale of the security is unlikely. During the year ended June 30, 2008, we determined that the decline in the fair value of our investment in the AMF Fund was other-than-temporary and recorded a pre-tax impairment charge of approximately \$659,000 on this investment. Due to continuing declines in the value of this Fund, we decided to invoke the payment-in-kind redemption option (which was the only redemption option available) on this Fund during the quarter ended September 30, 2008 and received \$1.4 million in cash and \$6.0 million in mortgage-backed securities including \$4.6 million in non-agency collateralized mortgage obligations that we carry as held to maturity. During the remainder of fiscal 2009, we recognized pre-tax other-than-temporary impairment charges of \$988,000 on these non-agency securities of which \$714,000 was recognized in earnings and \$274,000 was recorded in other comprehensive income. During the first three quarters of fiscal 2010, we recognized an additional \$446,000 of other-than temporary impairment charges relating to these same securities of which \$206,000 was recognized through earnings while \$240,000 was recorded through other comprehensive income. All other-than-temporarily impaired securities were subsequently sold during the fourth quarter of fiscal 2010.

At June 30, 2010, we had investment securities with fair values of approximately \$11.1 million of which we had approximately \$2.4 million in gross unrealized losses. All unrealized losses on investment securities at June 30, 2010 represented temporary impairments of value. However, if changes in the expected cash flows of these securities and/or prolonged price declines result in our concluding in future periods that the impairment of these securities is other than temporary, we will be required to record an impairment charge against income equal to the credit-related impairment.

Strong competition within our market area may limit our growth and profitability.

Competition is intense within the banking and financial services industry in New Jersey. In our market area, we compete with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies, brokerage and investment banking firms operating locally and elsewhere. Many of these competitors have substantially greater resources, higher lending limits and offer services that we do not or cannot provide. This competition makes it more difficult for us to originate new loans and retain and attract new deposits. Price competition for loans



may result in originating fewer loans, or earning less on our loans and price competition for deposits may result in a reduction of our deposit base or paying more on our deposits.

Our business is geographically concentrated in New Jersey and a downturn in economic conditions within the state could adversely affect our profitability.

A substantial majority of our loans are to individuals and businesses in New Jersey. The decline in the economy of the state could continue to have an adverse impact on our earnings. We have a significant amount of real estate mortgages, such that continuing decreases in local real estate values may adversely affect the value of property used as collateral. Adverse changes in the economy may also have a negative effect on the ability of our borrowers to make timely repayments of their loans, which may adversely influence our profitability.

Our return on equity compares unfavorably to other companies. This could negatively influence the price of our stock.

The net proceeds from our initial public offering in February 2005 substantially increased our equity capital. We expect to take time to invest this capital prudently. As a result, our return on equity, which is the ratio of earnings divided by average equity capital, is lower than that of many similar companies. To the extent that the stock market values a company based, in part, on its return on equity, our low return on equity relative to our peer group could negatively affect the trading price of our common stock. During the year ended June 30, 2010, there was ongoing evaluation and implementation of growth and diversification strategies related to execution of the Company's business plan. The Company expects to continue these efforts to grow and diversify the balance sheet with the goals of improving profitability.

The costs of our stock compensation plans are a significant expense and funding of the plans may dilute shareholders' ownership interest in Kearny Financial Corp.

Effective upon completion of the Company's initial public offering, the Bank established an Employee Stock Ownership Plan ("ESOP"). We currently recognize compensation expense for the ESOP as shares are committed for release to the participants' accounts each month based on the monthly average market price of the shares. We currently recognize additional annual employee compensation and benefit expenses and directors' compensation expense stemming from stock options granted and restricted stock awarded to directors and officers under the 2005 Stock Compensation and Incentive Plan. We expense the fair value of all options over their vesting periods and the fair value of restricted shares over the requisite service periods, in both cases five years. These additional expenses adversely affect our profitability and stockholders' equity.

The Company utilized open market purchases of common stock to fund restricted stock awards; however, the Company expects to fund stock options exercised through the issuance of shares from the Company's treasury account. Existing shareholders will experience a dilution in ownership interest in the event the Company relies on the issuance of shares from the Company's treasury account or from the issuance of authorized but un-issued shares rather than open market purchases to fund stock options.

Shareholders own a minority of Kearny Financial Corp.'s common stock and are not able to exercise voting control over most matters put to a vote of stockholders.

Kearny MHC owns a majority of Kearny Financial Corp.'s common stock, 74.5% at June 30, 2010 and is able to exercise voting control over most matters put to a vote of shareholders, including the election of directors. Kearny MHC may also exercise its voting control to prevent a sale or merger





transaction in which stockholders could receive a premium for their shares. The Board of Directors of Kearny MHC is also the Board of Directors of Kearny Financial Corp.

The Office of Thrift Supervision's policy on remutualization transactions could prohibit acquisition of Kearny Financial Corp., which may adversely affect our stock price.

The OTS regulations permit the acquisition of a mutual holding company by a mutual institution in a remutualization transaction. Current OTS policy, however, views remutualization transactions as raising significant issues concerning disparate treatment of minority stockholders and mutual members of the target entity and raising issues concerning the effect on the mutual members of the acquiring entity. The OTS may give these issues special scrutiny and reject applications providing for the remutualization of a mutual holding company unless the applicant can clearly demonstrate that there is no cause for OTS's concerns in the particular case. Should the OTS prohibit or otherwise restrict these transactions in the future, our stock price may be adversely affected.

Recently enacted financial reform legislation could substantially increase our compliance burden and costs and necessitate changes in the conduct of our business.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was signed into law. The Dodd-Frank Act will have a broad impact on the financial services industry, including significant regulatory and compliance changes. Many of the requirements called for in the Dodd-Frank Act will be implemented over time and most will be subject to implementing regulations over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on our operations is unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business. In particular, the following provisions of the Dodd-Frank Act, among others, are expected to impact our operations and activities, both currently and prospectively:

- Elimination of the OTS as our primary federal regulator, which may require us to adapt to a new regulatory regime;
  - New requirements for waivers of dividends by Kearny MHC, which could affect our dividend policies;
- Weakening of federal preemption standards applicable to Kearny Federal Savings Bank, which could expose us to state regulation;
- Changes in methodologies for calculating deposit insurance premiums and increases in required deposit insurance fund reserve levels, which could increase our deposit insurance expense;
  - Application of regulatory capital requirements to Kearny Financial Corp.; and
- Imposition of comprehensive, new consumer protection requirements, which could substantially increase our compliance burden and potentially expose us to new liabilities.

Further, we may be required to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements under the Dodd-Frank Act. Failure to comply with the new requirements may negatively impact our results of operations and financial condition. While we cannot predict what effect any presently contemplated or future



changes in the laws or regulations or their interpretations would have on us, these changes could be materially adverse to our investors.

#### Item 1B. Unresolved Staff Comments

Not applicable.

#### Item 2. Properties

The Company and the Bank conduct business from their administrative headquarters at 120 Passaic Avenue in Fairfield, New Jersey and 27 branch offices located in Bergen, Essex, Hudson, Middlesex, Morris, Ocean, Passaic and Union Counties, New Jersey. Seven of our offices are leased with remaining terms between one and 18 years. At June 30, 2010, our net investment in property and equipment totaled \$35.0 million. The following table sets forth certain information relating to our properties as of June 30, 2010. The net book values reported include our investment in land, building and/or leasehold improvements by property location

Office Location	Year Opened	Net Book Value as of June 30, 2010 (In Thousands)	Square Footage	Owned/Leased
Executive Office:				
120 Passaic Avenue Fairfield, New Jersey	2004	\$11,307	53,000	Owned
Main Office:				
614 Kearny Avenue Kearny, New Jersey	1928	921	6,764	Owned
Branches:				
425 Route 9 & Ocean Gate Drive Bayville, New Jersey	1973	15	3,500	Leased
417 Bloomfield Avenue Caldwell, New Jersey	1968	343	4,400	Owned
20 Willow Street East Rutherford, New Jersey	1969	53	3,100	Owned
534 Harrison Avenue Harrison, New Jersey	1995	612	3,000	Owned
1353 Ringwood Avenue Haskell, New Jersey	1996	—	2,500	Leased
718B Buckingham Drive Lakewood, New Jersey	2008	42	2,800	Leased
630 North Main Street Lanoka Harbor, New Jersey	2005	2,134	3,200	Owned

307 Stuyvesant Avenue Lyndhurst, New Jersey	1970	220	3,338	Owned
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Office Location	Year Opened	Net Book Value as of June 30, 2010 (In Thousands)		Square Footage	Owned/ Leased
270 Ryders Lane Milltown, New Jersey	1989	\$3	3,600		Leased
339 Main Road Montville, New Jersey	1996	—	1,850		Leased
119 Paris Avenue Northvale, New Jersey	1965	278	1,750		Owned
80 Ridge Road North Arlington, New Jersey	1952	121	3,500		Owned
510 State Highway 34 Old Bridge Township, New Jersey	2002	951	2,400		Owned
207 Old Tappan Road Old Tappan, New Jersey	1973	765	2,160		Owned
267 Changebridge Road Pine Brook, New Jersey	1974	181	3,600		Owned
917 Route 23 South Pompton Plains, New Jersey	2009	1,557	2,400		Owned
653 Westwood Avenue River Vale, New Jersey	1965	790	1,600		Owned
252 Park Avenue Rutherford, New Jersey	1974	1,624	1,984		Owned
520 Main Street Spotswood, New Jersey	1979	309	2,400		Owned
130 Mountain Avenue Springfield, New Jersey	1991	1,320	6,480		Owned
827 Fischer Boulevard Toms River, New Jersey	1996	654	3,500		Owned
2100 Hooper Avenue Toms River, New Jersey	2008	95	2,000		Leased
487 Pleasant Valley Way					

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West Orange, New Jersey	1971	124	3,000	Owned
216 Main Street West Orange, New Jersey	1975	136	2,400	Owned
250 Valley Boulevard Wood-Ridge, New Jersey	1957	1,622	9,500	Owned
661 Wyckoff Avenue Wyckoff, New Jersey	2002	2,481	6,300	Owned

Item 3. Legal Proceedings

The Bank, from time to time, is a party to routine litigation, which arises in the normal course of business, such as claims to enforce liens, condemnation proceedings on properties in which we hold security interests, claims involving the making and servicing of real property loans and other issues incident to our business. There were no lawsuits pending or known to be contemplated against the Company or the Bank at June 30, 2010 that would be expected to have a material effect on operations or income.

Item 4. [Removed and Reserved]



## PART II

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

(a) **Market Information.** The Company's common stock trades on The NASDAQ Global Select Market under the symbol "KRNY". The table below shows the reported high and low closing prices of the common stock and dividends paid per public share for each quarter during the last two fiscal years.

	High	Low	Dividends
Fiscal Year 2010			
Quarter ended September 30, 2009	\$ 11.74	\$ 10.37	\$ 0.05
Quarter ended December 31, 2009	\$ 10.47	\$ 9.54	\$ 0.05
Quarter ended March 31, 2010	\$ 10.56	\$ 9.50	\$ 0.05
Quarter ended June 30, 2010	\$ 10.77	\$ 8.42	\$ 0.05
Fiscal Year 2009			
Quarter ended September 30, 2008	\$ 13.95	\$ 10.78	\$ 0.05
Quarter ended December 31, 2008	\$ 12.86	\$ 10.69	\$ 0.05
Quarter ended March 31, 2009	\$ 12.80	\$ 7.80	\$ 0.05
Quarter ended June 30, 2009	\$ 12.22	\$ 10.28	\$ 0.05

Declarations of dividends by the Board of Directors depend on a number of factors, including investment opportunities, growth objectives, financial condition, profitability, tax considerations, minimum capital requirements, regulatory limitations, stock market characteristics and general economic conditions. The timing, frequency and amount of dividends are determined by the Board.

The Company's ability to pay dividends may also depend on the receipt of dividends from the Bank, which is subject to a variety of limitations under the regulations of the OTS on the payment of dividends.

As of September 3, 2009 there were 4,108 registered holders of record of the Company's common stock, plus approximately 2,702 beneficial (street name) owners.

(b) **Use of Proceeds.** Not applicable.



(c) Issuer Purchases of Equity Securities. Set forth below is information regarding the Company's stock repurchases during the fourth quarter of the fiscal year ended June 30, 2010.

## Issuer Purchases of Equity Securities

	Total Number of Shares (or Units) purchased	Average Price Paid Per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs *	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet be Purchased Under the Plans or Programs
April 1 – April 30, 2010	13,200	\$ 10.39	13,200	118,923
May 1 – May 31, 2010	118,923	10.15	118,923	-
June 1 – June 30, 2010	362,100	9.07	362,100	527,406
Total	494,223	\$ 9.37	494,223	527,406

\* On May 26, 2010, the Company announced the authorization of a fifth stock repurchase program for up to 889,506 shares or 5% of shares outstanding.

Stock Performance Graph. Set forth on Page 59 is a stock performance graph comparing the cumulative total shareholder return on the Company's common stock with (a) the cumulative total shareholder return on stocks included in the NASDAQ Composite Index, (b) the cumulative total shareholder return on stocks included in the SNL Thrift \$1 Billion - \$5 Billion Index and (c) the cumulative total shareholder return on stocks included in the SNL Thrift MHC Index, in each case assuming an investment of \$100.00 as of June 30, 2005. The cumulative total returns for the indices and the Company are computed assuming the reinvestment of dividends that were paid during the period. It is assumed that the investment in the Company's common stock was made at the initial public offering price of \$10.00 per share.

Index	6/30/05	6/30/06	6/30/07	6/30/08	6/30/09	6/30/10
Kearny Financial Corp.	\$100	\$127	\$118	\$ 97	\$104	\$ 85
NASDAQ Composite	100	106	127	111	89	103
SNL Thrift \$1 B - \$5 B						
Index	100	108	105	80	66	65
SNL Thrift MHC Index	100	116	133	124	112	123

The NASDAQ Composite Index measures all NASDAQ domestic and international based common type stocks listed on The NASDAQ Stock Market. The SNL indices were prepared by SNL Financial LC, Charlottesville, Virginia. The SNL Thrift \$1 Billion - \$5 Billion Index includes all thrift institutions with total assets between \$1.0 billion and \$5.0 billion. The SNL Thrift MHC Index includes all publicly traded mutual holding companies.

There can be no assurance that the Company's future stock performance will be the same or similar to the historical stock performance shown in the graph above. The Company neither makes nor endorses any predictions as to stock performance.

## Item 6. Selected Financial Data

The following financial information and other data in this section are derived from the Company's audited consolidated financial statements and should be read together therewith.

	2010	2009	At June 30,		
			2008	2007	2006
	(In Thousands)				
Balance Sheet Data:					
Assets	\$ 2,339,813	\$ 2,124,921	\$ 2,083,039	\$ 1,917,253	\$ 1,991,773
Net loans receivable	1,005,152	1,039,413	1,021,686	860,493	703,613
Mortgage-backed securities available for sale	703,455	683,785	726,023	643,779	670,329
Mortgage-backed securities held to maturity	1,700	4,321	—	—	—
Securities available for sale	29,497	28,027	38,183	88,869	222,793
Securities held to maturity	255,000	—	—	—	—
Cash and cash equivalents	181,422	211,525	131,723	163,341	230,279
Goodwill	82,263	82,263	82,263	82,263	82,263
Deposits	1,623,562	1,421,201	1,379,032	1,411,713	1,443,738
Federal Home Loan Bank advances	210,000	210,000	218,000	28,488	61,105
Total stockholders' equity	485,926	476,720	471,371	462,592	475,134

	For the Years Ended June 30,				
	2010	2009	2008	2007	2006
	(In Thousands, Except Percentage and Per Share Amounts)				
Summary of Operations:					
Interest income	\$ 93,108	\$ 97,908	\$ 97,367	\$ 95,561	\$ 89,323
Interest expense	36,321	44,200	50,528	50,468	38,645
Net interest income	56,787	53,708	46,839	45,093	50,678
Provision for loan losses	2,616	317	94	571	72
Net interest income after provision for loan losses	54,171	53,391	46,745	44,522	50,606
Non-interest income, excluding (loss) gain on securities	2,395	2,648	2,708	2,434	2,302
Non-interest income from (loss) gain on sale of securities	509	(415)	—	55	1,023
Loss on impairment of securities	(206)	(714)	(659)	—	—
Non-interest expenses	45,094	43,922	40,939	44,856	42,046
Income before income taxes	11,775	10,988	7,855	2,155	11,885
Provisions for income taxes	4,963	4,597	1,951	221	2,277
Net income	\$ 6,812	\$ 6,391	\$ 5,904	\$ 1,934	\$ 9,608
Share and Per Share Data:					
Net income per share – basic	\$ 0.10	\$ 0.09	\$ 0.08	\$ 0.03	\$ 0.13
Net income per share – diluted	\$ 0.10	\$ 0.09	\$ 0.08	\$ 0.03	\$ 0.13
	67,920	68,710	69,522	70,417	71,715

Weighted average number of  
common shares outstanding –  
basic

Weighted average number of  
common shares outstanding –  
diluted

	67,920	68,710	69,522	70,417	71,715
Cash dividends per share (1)	\$ 0.20	\$ 0.20	\$ 0.20	\$ 0.20	\$ 0.19
Dividend payout ratio (2)	53.7%	54.9%	62.5%	192.6%	49.3%

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	At or For the Years Ended June 30,				
	2010	2009	2008	2007	2006
<b>Performance Ratios:</b>					
Return on average assets (net income divided by average total assets)	0.31%	0.31%	0.29%	0.10%	0.47%
Return on average equity (net income divided by average equity)	1.42	1.35	1.26	0.41	1.94
Net interest rate spread	2.45	2.25	1.81	1.70	2.10
Net interest margin	2.83	2.81	2.54	2.43	2.67
Average interest-earning assets to average interest-bearing liabilities	120.88	124.16	126.49	126.82	127.82
Efficiency ratio (non-interest expense divided by the sum of net interest income and non-interest income)	75.81	79.53	83.74	94.27	77.86
Non-interest expense to average assets	2.04	2.11	2.04	2.23	2.05
<b>Asset Quality Ratios:</b>					
Non-performing loans to total loans	2.13	1.26	0.15	0.17	0.13
Non-performing assets to total assets	0.93	0.62	0.08	0.08	0.05
Net charge-offs to average loans outstanding	0.05	0.00	0.00	0.00	0.01
Allowance for loan losses to total loans	0.84	0.62	0.59	0.70	0.77
Allowance for loan losses to non-performing loans	39.70	48.92	388.05	406.25	578.66
<b>Capital Ratios:</b>					
Average equity to average assets	21.66	22.73	23.41	23.56	24.16
Equity to assets at period end	20.77	22.43	22.63	24.13	23.85
Tangible equity to tangible assets at period end	17.36	18.98	19.51	21.10	21.19

(1) Excludes dividends waived by Kearny MHC.

(2) Represents cash dividends paid divided by net income.

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

### General

This discussion and analysis reflects Kearny Financial Corp.'s consolidated financial statements and other relevant statistical data. We include it to enhance your understanding of our financial condition and results of operations. You should read the information in this section in conjunction with Kearny Financial Corp.'s consolidated financial statements and notes thereto contained in this Annual Report on Form 10-K and the other statistical data provided herein.

### Overview

**Financial Condition.** Total assets increased \$214.9 million to \$2.34 billion at June 30, 2010 from \$2.12 billion at June 30, 2009. The increase was due primarily to increases in mortgage-backed and non-mortgage-backed securities partially offset by decreases in cash and cash equivalents and net loans receivable.

In general, it remains the long term goal of our business plan change the Bank's balance sheet to reflect a greater percentage of earnings assets in the loan portfolio while, in turn, reducing the relative size of the securities portfolio. Within the loan portfolio, the Company's business plan continues to call for increased origination of commercial loans with an emphasis on commercial mortgages including multi-family and nonresidential mortgage loans.

The lending environment during fiscal 2010, however, continued to reflect the challenging economic environment resulting from the fiscal crisis of 2008-2009. Those challenges include declining real estate values coupled with increased unemployment which, together, have significantly reduced demand for new loan originations by qualified borrowers. Consequently, the loan portfolio declined on both a dollar and percentage of assets basis during the current fiscal year. At June 30, 2010, net loans receivable comprised 43.0% of total assets compared to 48.9% at June 30, 2009. Year-over-year, net loans receivable decreased \$34.3 million, or 3.3%. Within the loan portfolio, however, commercial mortgages grew \$5.6 million to \$203.0 million while one-to-four family mortgage loans, including first mortgages and home equity loans and lines of credit, declined \$38.0 million to \$776.8 million.

In contrast, investment securities, including mortgage-backed and non-mortgage-backed securities, comprised 42.3% of total assets at June 30, 2010 compared to 33.7% at June 30, 2009. Year over year, investment securities increased \$273.5 million, or 38.2%. Generally, the cash flows from net loan repayments were used to fund a portion of the growth in investment securities during fiscal 2010. Additional funding for the growth in investment securities was also provided by the reinvestment of a portion of the Company's cash and cash equivalents which declined \$30.1 million from June 30, 2009 to June 30, 2010. A majority of the growth in investment securities during fiscal 2010, however, was funded through deposit growth.

At June 30, 2010, our total deposits were \$1.62 billion compared to \$1.42 billion at June 30, 2009. Year-over-year, certificates of deposit and non-maturity deposits increased \$74.8 million and \$127.6 million, respectively. The growth in deposits continued despite the Bank continuing to reduce its deposit offering rates on most products reflecting, in part, consumer demand for the safety of FDIC-insured accounts versus noninsured investment alternatives. The growth in non-maturity deposits also reflected the Bank's promotion of its "High Yield Checking" product which is primarily designed to attract core deposits in the form of customers' primary checking accounts through interest rate and fee reimbursement incentives to qualifying customers.





The balance of FHLB of New York borrowings was unchanged at \$210.0 million at June 30, 2010 from June 30, 2009. Due to continuing deposit inflows and flagging loan demand, there was no need for additional borrowing during fiscal 2010.

Stockholders' equity increased \$9.2 million to \$485.9 million at June 30, 2010 from \$476.7 million at June 30, 2009. The increase reflected was partly attributable to an increase in accumulated other comprehensive income, net of income taxes, due to mark-to-market adjustments to the available for sale non-mortgage-backed securities and mortgage-backed securities portfolios and benefit plan adjustments. The increase in stockholders' equity also reflected increases in paid-in-capital relating to the offsets of stock benefit plan expense during the year as well as the net increase retained earnings resulting from the Company's net income for fiscal 2010, net of dividends paid to shareholders. Partially offsetting these increases was the Company's share repurchase activity which resulted in an increase of \$8.8 million in Treasury stock during fiscal 2010.

**Results of Operations.** Our results of operations depend primarily on our net interest income. Net interest income is the difference between the interest income we earn on our interest-earning assets and the interest we pay on our interest-bearing liabilities. It is a function of the average balances of loans and investments versus deposits and borrowed funds outstanding in any one period and the yields earned on those loans and investments and the cost of those deposits and borrowed funds. Our results of operations are also affected by our provision for loan losses, non-interest income and non-interest expense.

Net income for the fiscal year ended June 30, 2010 was \$6.8 million, or \$0.10 per diluted share; an increase of \$421,000 from \$6.4 million, or \$0.09 per diluted share for the fiscal year ended June 30, 2009. The increase in net income year-over-year resulted primarily from increases in net interest income and non-interest income, partially offset by increases in non-interest expense, income taxes and the provision for loan losses.

Our net interest income increased \$3.1 million to \$56.8 million for the fiscal year ended June 30, 2010 from \$53.7 million for the fiscal year ended June 30, 2009. The net interest rate spread increased to 2.45% for fiscal 2010 from 2.25% for fiscal 2009 as the cost of average interest-bearing liabilities fell to 2.19% from 2.87% while the yield on average interest-earning assets decreased to 4.64% from 5.12%. Total interest income decreased to \$93.1 million during the fiscal year ended June 30, 2010 from \$97.9 million during the fiscal year ended June 30, 2009 due to a decrease in the average yield on interest-earning assets, partially offset by an increase in their average balance. Total interest expense decreased to \$36.3 million from \$44.2 million for those same comparative periods due to a decrease in the average cost of interest-bearing liabilities that was partially offset by an increase in their average balance.

The provision for loan losses increased \$2.3 million to \$2.6 million for fiscal 2010 compared to \$317,000 for fiscal 2009. The net increase in the provision primarily reflected the need to establish a comparatively greater level of specific valuation allowances on impaired loans during the current year. The provision also reflected changes to the allowance for loan losses attributable to the historical and environmental loss factors applied to the remaining balance of non-impaired loans whose aggregate balances declined during fiscal 2010.

Non-interest income, excluding sale gains and losses and impairments of securities, decreased \$253,000 to \$2.4 million during the fiscal year ended June 30, 2010 compared to \$2.6 million during the fiscal year ended June 30, 2009. The decline was primarily due to a decrease in miscellaneous income attributable, in part, to income recognized during fiscal 2009 attributable to the sale of a branch for which no such income was recorded during fiscal 2010. The Company also recognized REO operations expense in fiscal 2010 for which no such expense was recorded during fiscal 2009.



The increase in non-interest income also reflected net improvements in income totaling \$1.4 million associated with investment security-related activities. Specifically, the Company recorded net security sale gains of \$509,000 for fiscal 2010 compared with net sale losses of \$415,000 during fiscal 2009 while other-than-temporary impairment recognized in earnings totaled \$206,000 during fiscal 2010 compared to \$714,000 for fiscal 2009.

Non-interest expense increased \$1.2 million to \$45.1 million for the fiscal year ended June 30, 2010 from \$43.9 million for the fiscal year ended June 30, 2009. The increase in non-interest expense resulted primarily from increases in salaries and employee benefits expense that were partially offset by declines in deposit insurance expense and other miscellaneous expenses. The increase in non-interest expense also reflected merger-related costs recorded during fiscal 2010 for which no such expenses were recognized during fiscal 2009. Such expenses were attributable to the Company's proposed acquisition of Central Jersey Bancorp announced on May 25, 2010.

The combined effects of these factors resulted in comparatively greater pre-tax net income during fiscal 2010 compared with fiscal 2009 resulting in a comparative increase in income tax expense during the more recent period.

**Business Strategy.** The general goals of the Company's current business plan are to profitably deploy capital and enhance earnings through a variety of balance sheet growth and diversification strategies through which the Company intends to evolve from a traditional thrift business model toward that of a full service, community bank. The key strategies of the Company's business plan and its performance in relation to those strategies during fiscal 2010 are noted below:

- Increasing the volume of loan originations and the size of the Company's loan portfolio relative to its securities portfolio;

From June 30, 2006 to June 30, 2009, the Company had reported consistent annual growth in its overall loan portfolio which increased from \$708.0 million to \$1.04 billion between those periods. As noted earlier, the severe economic challenges currently facing our regional and national economy presented significant headwinds which adversely impacted our ability to carry the continuing achievement of the first strategic goal throughout fiscal 2010. As such, the Company's loan portfolio declined to \$1.01 billion at June 30, 2010. Subject to economic conditions in the coming year, it remains the Company's goal to return to the trend of growth in the loan portfolio funded, in part, by net principal reductions of investment securities during fiscal 2011.

- Increasing the origination of commercial loans, including commercial mortgages and commercial business loans, with an emphasis on multi-family and nonresidential mortgage loans;

Despite the challenging economic environment during fiscal 2010, the Company continued its consistent annual growth in the commercial mortgage loan portfolio which increased to \$203.0 million at June 30, 2010 from \$197.4 million at June 30, 2009 and \$107.1 million at June 30, 2006. The balance of commercial business loans declined nominally to \$14.4 million at June 30, 2010 from \$14.8 million at June 30, 2009 after growing to that level from \$3.2 million at June 30, 2006. To support the continued achievement of the goals associated with this strategy, the Bank hired two commercial lenders and two commercial credit analysts during fiscal 2010 and continues to actively seek additional lenders to augment its commercial loan staff. Subject to economic

conditions in the coming year, it remains the Company's goal to return to the trend of commercial loan growth during fiscal 2011.

- Maintaining high asset quality;

The Company continues to maintain a strong level of asset quality to complement the execution of the loan-related strategies noted above. At June 30, 2010, nonperforming assets, including accruing loans over 90 days past due, nonaccrual loans and repossessed assets, comprised 0.93% of the Company's total assets. The Company's comparable nonperforming asset ratio as of June 30, 2009 was 0.62% indicating a modest increase in nonperforming assets from year to year. The level of increase in nonperforming assets largely reflects the deterioration of the regional and local economies that has resulted in increased levels of unemployment and declines in real estate values. Despite a modest increase in its nonperforming assets, the relative strength of the Company's asset quality is supported by a comparison of its nonperforming asset ratio to that of its peers. Based upon information published by the OTS in the Uniform Thrift Performance Report ("UTPR") for the quarter ended June 30, 2010, the median nonperforming asset ratio for thrift institutions in the northeast region with total assets ranging from \$1 billion to \$5 billion was 2.03% indicating that the Company's level of nonperforming assets is significantly less than that of its peers at June 30, 2010.

As noted earlier, the increase in the Company's nonperforming assets is disproportionately attributable to loans and participations acquired from external sources. For example, \$12.3 million or 57.1% of the Company's nonperforming loans at June 30, 2010 represent loans originally purchased from Countrywide which are now serviced by Bank of America. An additional \$1.7 million or 8.1% of nonperforming loans represent participations originally acquired through TICIC. The remaining \$7.5 million or 34.8% of nonperforming loans, representing 0.32% of total assets, comprise internally originated loans that are nonperforming at June 30, 2010. The loan-related strategies noted above emphasize growth of internally originated and underwritten loans. Based upon the information above, such loans have historically demonstrated a level of resiliency against credit deterioration that has compared favorably to the Company's externally originated loan portfolios and the loan portfolios of its peers as defined above.

- Building the Company's core banking business through internal growth and de novo branching;

During the first quarter of fiscal 2010, the Bank opened a full service branch location in Pequannock Township, NJ. This de novo branch represented the Bank's 27th full service branch location. By June 30, 2010, the Pequannock branch had grown to \$27.7 million in total deposits. Deposits at the Bank's remaining 26 branches grew by a total of \$174.7 million or 12.2% for the year ended June 30, 2010. In total, deposits grew \$202.4 million or 14.2% for the year ended June 30, 2010. Of that growth, \$127.6 million or 63.0% was attributed to nonmaturity deposits while the remaining \$74.8 million or 37.0% was attributable to growth in certificates of deposit.

- Actively seeking out franchise expansion opportunities such as the acquisition of other financial institutions or branches;

As a complement to the organic growth strategies noted above, the Company actively seeks out opportunities to deploy capital, diversify its balance sheet mix and enhance

earnings through mergers and acquisitions with other institutions. Toward that end, the Company announced its proposed acquisition of Central Jersey Bancorp on May 25, 2010. The transaction, which is expected to close during the second fiscal quarter ending December 31, 2010, will add 13 retail branches in Monmouth and Ocean Counties to the Bank's existing branch network while greatly enhancing the Bank's commercial lending and business development resources.

Based upon the most recent quarterly reports filed with the SEC on Form 10-Q, Central Jersey Bancorp reported nonperforming assets totaling \$9.8 million or 1.7% of total assets at June 30, 2010 with such balances increasing by \$77,000 from \$9.7 million at the close of their fiscal year ended December 31, 2009. In relation to the Company's level of nonperforming assets at June 30, 2010, the acquisition of Central Jersey Bancorp is expected to modestly increase its level of nonperforming assets on both a dollar and percentage of assets basis. However, the combined company's pro forma nonperforming asset ratio as of June 30, 2010 remains well below that reported by the OTS for the northeast regional peer group via the UPTR noted earlier.

- Develop and promote consumer and business-oriented products and services designed to emphasize growth in core deposits and multiple account relationships.

During the latter half of fiscal 2010, the Bank launched its "High Yield Checking" product which is primarily designed to attract core deposits in the form of customers' primary checking accounts through the payment of interest rate and fee incentives to qualifying customers. Qualification is based upon the required performance of certain electronic transaction and internet-based account management activities which promote use of such accounts as a consumer's primary checking account. The acquisition of consumers' primary checking accounts and requisite use of the companion internet-banking services are expected to provide opportunities for the Bank to promote additional products and services to its customers.

Through the proposed acquisition of Central Jersey Bank noted above, the Bank is expecting to broaden its menu of business-related products and services providing an opportunity to expand its business banking relationships throughout the combined institution.

#### Critical Accounting Policies

Our accounting policies are integral to understanding the results reported. We describe them in detail in Note 1 to the Company's consolidated financial statements beginning on Page F-10 of this document. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the consolidated statements of financial condition and revenues and expenses for the periods then ended. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant changes relate to the determination of the allowance for loan losses, the evaluation of securities impairment and the impairment testing of goodwill.

**Allowance for Loan Losses.** The allowance for loan losses is a valuation account that reflects the Company's estimation of the losses in its loan portfolio to the extent they are both probable and reasonable to estimate. The balance of the allowance is generally maintained through provisions for loan losses that are charged to income in the period that estimated losses on loans are identified by the

Company's loan review system. The Company charges losses on loans against the allowance as such losses are actually incurred. Recoveries on loans previously charged-off are added back to the allowance.

As described in greater detail in the notes to consolidated financial statements, the Company's allowance for loan loss calculation methodology utilizes a "two-tier" loss measurement process that is performed quarterly. Through the first tier of the process, the Company first identifies the loans that must be reviewed individually for impairment. Such loans generally represent the Company's larger and/or more complex loans including commercial mortgage loans, but may also include certain individual one-to-four family mortgage loans, home equity loans and home equity lines of credit. A reviewed loan is deemed to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Once a loan is determined to be impaired, management measures the amount of the estimated impairment associated with that loan which is generally defined as the amount by which the carrying value of a loan exceeds its fair value. The Company establishes specific valuation allowances for loan impairments in the fiscal period during which they are identified.

The second tier of the loss measurement process involves estimating the probable and estimable losses which addresses loans not otherwise individually reviewed for impairment. Such loans generally comprise large groups of smaller-balance homogeneous loans, such as one-to-four family mortgage loans, home equity loans and lines of credit and consumer loans, but also include the remaining non-impaired loans of the larger and/or more complex types that were not individually reviewed for impairment.

Valuation allowances established in accordance with the second tier of the loss measurement process utilize historical and environmental loss factors to collectively estimate the level of probable losses within defined segments of the Company's loan portfolio. To calculate its historical loss factors, the Company's allowance for loan loss methodology generally utilizes a 24 month moving average of annual net charge-off rates (charge-offs net of recoveries) by loan segment, where available, to calculate its actual, historical loss experience. The outstanding principal balance of each loan segment is multiplied by the applicable historical loss factor to estimate the level of probable losses based upon the Company's historical loss experience.

Environmental loss factors are based upon specific qualitative criteria representing key sources of risk within the loan portfolio. Such risk criteria includes the level of and trends in delinquencies and non-accrual loans; the effects of changes in credit policy; the experience, ability and depth of the lending function's management and staff; national and local economic trends and conditions; credit risk concentrations and changes in local and regional real estate values. The outstanding principal balance of each loan segment is multiplied by the applicable environmental loss factor to estimate the level of probable losses based upon the qualitative risk criteria.

The sum of the probable and estimable loan losses calculated in accordance with loss measurement processes, as described above, represents the total targeted balance for the Company's allowance for loan losses at the end of a fiscal period. A more detailed discussion of the Company's allowance for loan loss calculation methodology is presented in Note 1 of the Company's consolidated financial statements.

**Impairment Testing of Goodwill.** We record goodwill, representing the excess of amounts paid over the fair value of net assets of the institutions acquired in purchase transactions, at its fair value at the date of acquisition. Through June 30, 2002, we amortized goodwill using the straight-line method over 15 years. Effective July 1, 2002, we adopted the FASB's revised account guidance applicable to the accounting and impairment testing of goodwill. Goodwill is tested and deemed impaired when the carrying value of goodwill exceeds its implied fair value. Goodwill was most recently tested as of May





31, 2010, at which time no impairment was indicated. At June 30, 2010, we reported goodwill of \$82.3 million. The value of the goodwill can change in the future. We expect the value of the goodwill to decrease if there is a significant decrease in the franchise value of the Bank. If an impairment loss is determined in the future, we will reflect the loss as an expense for the period in which the impairment is determined, leading to a reduction of our net income for that period by the amount of the impairment loss.

**Other-than-Temporary Impairment of Securities.** If the fair value of a security is less than its amortized cost, the security is deemed to be impaired. Management evaluates all securities with unrealized losses quarterly to determine if such impairments are “temporary” or “other-than-temporary” in accordance with applicable accounting guidance.

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

The Company accounts for other-than-temporary impairments (“OTTI”) based upon several considerations. First, OTTI on securities that the Company has decided to sell as of the close of a fiscal period, or will, more likely than not, be required to sell prior to the full recovery of their fair value to a level equal to or exceeding their amortized cost, are recognized in earnings. If neither of these conditions regarding the likelihood of the securities’ sale is applicable, then the OTTI is bifurcated into credit-related and noncredit-related components. 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. The noncredit-related component represents the remaining portion of the impairment not otherwise designated as credit-related. The Company recognizes credit-related, OTTI in earnings. However, noncredit-related, other-than-temporary impairments on debt securities are recognized in accumulated other comprehensive income.

#### Comparison of Financial Condition at June 30, 2010 and June 30, 2009

**General.** Total assets increased \$214.9 million to \$2.34 billion at June 30, 2010, from \$2.12 billion at June 30, 2009. The increase in total assets was due primarily to increases in mortgage-backed and non-mortgage-backed securities partially offset by decreases in cash and cash equivalents and net loans receivable. The overall increase in total assets was complemented by growth in deposits and an increase in stockholders’ equity.

**Cash and Cash Equivalents.** Cash and cash equivalents, which consist of interest-earning and noninterest-earning deposits in other banks, decreased \$30.1 million to \$181.4 million at June 30, 2010 from \$211.5 million at June 30, 2009. The decline in short term, liquid assets was largely attributable to the continued reinvestment of a portion of the Company’s excess liquidity into investment securities. Such excess liquidity has generally resulted from the combined effects of deposit growth coupled with net reductions in the loan portfolio as repayments outpaced new loan originations and purchases.

In accordance with the overall goals of its strategic business plan, the Company had deferred the reinvestment of a portion of incoming cash flows during fiscal 2010 resulting in comparatively higher



average balances of short term, liquid assets held as a funding source for future loan originations. While the long term strategic goal remains in place, the Company's loan origination volume generally declined during fiscal 2010 compared to the prior year due, in part, to the significant economic challenges and declining real estate values that characterize the current lending marketplace. As a result, the Company continues to face the risk to near term earnings resulting from maintaining comparatively higher average balances of cash and cash equivalents whose yields reflect historically low short-term market interest rates.

In recognition of the growing opportunity cost to near term earnings resulting from the accumulation of short term, liquid assets, a portion of the Company's excess liquidity was reinvested into investment securities during the year ended June 30, 2010.

At June 30, 2010, the balance of interest-bearing deposits primarily included funds on deposit with a money center bank and the FHLB of New York. Management routinely transfers funds between the two depository institutions to maximize the return on the funds, with the former pricing off of 30-day Libor and the latter off of the federal funds rate.

**Securities Available for Sale.** Non-mortgage-backed securities classified as available for sale increased by \$1.5 million to \$29.5 million at June 30, 2010 from \$28.0 million at June 30, 2009. The increase in the portfolio was attributable to an increase in the fair value of the portfolio partially offset by principal repayments. At June 30, 2010, the available for sale non-mortgage-backed securities portfolio consisted of \$3.9 million of SBA pass-through certificates, \$19.0 million of municipal bonds and \$6.6 million of single issuer trust preferred securities with amortized costs of \$4.0 million, \$18.1 million and \$8.9 million, respectively. The net unrealized loss for this portfolio was reduced to \$1.5 million at June 30, 2010 from \$3.6 million as of June 30, 2009. Based on its evaluation, management has concluded that no other-than-temporary impairment is present within this segment of the investment portfolio at June 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 increased to \$255.0 million at June 30, 2010 from \$-0- at June 30, 2009 resulting from the Company's purchase of fixed rate, callable agency debentures during fiscal 2010. As of June 30, 2010, a total of \$200.0 million of these debentures have remaining terms to maturity of five years or less while securities having total balances of \$40.0 million and \$15.0 million have remaining terms to maturity of five to ten years and greater than ten years, respectively. The purchase of these securities deployed a portion of the Company's excess liquidity that had accumulated for the reasons noted earlier.

**Loans Receivable.** Loans receivable, net of unamortized premiums, deferred costs and the allowance for loan losses, decreased \$34.3 million to \$1.01 billion at June 30, 2010 from \$1.04 billion at June 30, 2009. The decrease in net loans receivable was primarily attributable to net decreases in the balances of residential mortgage loans which were partially offset by net increases in the balance of commercial mortgage loans and the funded portion of construction loans.

Residential mortgage loans, in aggregate, decreased by \$38.0 million to \$776.8 million at June 30, 2010 from \$814.8 million at June 30, 2009. The components of the aggregate decrease included a net reduction in the balance of one-to-four family first mortgage loans of \$25.5 million to \$663.9 million at June 30, 2010 coupled with net declines in the balance of home equity loans and home equity lines of credit of \$11.7 million and \$796,000, respectively, whose ending balances at June 30, 2010 were \$101.7 million and \$11.3 million, respectively. The reduction in the balance of residential mortgage loans reflects management's continued adherence to its disciplined pricing policy coupled with 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.

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In total, residential mortgage loan origination volume for the year ended June 30, 2010 was \$132.7 million. Loan volume for fiscal 2010 reflected originations of one-to-four family first mortgage loans totaling \$102.1 million, of which \$28.3 million, \$13.5 million, \$27.1 million and \$33.3 million were originated during the four quarters ended September 30, 2009, December 31, 2009, March 31, 2010 and June 30, 2010, respectively. Aggregate originations of home equity loans and home equity lines of credit for fiscal 2010 totaled \$30.6 million, of which \$11.6 million, \$8.1 million, \$4.9 million and \$6.0 million, were originated during the same comparative linked quarters, respectively.

Commercial loans, in aggregate, increased by \$5.2 million to \$217.4 million at June 30, 2010 from \$212.2 million at June 30, 2009. The components of the aggregate increase included growth in nonresidential mortgage loans of \$6.1 million partially offset by nominal decreases in the balance of multi-family mortgage loans and business loans of \$460,000 and \$460,000, respectively. The ending balances of nonresidential mortgage loans, multifamily loans and commercial business loans at June 30, 2010 were \$177.9 million, \$25.1 million and \$14.4 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 fiscal 2010 was \$34.5 million. Loan volume for fiscal 2010 reflected originations of multi-family and nonresidential real estate mortgage loans totaling \$31.0 million, of which \$13.7 million, \$7.5 million, \$9.3 million and \$532,000 were originated during the quarters ended September 30, 2009, December 31, 2009, March 31, 2010 and June 30, 2010, respectively. Aggregate originations of commercial business loans for fiscal 2010 totaled \$3.5 million, of which \$1.2 million, \$324,000, \$532,000 and \$1.4 million were originated during the same comparative linked quarters, respectively.

The outstanding balance of construction loans, net of loans-in-process, increased by \$1.3 million to \$14.7 million at June 30, 2010. The net increase in construction loans resulted from additional disbursements on construction loans less repayments on such loans. Construction loan disbursements for the year ended June 30, 2010 totaled \$7.1 million, of which \$4.1 million, \$1.5 million, \$881,000 and \$650,000 were funded during the quarters ended September 30, 2009, December 31, 2009, March 31, 2010 and June 30, 2010, respectively.

Finally, other loans, primarily comprising account loans and deposit account overdraft lines of credit, decreased \$258,000 to \$4.2 million at June 30, 2010. Other loan originations for the year ended June 30, 2010 totaled approximately \$1.3 million, of which \$374,000, \$346,000, \$302,000 and \$290,000 were originated during the quarters ended September 30, 2009, December 31, 2009, March 31, 2010, and June 30, 2010, respectively.

The balance of the allowance for loan losses increased by \$2.1 million to \$8.6 million or 0.84% of total loans at June 30, 2010 from \$6.4 million or 0.62% of total loans at June 30, 2009. As of those same dates, nonperforming loans increased \$8.4 million to \$21.6 million or 2.13% of total loans from \$13.2 million or 1.26% of total loans.

The increase in nonperforming loans included an increase in the balance of loans 90 days or more past due and still accruing of \$7.3 million to \$12.3 million at June 30, 2010 from \$5.0 million at June 30, 2009. For those same comparative dates, the corresponding number of loans 90 days or more past due and still accruing increased by 16 to 28 loans from 12 loans.

Loans reported as 90 days or more past due and still accruing at June 30, 2010 include 27 residential mortgage loans secured by New Jersey properties with aggregate outstanding balances totaling \$11.7 million as of that date. These loans were originally purchased from Countrywide Home Loans, Inc. ("Countrywide") and continue to be serviced by their acquirer, Bank of America through its subsidiary, BAC Home Loans Servicing, LP. In accordance with our agreement, the servicer advances scheduled



principal and interest payments to the Bank when such payments are not made by the borrower. The timely receipt of principal and interest from the servicer ensures the continued accrual status of the Bank's loan. However, the delinquency status reported for these nonperforming loans reflects the borrower's actual delinquency irrespective of the Bank's receipt of advances which will be recouped by the servicer from the Bank in the event the borrower does not reinstate the loan. Based upon updated collateral valuations, the Bank has established specific valuation allowances totaling \$2.4 million for the identified impairment attributable to 22 of these 27 loans at June 30, 2010. The remaining five nonperforming Countrywide loans reported as 90 days or more past due and still accruing are in various stages of collection, workout or foreclosure with no estimated impairments requiring specific valuation allowances based upon the Company's evaluation at June 30, 2010. As of that same date, the Bank owned a total of 170 residential mortgage loans with an aggregate outstanding balance of \$84.9 million that were originally acquired from Countrywide. Of these loans, an additional 11 loans totaling \$4.2 million are 30-89 days past due and are in various stages of collection.

The net increase in nonperforming loans also included a \$1.1 million increase in the balance of nonaccrual loans to \$9.2 million at June 30, 2010 from \$8.1 million at June 30, 2009. For those same comparative dates, the corresponding number of nonaccrual loans increased to 26 loans from 21 loans. Nonaccrual loans at June 30, 2010 include 11 residential mortgage loans totaling \$2.1 million, three construction loans totaling \$468,000, five multi-family loans totaling \$1.6 million, two nonresidential mortgage loans totaling \$2.7 million, three secured business loans totaling \$2.3 million and two consumer loans totaling \$1,400.

As of June 30, 2010, the Company has established specific valuation allowances totaling \$1.7 million in the full amount of the outstanding balances of four of the five nonaccrual multifamily mortgage loans and one of the three nonaccrual construction loans. These five loans represent nonperforming participations acquired through the Thrift Institutions Community Investment Corporation ("TICIC"), a subsidiary of the New Jersey Bankers Association. As of that same date, the Company has established a specific valuation allowance of approximately \$4,800 against the entire balance of one secured business loan totaling that was reported as nonaccrual at June 30, 2010. The remaining 20 nonaccrual loans totaling \$7.6 million are in various stages of collection, workout or foreclosure with no estimated losses requiring specific valuation allowances based upon the Company's evaluation at June 30, 2010.

In addition to the loans noted above, the Company has established an additional specific valuation allowance of approximately \$220,000 attributable to one impaired multifamily loans with an outstanding principal balances of \$2.5 million. While not nonperforming at June 30, 2010, the loan is adversely classified with an impairment identified in the amount of the specific valuation allowance noted.

**Mortgage-backed Securities Available for Sale.** Mortgage-backed securities available for sale, all of which are agency pass-through securities, increased \$19.7 million to \$703.5 million at June 30, 2010 from \$683.8 million at June 30, 2009. The net increase reflected purchases of approximately \$224.6 million of fixed rate, agency mortgage-backed securities and an increase in the unrealized gain on the securities of \$11.4 million. These increases were partially offset by the sale of securities with book values of \$32.7 million with the remaining \$182.1 million decrease primarily attributable to cash repayment of principal net of discount accretion and premium amortization. The net unrealized gain for this portfolio was \$30.0 million as of 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 June 30, 2010. The purchases of the mortgage-backed securities during the year ended June 30, 2010 included approximately \$24.1 million of issues eligible to meet the Community Reinvestment Act investment test during the reporting period. (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, including agency pass-through securities as well as agency and non-agency collateralized mortgage obligations, decreased \$2.6 million to \$1.7 million at June 30, 2010 from \$4.3 million at June 30, 2009. The decrease reflected the sale of non-investment grade, non-agency collateralized mortgage obligations with an aggregate amortized cost and net book value of \$2.1 million and \$1.5 million, respectively. These balances reflected the cumulative impact of credit-related and non-credit-related OTTI changes relating to the securities. The remaining \$1.1 million decrease was primarily attributable to cash repayment of principal net of discount accretion and premium amortization.

At June 30, 2010, the Company's remaining portfolio of non-agency CMOs totaled 20 securities with an aggregate outstanding balance of approximately \$310,000. These securities were not other-than-temporarily impaired and were rated as investment grade at June 30, 2010. The remainder of the held to maturity mortgage-backed securities portfolio at June 30, 2010 is comprised of government agency mortgage pass-through securities and collateralized mortgage obligations that were also not other-than-temporarily impaired based upon management's evaluation as of that date. (For additional information refer to Notes 5 and 6 to consolidated financial statements.)

**Other Assets.** Other noteworthy changes include a net increase of approximately \$4.1 million in other assets that was largely attributable to the remaining balance of the Bank's original \$5.0 million prepayment of FDIC insurance during the prior quarter ended December 31, 2009. This prepayment originally resulted from the FDIC's requirement that all insured depository institutions prepay their federal deposit insurance assessments through 2012 at December 30, 2009. An increase of \$3.6 million in the cash surrender value of bank owned life insurance reflected additional policy premiums of \$3.0 million funded during the year coupled with increases in the cash surrender value of the associated policies of \$556,000 recognized through earnings during fiscal 2010. These increases were partially offset by a decline in the balance of the Company's net deferred income tax asset from \$1.4 million at June 30, 2009 to \$-0- at June 30, 2010 reflecting a change in the Company's net deferred income tax position from a net deferred income tax asset to a net deferred income tax liability. The change was largely attributable to an increase in the tax-effected unrealized gains associated with the Company's available for sale investment securities portfolios from June 30, 2009 to June 30, 2010. A corresponding increase in deferred income tax liabilities has been recorded at June 30, 2010.

**Deposits.** Deposits increased \$202.4 million to \$1.62 billion at June 30, 2010 from \$1.42 billion at June 30, 2009. Despite the Bank continuing to maintain a disciplined pricing strategy throughout fiscal 2010 that resulted in noteworthy declines in deposit offering rates, growth was reported across all categories of deposits. For the year ended June 30, 2010, interest-bearing demand deposits increased \$92.5 million to \$256.2 million, savings deposits increased \$32.5 million to \$334.2 million, certificates of deposit increased \$74.8 million to \$979.5 million and non-interest-bearing demand deposits increased \$2.5 million to \$53.7 million. As noted earlier, the overall increase in deposits was partly attributable to consumer demand for the safety of FDIC-insured accounts in lieu of non-insured investment alternatives. The growth in deposits also reflected the Bank's promotion of its "High Yield Checking" product described earlier as well as the new deposits gathered at its de novo branch opened in Pequannock, NJ during fiscal 2010.

As discussed in greater detail below under Item 7A. Quantitative and Qualitative Disclosures About Market Risk, 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.



Advances from FHLB. The outstanding balance of FHLB advances was unchanged at \$210 million at June 30, 2010 from June 30, 2009 reflecting the absence of new advances or maturities during the fiscal 2010.

Stockholders' Equity. During the year ended June 30, 2010 stockholders' equity increased \$9.2 million to \$485.9 million from \$476.7 million at June 30, 2009. The increase was partly attributable to a \$8.4 million increase in accumulated other comprehensive income due primarily to the aggregate mark-to-market adjustment to the available for sale securities portfolios and benefit plan related adjustments to equity. The increase in stockholders' equity also reflected net income during the period of \$6.8 million. Also contributing to the increase was \$1.5 million for ESOP shares earned, \$3.1 million for restricted stock plan shares earned and an adjustment to equity of \$1.9 million for expensing stock options. Partially offsetting these increases to stockholders' equity was a \$7.8 million increase in treasury stock due to the purchase of 897,323 shares of the Company's common stock as well as \$3.7 million in cash dividends declared for payment to shareholders, net of waived dividends.

#### Comparison of Operating Results for the Years Ended June 30, 2010 and June 30, 2009

General. Net income for the year ended June 30, 2010 was \$6.8 million, or \$0.10 per diluted share; an increase of \$421,000 compared to \$6.4 million, or \$0.09 per diluted share for the year ended June 30, 2009. The increase in net income between fiscal years resulted primarily from increases in net interest income and non-interest income which were partly offset by increases in the provision for loan losses, 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 year ended June 30, 2010 was \$56.8 million, an increase of \$3.1 million from \$53.7 million for the year ended June 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, resulting primarily from the downward re-pricing of certificates of deposit, that more than offset the increase in interest expense attributable to an increase in the average balance of interest-bearing deposits. The decrease in interest income was primarily attributable to an increase in the average balance of lower yielding cash and cash equivalents and non-mortgage-backed securities in relation to the declines in the average balance of comparatively higher yielding loans.

As a result of these factors, the Company's net interest rate spread increased 20 basis points to 2.45% for the year ended June 30, 2010 from 2.25% for the year ended June 30, 2009. The increase in the net interest rate spread reflected a decrease in the cost of interest bearing liabilities of 68 basis points to 2.19% from 2.87% which was partially offset by a decrease in the yield on earning assets of 48 basis points to 4.64% from 5.12% 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 increase in net interest income and net interest rate spread was also reflected in the Company's net interest margin which increased two basis points to 2.83% for the year ended June 30, 2010 from 2.81% for the year ended June 30, 2009. The lesser improvement in net interest margin compared the improvement in net interest spread partly reflects proportionately greater growth in the average balance of noninterest-earning assets compared with that of noninterest-bearing liabilities between the comparative periods. Specifically, the average balance of noninterest-bearing liabilities increased by \$6.0 million to \$74.4 million for the year ended June 30, 2010 from \$68.4 million for the year ended June 30, 2009. By comparison, the average balance of noninterest-earning assets increased by \$37.8 million to \$207.2 million for the year ended June 30, 2010 from \$169.4 million for the year ended



June 30, 2009. The disparity in growth between noninterest-earning assets versus noninterest-bearing liabilities is also reflected in the Company's ratio of average interest-earning assets to average interest-bearing liabilities which decreased to 120.9% for the year ended June 30, 2010 from 124.2% for the year ended June 30, 2009.

The increase in noninterest-earning assets was attributable, in part, to an increase of \$25.9 million in the average balance of noninterest-earning cash. The growth in the Company's short term, liquid assets, including noninterest-earning cash, had accumulated over several consecutive quarters due largely to retail deposit growth outpacing the Company's near-term ability to deploy such funds into high quality loans. As noted in greater detail below, a portion of such funds have been reinvested into high quality investment securities during the year ended June 30, 2010. The increase in noninterest-earning assets also reflected an aggregate increase in the average balance of the unrealized gain in available for sale investment securities, including mortgage-backed and non-mortgage-backed securities, totaling \$14.0 million.

**Interest Income.** Total interest income decreased \$4.8 million to \$93.1 million for the year ended June 30, 2010 from \$97.9 million for the year ended June 30, 2009. As noted above, the decrease in interest income reflected a decrease in the average yield on earning assets which declined 48 basis points to 4.64% for the year ended June 30, 2010 from 5.12% for the year ended June 30, 2009. The decrease in the average yield was partially offset by an increase in the average balance of interest-earning assets which increased \$96.2 million to \$2.01 billion from \$1.91 billion for the same comparative period.

Interest income from loans decreased \$2.4 million to \$58.1 million for the year ended June 30, 2010 from \$60.6 million for the year ended June 30, 2009. The decrease in interest income on loans was primarily attributable to a decrease in their average balance which declined \$33.7 million to \$1.03 billion for the year ended June 30, 2010 from \$1.06 billion for the year ended June 30, 2009.

Within the reported decline in the average balance of loans, the Company reported a \$55.4 million reduction in the average balance of residential mortgage loans to \$791.2 million for the year ended June 30, 2010 from \$846.6 million for the year ended June 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. 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 \$21.5 million in the average balance of commercial loans to \$219.6 million from \$198.1 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 reflects the Company's long-term expanded strategic emphasis in commercial lending coupled with a continuing favorable pricing environment for these loans.

The overall decrease in interest income on loans also reflects a decrease in their average yields which declined five basis points to 5.64% for the year ended June 30, 2010 from 5.69% for the year ended June 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 \$4.5 million to \$30.5 million for the year ended June 30, 2010 from \$34.9 million for the year ended June 30, 2009. The decrease in interest income reflected a decrease in the average yield on mortgage-backed securities coupled with the impact of a decline in their average balance. The average yield on mortgage-backed securities declined 53 basis points to 4.49% for the year ended June 30, 2010 from 5.02% for the year ended June 30, 2009 while the average balance of the securities decreased \$19.2 million to \$677.5 million from \$686.7 million for those same comparative periods.

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 decrease in the average balance of mortgage-backed securities generally reflects security repayments and sales that have outpaced the Company's purchase of mortgage-backed securities through fiscal 2010.

Interest income from non-mortgage-backed securities increased \$2.7 million to \$3.7 million for the year ended June 30, 2010 from \$1.0 million for the year ended June 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 \$103.6 million to \$137.5 million for the year ended June 30, 2010 from \$33.9 million for the year ended June 30, 2009. For those same comparative periods, the average yield on non-mortgage-backed securities decreased by 38 basis point to 2.69% from 3.07%.

The increase in the average balance of non-mortgage backed securities was primarily attributable to a \$103.6 million increase in the average balance of taxable securities to \$119.3 million during the year ended June 30, 2010 from \$15.7 million for the year ended June 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 change in the average yield on non-mortgage backed securities reflected a decrease of 3 basis points in the yield of taxable securities to 2.57% during the year ended June 30, 2010 from 2.60% during the year ended June 30, 2009 while the average yield on tax-exempt securities declined one basis point to 3.48% from 3.49%.

Interest income from other interest-earning assets decreased \$535,000 to \$828,000 for the year ended June 30, 2010 from \$1.4 million for the year ended June 30, 2009. The decrease in interest income was primarily attributable to a decrease in the average yield on other interest-earning assets which declined 67 basis points to 0.51% for the year ended June 30, 2010 from 1.18% for the year ended June 30, 2009. The decline in average yield was partially offset by an increase in the average balance of other interest-earning assets which increased \$45.6 million to \$161.4 million for the year ended June 30, 2010 from \$115.8 million for the year ended June 30, 2009.

The decrease in the average yield on other interest-earning assets primarily reflects a decrease in the average yield of interest-earning deposits resulting from the decline in short term, market interest rates to historical lows. The increase in the average balance of other interest-earning assets was primarily attributable to a \$45.6 million increase in the average balance of interest-earning deposits to \$148.4 million for the year ended June 30, 2010 from \$102.8 million for the year ended June 30, 2009. The increase in the average balance of interest-earning deposits reflects the accumulation of short term liquid assets described earlier.

**Interest Expense.** Total interest expense decreased \$7.9 million to \$36.3 million for the year ended June 30, 2010 from \$44.2 million for the year ended June 30, 2009. As noted earlier, the decrease in interest expense reflected a decrease in the average cost of interest-bearing liabilities which declined 68 basis points to 2.19% for the year ended June 30, 2010 from 2.87% for the year ended June 30, 2009. The decrease in the average cost was partially offset by an increase in the average balance of interest-bearing liabilities of \$121.3 million to \$1.66 billion from \$1.54 billion for the same comparative periods.

Interest expense attributed to deposits decreased \$7.6 million to \$28.1 million for the year ended June 30, 2010 from \$35.7 million for the year ended June 30, 2009. The decrease resulted primarily from a 76 basis point decrease in the average cost of interest-bearing deposits to 1.94% for the year ended June 30, 2010 from 2.70% for the year ended June 30, 2009. The reported decrease in the average cost was reflected across all categories of interest-bearing deposits and was primarily attributable to the overall declines in market interest rates. For the same comparative periods, the average cost of interest-bearing checking accounts decreased 17 basis points to 1.17% from 1.34%, the average cost of savings accounts decreased 2 basis points to 1.03% from 1.05% and the average cost of certificates of deposit decreased 109 basis points to 2.41% from 3.50%.

The decrease in the average cost was partially offset by a \$126.4 million increase in the average balance of interest-bearing deposits to \$1.45 billion for the year ended June 30, 2010 from \$1.32 billion for the year ended June 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 to protect their financial assets given the recent volatility in the financial markets for uninsured investment products. For the same comparative periods, the average balance of interest-bearing checking accounts increased \$41.7 million to \$198.6 million from \$156.9 million, the average balance of savings accounts increased \$22.2 million to \$315.7 million from \$293.5 million and the average balance of certificates of deposit increased \$62.4 million to \$935.7 million from \$873.3 million. As of June 30, 2010, approximately \$716.3 million or 73.1% of certificates of deposit, with a weighted average cost of 1.80%, mature within one year. Because the Bank's offering rates for CDs maturing in one year or less are generally lower than 1.80% at June 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 decreased \$274,000 to \$8.2 million for the year ended June 30, 2010 from \$8.5 million for the year ended June 30, 2009. The decrease in interest expense was attributable to the combined effects of a decline in both the average balance and average cost of FHLB advances between the comparative periods. The average balance of FHLB advances decreased \$5.1 million to \$210.0 million for the year ended June 30, 2010 from \$215.1 million for the year ended June 30, 2009 while the average cost of FHLB advances declined three basis points to 3.92% from 3.95% for those same comparative periods. The decline in the average balance and average cost of FHLB advances was primarily attributable to the repayment of maturing advances totaling \$8.0 million with a weighted average cost of 5.47% during the fiscal year ended June 30, 2009.

**Provision for Loan Losses.** The provision for loan losses increased \$2.3 million to \$2.6 million for the year ended June 30, 2010 from \$317,000 for the year ended June 30, 2009. The provision in the current period reflected required net increases to the allowance for loan losses attributable primarily to estimated specific losses on several impaired mortgage loans on residential and multi-family properties located in New Jersey, as discussed in greater detail above. The provision also reflected changes 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 \$1.2 million to \$2.7 million for the year ended June 30, 2010 from \$1.5 million for the year ended June 30, 2009. Excluding sale gains and losses and impairments of securities, non-interest income decreased \$253,000 to \$2.4 million during the fiscal year ended June 30, 2010 compared to \$2.6 million during the fiscal year ended June 30, 2009. As noted earlier, the decline was primarily due to a decrease in miscellaneous income attributable, in part, to income recognized during fiscal 2009 attributable to a \$132,000 gain on the sale of a branch for which no such income was recorded during fiscal 2010. The Company also recognized REO operations expense of \$25,000 in fiscal 2010 for which no such expense was recorded during fiscal 2009. The decline in noninterest income between comparative periods also reflects a reduction in deposit and branch-related fees and charges. Finally, the decrease in noninterest income also reflected a decline in income from the Bank's official check clearing agent. The clearing agent is no longer able to compensate its clients at a meaningful level for use of the float on official checks due to significant losses and reduced yields in its investment securities portfolio.

The declines in noninterest income noted above were more than offset by increases in income totaling \$1.4 million associated with investment security-related activities. Specifically, the Company recorded net security sale gains of \$509,000 for fiscal 2010 compared with net sale losses of \$415,000 during fiscal 2009. The net security sale gains during fiscal 2010 resulted, in part, from gains associated with the sale of agency, pass-through securities. These gains were partially offset by losses on the sale of the Company's outstanding balance of non-investment grade, non-agency collateralized mortgage obligations ("CMOs"). The CMOs sold were originally acquired as investment grade securities upon the in-kind redemption of the Bank's interest in the AMF Ultra Short Mortgage Fund ("AMF Fund") during the quarter ended September 30, 2008. The security sale loss of \$415,000 recognized during fiscal 2009 was fully attributable to the AMF Fund in-kind redemption transaction.

Subsequent to their acquisition, the ratings of these securities declined below investment grade with most ultimately being identified as other-than-temporarily impaired ("OTTI"). Such impairments required the recognition of the impairment charges recognized through earnings during fiscal 2010 and 2009 totaling \$206,000 and \$714,000, respectively.

**Non-Interest Expenses.** Non-interest expense increased \$1.2 million to \$45.1 million for the fiscal year ended June 30, 2010 from \$43.9 million for the fiscal year ended June 30, 2009. The increase in non-interest expense resulted primarily from increases in salaries and employee benefits expense that were partially offset by declines in deposit insurance expense and other miscellaneous expenses. The increase in non-interest expense also reflected merger-related costs of \$373,000 recorded during fiscal 2010 for which no such expenses were recognized during fiscal 2009. Such expenses were attributable to the Company's proposed acquisition of Central Jersey Bancorp announced on May 25, 2010.

Employee compensation-related expenses increased by approximately \$1.5 million to \$26.9 million for the year ended June 30, 2010 from \$25.4 million for the year ended June 30, 2009. Such increases reflected additional costs associated with staff augmentation attributable, in part, to de novo branch expansion and growth in commercial lending resources. More generally, however, the increase in expense also reflects the increase in compensation-related costs attributable to annual increases in wages and salaries of existing staff and overall increases to benefits costs including employee health care benefits. The increase in year-over-year employee compensation expense also reflects an actuarial adjustment that reduced pension expense in the earlier comparative period for which a lesser reduction in expense was recorded during the current period. Partially offsetting these increases was a decline in ESOP expense reflecting the reduction in the market price of the Company's common stock between comparative periods.





Federal deposit insurance premium expense decreased \$557,000 to \$1.3 million for the year ended June 30, 2010 from \$1.9 million for the year ended June 30, 2009. The decrease was primarily attributable to the recognition of the FDIC's Special Assessment totaling \$872,000 during fiscal 2009 for which no such assessment was paid during fiscal 2010. Partially offsetting the decrease, however was an increase in the current year's assessment rate charged by the FDIC on the balance of insurable deposits held by the Bank coupled with the effect of the year-over-year growth in the balance of those deposits.

Finally, miscellaneous non-interest expense declined \$134,000 to \$4.8 million for the year ended June 30, 2010 from \$4.9 million for the year ended June 30, 2009. The decline reflects various decreases and partially offsetting increases throughout a variety of general and administrative expense categories that, in aggregate, resulted in the reported decline in non-interest expense.

Provision for Income Taxes. The provision for income taxes increased \$366,000 to \$5.0 million during the for the year ended June 30, 2010 from \$4.6 million during the year ended June 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 years ended June 30, 2010 and June 30, 2009 were 42.1% and 41.8%, respectively.

#### Comparison of Operating Results for the Years Ended June 30, 2009 and June 30, 2008

General. Net income for the fiscal year ended June 30, 2009 was \$6.4 million, or \$0.09 per diluted share; an increase of \$487,000 compared to \$5.9 million, or \$0.09 per diluted share for the fiscal year ended June 30, 2008. The increase in net income year-over-year resulted primarily from an increase in net interest income, partially offset by increases in loss on sales and impairments of securities, non-interest expense and income taxes as well as an increase in provision for loan losses and a decrease in non-interest income (excluding loss on securities).

Net Interest Income. Net interest income for the fiscal year ended June 30, 2009 was \$53.7 million, an increase of \$6.9 million compared to \$46.8 million for the fiscal year ended June 30, 2008. Net interest income increased year-over-year due to an increase in interest income and a decrease in interest expense.

The Company's net interest rate spread increased 44 basis points to 2.25% during the fiscal year ended June 30, 2009 from 1.81% during the fiscal year ended June 30, 2008. The 525 basis point reduction in the federal funds rate between September 2007 and December 2008 had a significant effect on the Company's cost of funds and return on earning assets. The Bank's cumulative gap position or timing mismatch of potential re-pricing of assets and liabilities continued to be liability sensitive. As a result, the Bank's cost of funds declined more rapidly than the yield on its earning assets during the first half of the year. However, that trend started to change during the quarter ended March 31, 2009 such that the decrease in the yield on earning assets began to accelerate leading to a more rapid decline relative to the decrease in the cost of funds, due primarily to the accumulation of cash and cash equivalents. Year-over-year, the yield on average interest-earning assets decreased 15 basis points to 5.12% while the cost of average interest-bearing liabilities decreased 59 basis points to 2.87%. The average return on earning assets decreased due to decreases in the yields on average loans receivable, non-mortgage-backed securities and other interest-earning assets, partially offset by an increase in the yield on average mortgage-backed securities. During the same period, the average cost of funds decreased due to decreases in both the cost of average interest-bearing deposits and the cost of average borrowed money.

The Company's net interest margin increased 27 basis points to 2.81% during the fiscal year ended June 30, 2009, compared to 2.54% during the fiscal year ended June 30, 2008. The ratio of average interest-earning assets to average interest-bearing liabilities was 124.2% during the fiscal year ended June



30, 2009, compared to 126.5% during the fiscal year ended June 30, 2008. Average interest-earning assets during the fiscal year ended June 30, 2009 were \$1.91 billion, an increase of \$64.3 million compared to \$1.85 billion during the fiscal year ended June 30, 2008. Year-over-year, the increase in average interest-earning assets resulted from an increase in average loans receivable, partially offset by decreases in average mortgage-backed securities, non-mortgage-backed securities and other interest-earning assets. Average interest-bearing liabilities during the fiscal year ended June 30, 2009 were \$1.54 billion, an increase of \$79.2 million compared to \$1.46 billion during the fiscal year ended June 30, 2008. Year-over-year, the increase in average interest-bearing liabilities resulted from increases in average interest-bearing deposits and average borrowed money. During the prior fiscal year, management considered FHLB advances to be a favorable alternative to certificates of deposit as a funding source given the interest rate environment at the time.

**Interest Income.** Total interest income increased \$541,000 to \$97.9 million during the fiscal year ended June 30, 2009, from \$97.4 million during the fiscal year ended June 30, 2008 due to an increase in average interest-earning assets, partially offset by a decrease in average yield. The increase in interest income resulted primarily from an increase in interest on loans receivable and to a lesser degree mortgage-backed securities, partially offset by decreases in interest from non-mortgage-backed securities and other interest-earning assets.

Interest income from loans receivable increased \$5.5 million to \$60.6 million during the fiscal year ended June 30, 2009 from \$55.1 million during the fiscal year ended June 30, 2008 due to growth in the average loan portfolio, partially offset by a decrease in average yield. In keeping with the Company's business plan, the loan portfolio continued to generate an increasing proportion of the Company's interest income. Average loans receivable constituted 55.7% of average interest-earning assets during the fiscal year ended June 30, 2009, compared to 51.5% during the fiscal year ended June 30, 2008. Average loans receivable increased \$113.0 million to \$1.06 billion during the fiscal year ended June 30, 2009, compared to \$951.0 million during the fiscal year ended June 30, 2008. The steady decline in short-term interest rates since September 2007 contributed to a decrease in the average yield on loans receivable, which decreased 11 basis points to 5.69% during the fiscal year ended June 30, 2009, compared to 5.80% during the fiscal year ended June 30, 2008. The average yield had been decreasing as higher coupon mortgages were replaced by new loans with lower coupons. Also contributing to the decrease in the loan portfolio's yield year-over-year was the increase in average residential first mortgages, home equity loans and home equity lines of credit relative to higher yielding nonresidential and multi-family mortgages and commercial business loans. During the fiscal year ended June 30, 2009, average residential first mortgages, home equity loans and home equity lines of credit in aggregate totaled \$846.6 million, an increase of \$97.8 million from \$748.8 million during the fiscal year ended June 30, 2008. By comparison, average nonresidential and multi-family mortgages and commercial business loans in aggregate totaled \$198.1 million during the fiscal year ended June 30, 2009, an increase of \$13.2 million from \$184.9 million during the fiscal year ended June 30, 2008.

Interest income from mortgage-backed securities increased \$171,000 to \$34.9 million during the fiscal year ended June 30, 2009 compared to \$37.8 million during the fiscal year ended June 30, 2008 due to an increase in average yield, partially offset by a decrease in average mortgage-backed securities. The average yield on mortgage-backed securities increased five basis points to 5.02% during the fiscal year ended June 30, 2009 from 4.97% during the fiscal year ended June 30, 2008. Average mortgage-backed securities decreased \$3.2 million to \$696.7 million during the fiscal year ended June 30, 2009 compared to \$699.9 million during the fiscal year ended June 30, 2008. For the most part, rate adjustments on pass-through certificates containing adjustable-rate mortgages and discount accretion attributed to the addition of the mortgage-backed securities received from the AMF Fund were responsible for the increase in average yield. However, the average yield had been decreasing due to an increase in prepayments within the underlying mortgage portfolios as refinancing activity accelerated. Reinvestment of principal



payments was limited to the purchase of \$77.4 million of new securities compared to repayments totaling \$138.5 million, contributing to the decrease in average mortgage-backed securities. Generally, management was reluctant to reinvest in additional mortgage-backed securities due to the low interest rate environment. To the extent that the Bank did not need the funds for loan originations the cash flows accumulated in cash and cash equivalents. Partially offsetting the decrease in the average balance was the addition of the mortgage-backed securities received from the AMF Fund during the quarter ended September 30, 2008.

Interest income from non-mortgage-backed securities decreased \$1.3 million to \$1.0 million during the fiscal year ended June 30, 2009 from \$2.3 million during the fiscal year ended June 30, 2008 due to a decrease in average securities as well as a decrease in average yield. Average non-mortgage-backed securities decreased \$19.5 million to \$33.9 million during the fiscal year ended June 30, 2009 compared to \$53.4 million during the fiscal year ended June 30, 2008. Average taxable securities decreased \$7.5 million to \$15.7 million during the fiscal year ended June 30, 2009 compared to \$23.2 million during the fiscal year ended June 30, 2008 due primarily to the redemption-in-kind of the AMF Fund, which resulted in the reclassification of the underlying mortgage-backed instruments to mortgage-backed securities during the quarter ended September 30, 2008. Average tax-exempt securities decreased \$12.0 million to \$18.2 million during the fiscal year ended June 30, 2009 from \$30.2 million during the fiscal year ended June 30, 2008 due primarily to the sales of municipal bonds during the prior fiscal year. The average yield on non-mortgage-backed securities fell 116 basis points to 3.07% during the fiscal year ended June 30, 2009 from 4.23% during the fiscal year ended June 30, 2008 due primarily to the year-over-year decrease in the yield on taxable securities. The average yield on taxable securities decreased 251 basis points to 2.60%, while the average yield on tax-exempt securities decreased only seven basis points to 3.49%, year-over-year. Contributing to the decrease in the average yield on taxable securities was the effect of falling interest rates on SBA variable-rate pass-through certificates and variable-rate trust preferred securities as well as the redemption-in-kind of the AMF Fund.

Interest income from other interest-earning assets decreased \$3.8 million to \$1.4 million during the fiscal year ended June 30, 2009 from \$5.2 million during the fiscal year ended June 30, 2008. The decrease was due to decreases in average other interest-earning assets, primarily interest-earning deposits, and in the average yield on those assets. Average other interest-earning assets decreased \$26.0 million to \$115.8 million during the fiscal year ended June 30, 2009 from \$141.8 million during the fiscal year ended June 30, 2008. Average interest-earning deposits decreased \$28.1 million to \$102.8 million during the fiscal year ended June 30, 2009 from \$130.9 million during the fiscal year ended June 30, 2008, partially offset by a \$2.1 million increase in average FHLB capital stock to \$13.0 million from \$10.9 million, year-over-year. Following the addition of \$200.0 million in FHLB advances during fiscal year 2008, cash and cash equivalents were redeployed to fund loan originations and purchases and was the primary factor contributing to the decrease in average other interest-earning assets until cash began to build in December 2008 and thereafter. The 525 basis point reduction in the federal funds rate between September 2007 and December 2008 was primarily responsible for the decrease in the yield on average other interest-earning assets, which fell 250 basis points from 3.68% during the fiscal year ended June 30, 2008 to 1.18% during the fiscal year ended June 30, 2009, including a 270 basis point decrease to 0.74% in the average yield on average interest-earning deposits.

Interest Expense. Total interest expense decreased \$6.3 million to \$44.2 million during the fiscal year ended June 30, 2009 compared to \$50.5 million during the fiscal year ended June 30, 2008 due to a decrease in the average cost of funds, partially offset by an increase in average interest-bearing liabilities. The decrease in interest expense resulted from a decrease in interest expense from deposits, partially offset by an increase in interest expense from borrowings.

Interest expense attributed to deposits decreased \$7.6 million to \$35.7 million during the fiscal year ended June 30, 2009 from \$43.3 million during the fiscal year ended June 30, 2008. The decrease resulted primarily from a decrease in the average cost of deposits, partially offset by an increase in average interest-bearing deposits. The average cost of interest-bearing deposits decreased 67 basis points to 2.70% during the fiscal year ended June 30, 2009 compared to 3.37% during the fiscal year ended June 30, 2008 due primarily to the decrease in the average cost of certificates of deposit. Average interest-bearing deposits increased \$39.2 million to \$1.32 billion during the fiscal year ended June 30, 2009 from \$1.28 billion during the fiscal year ended June 30, 2008. Year-over-year, average interest-bearing demand deposit accounts increased \$7.0 million to \$156.9 million due primarily to an increase in tiered money market deposit accounts, while their average cost decreased 47 basis points to 1.34%, in conjunction with falling short-term interest rates. The tiered money market deposit accounts were introduced during the prior year in an attempt to attract core deposits as well as to keep savings deposits from leaving the institution. Average savings accounts decreased \$10.3 million to \$293.5 million while their average cost decreased three basis points to 1.05%, as depositors transferred funds to alternative investments, including certificates of deposit and tiered money market deposit accounts. Average certificates of deposit increased \$42.6 million to \$873.3 million, while their average cost decreased 99 basis points to 3.50%. During the quarter ended December 31, 2008, deposit rates in the marketplace began to pull back in conjunction with falling interest rates. As a result, the Bank's deposit flows turned positive as the competition lowered their rates bringing them in line with those offered by the Bank. Since there was little demand for loans and virtually no return on cash and cash equivalents, management attempted to control deposit inflows by cutting the Bank's deposit pricing several times, particularly for certificates of deposit. Nevertheless, deposits continued to build throughout the quarter ended June 30, 2009.

Interest expense attributed to FHLB advances increased \$1.3 million to \$8.5 million during the fiscal year ended June 30, 2009 from \$7.2 million during the fiscal year ended June 30, 2008 due to an increase in average borrowings, partially offset by a decrease in the average cost of borrowings. Average borrowings increased \$40.0 million to \$215.1 million during the fiscal year ended June 30, 2009 from \$175.1 million during the fiscal year ended June 30, 2008. The average cost of borrowings decreased 17 basis points to 3.95% during the fiscal year ended June 30, 2009 from 4.12% during the fiscal year ended June 30, 2008. The Bank borrowed \$200.0 million during the fiscal year ended June 30, 2008 at a weighted average cost of 3.79% contributing to the decrease in the cost of average borrowings. The increase in borrowings during the prior period resulted primarily from a need to replenish liquidity utilized to fund loan originations and fund deposit outflows and make cash available for potential implementation of growth and diversification strategies related to execution of the Company's business plan. The advances were determined to be a cheaper funding source compared to certificates of deposit. Due to the Bank's excess liquidity, management repaid maturing advances totaling \$8.0 million with a weighted average cost of 5.47% during the fiscal year ended June 30, 2009.

**Provision for Loan Losses.** For the year ended June 30, 2009, the Company recorded a provision for loan losses of approximately \$317,000 representing an increase of \$223,000 from a provision of \$94,000 recorded during fiscal 2008. The provision during fiscal 2009 was augmented by approximately \$13,000 in net recoveries resulting in a net increase in the allowance for loan losses of approximately \$330,000 to \$6.4 million at June 30, 2009 from \$6.1 million at June 30, 2008.

This increase to the allowance during fiscal 2009 reflects net additions to specific valuation allowances of approximately \$267,000 relating to impaired loans coupled with net additions to general valuation allowances of approximately \$63,000 arising from the application of the historical and environmental loss factors to the outstanding balance of the remaining, non-impaired loans within the Company's portfolio.





By comparison, during fiscal 2008 the balance of the allowance for loan losses increased \$55,000 from \$6.0 million at June 30, 2007 to \$6.1 million at June 30, 2008 reflecting additional provisions of \$94,000 partially offset by net charge-offs of \$39,000. The provision for fiscal 2008 reflected the Company's implementation of a new allowance for loan loss calculation methodology coupled with the effects of continued net loan growth and a reduction in the balance of total classified assets from the earlier year.

A detailed discussion concerning the activity in the Company's allowance for loan loss, including the basis for the Company's provisions to the allowance for the fiscal years ended June 30, 2009 and June 30, 2008, is presented in the Lending Activity section of this document under the heading Allowance for Loan Losses located within the Asset Quality discussion.

**Non-Interest Income.** Non-interest income, excluding loss on sales and impairments of securities, decreased \$60,000 to \$2.6 million during the fiscal year ended June 30, 2009 from \$2.7 million during the fiscal year ended June 30, 2008. Fees and service charges increased \$79,000 to \$1.4 million during the fiscal year ended June 30, 2009 compared to \$1.3 million during the fiscal year ended June 30, 2008 due primarily to an increase in fees from retail operations. Miscellaneous income decreased \$139,000 to \$1.2 million during the fiscal year ended June 30, 2009 from \$1.4 million during the fiscal year ended June 30, 2008 due primarily to a \$235,000 decrease in income from the Bank's official check clearing agent, partially offset by a \$132,000 gain realized from the sale of deposits in the Bank's Irvington, New Jersey retail branch. The official check clearing agent was no longer able to compensate its clients at a meaningful level for use of the float on official checks due to significant losses in its mortgage-backed securities portfolio.

Loss on sales and impairments of securities totaled \$1.13 million during fiscal 2009 compared to \$659,000 during the prior fiscal year. As a result of the redemption-in-kind of the AMF Fund in July 2008, the underlying securities were written down to fair value as of the trade date resulting in a pre-tax charge to earnings of \$415,000. During the quarter ended March 31, 2009, the Company recognized other-than-temporary impairments attributed to the non-agency collateralized mortgage obligations received from the fund totaling \$570,000, all of which were recorded through earnings. Of that balance, approximately \$290,000 was subsequently determined by the Company to be "credit-related" with the remaining \$280,000 attributed to noncredit-related factors. In accordance with its adoption of FSP FAS 115-2 and FAS 124-2, the Company recorded a cumulative effect of adoption adjustment effective April 1, 2009 between retained earnings and accumulated other comprehensive income totaling \$165,000 representing the after-tax effect of the adoption. The Company also identified an additional \$144,000 of credit-related, other-than-temporary impairments that were recognized through earnings during the quarter ended June 30, 2009. An additional \$274,000 on noncredit-related other-than-temporary impairments were identified and recorded through accumulated other comprehensive income on a tax effected basis during that same quarter. During the prior fiscal year, an other-than-temporary impairment pre-tax charge of \$659,000 was recorded for the AMF Fund. Other gain/loss on sales of securities recorded during the fiscal year ended June 30, 2008 netted to zero.

**Non-Interest Expenses.** Non-interest expense increased \$3.0 million, or 7.3% to \$43.9 million during the fiscal year ended June 30, 2009 from \$40.9 million during the fiscal year ended June 30, 2008. Year-over-year the increase in non-interest expense was primarily the result of increases in salaries and employee benefits expense, net occupancy expense of premises, federal deposit insurance premium expense and miscellaneous expense, partially offset by a decrease in amortization of intangible assets expense. Federal deposit insurance premium expense represented \$1.7 million, or 56.7% of the total increase in non-interest expense, year-over-year. All other elements of non-interest expense decreased in the aggregate by \$61,000, or 0.8%.



Salaries and employee benefits expense increased \$771,000 to \$25.4 million during the fiscal year ended June 30, 2009 compared to \$24.7 million during the fiscal year ended June 30, 2008. The increase in salaries and employee benefits was due primarily to a \$935,000 increase in compensation expense to \$14.7 million year-over-year due primarily to normal salary increases, additions to the staff and payment of non-recurring severance packages totaling \$80,000. There was a \$650,000 reduction to \$262,000 in pension plan expense, year-over-year, primarily related to reduced contributions required by the Bank's multiple-employer pension plan. Also contributing to the increase was a \$489,000 increase in benefits expense to \$4.1 million, which resulted from a non-recurring dividend of \$253,000 the Bank received from its health insurance carrier during the comparative period as well as the year-over-year increase in health insurance costs. All other elements of salaries and employee expense which totaled \$6.4 million; including ESOP expense, stock benefit plans expense and payroll taxes expense, decreased in the aggregate by \$3,000.

Net occupancy expense of premises increased \$389,000 to \$4.1 million during the fiscal year ended June 30, 2009 compared to \$3.7 million during the fiscal year ended June 30, 2008. Rent expense, net, increased \$79,000 to \$354,000 due primarily to additional leased space occupied by new retail branches, which opened in Brick Township, New Jersey during March 2008 and Lakewood, New Jersey during May 2008. An increase of \$147,000 to \$1.04 million in repairs and maintenance expense was attributed to generally higher costs to maintain the Bank's facilities, including a \$100,000 increase in snow removal costs, year-over-year. Property taxes, depreciation, utilities and other expenses increased in the aggregate by \$163,000 to \$2.7 million during the fiscal year ended June 30, 2009. Contributing to the increase in net occupancy expense of premises was the relocation of personnel to the second floor of the Company's administrative headquarters building in Fairfield, New Jersey, which had been previously unoccupied.

Federal deposit insurance premium expense increased \$1.7 million to \$1.9 million during the fiscal year ended June 30, 2009 compared to \$186,000 during the fiscal year ended June 30, 2008. The Bank used its remaining special assessment credit of \$579,000 to offset the cost of its deposit insurance premium, which was fully utilized by March 31, 2009. The FDIC's assessment for deposit insurance increased \$806,000 to \$992,000 during the fiscal year ended June 30, 2009 compared to \$186,000 during the fiscal year ended June 30, 2008 due primarily to an increase in the assessment rate. The final rule for the quarter ended March 31, 2009 raised the assessment rate for the most highly rated institutions to between 12 and 14 basis points, which increased the Bank's assessment rate five basis points to 12 basis points (annualized). An additional significant contributing factor to the increase was the FDIC's special assessment of \$872,000, which was based on the Bank's June 30, 2009 Total Assets minus Tier 1 Capital multiplied by five basis points.

Amortization of intangible assets expense decreased \$212,000 to \$29,000 during the fiscal year ended June 30, 2009 compared to \$241,000 during the fiscal year ended June 30, 2008. The decrease was due to the completion in October 2007 of amortization of an intangible asset acquired during the purchase of West Essex Bank in 2003.

Miscellaneous expense increased \$418,000 to \$4.9 million during the fiscal year ended June 30, 2009 compared to \$4.4 million during the fiscal year ended June 30, 2008. Of note, fiscal 2009 included a \$75,000 non-recurring payment made to an information technology service provider for the purpose of hiring the provider's employee, a \$106,000 increase in loan expense due primarily to higher servicing fees resulting from an increase in the Bank's serviced mortgage portfolio and a \$138,000 increase in correspondent bank service charges. The higher correspondent bank service charges were primarily attributed to costs associated with implementation of digitally imaged customer check deposits.

Provision for Income Taxes. The provision for income taxes increased \$2.6 million to \$4.6 million during the fiscal year ended June 30, 2009 from \$2.0 million during the fiscal year ended June 30, 2008. The Company's effective tax rate was approximately 41.8% during the fiscal year ended June 30, 2009 compared to 24.8% during the fiscal year ended June 30, 2008. The effective tax rate increased due to an increase in pre-tax income as well as a reduction in income from tax-exempt instruments as a percentage of pre-tax income as pre-tax income increased. Tax-exempt interest was 10.8% of income before taxes during the fiscal year ended June 30, 2009 compared to 20.7% of income before taxes during the fiscal year ended June 30, 2008. Also contributing to the higher effective tax rate year-over-year was a \$1.2 million income tax benefit recognized during the year ended June 30, 2008 attributable to the reversal of a previously established valuation allowance related to state net operating loss carryforwards.

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Average Balance Sheet. The following table sets forth certain information relating to Kearny Financial Corp. at the date and for the periods indicated. We derived the average yields and costs by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods presented with daily balances used to derive average balances.

	At June 30, 2010		Average Balance	2010		For the Years Ended June 30, 2009		Average Yield/Cost	Av Ba
	Actual Balance	Actual Yield/Cost		Interest	Average Yield/Cost	Average Balance	Interest		
(Dollars in Thousands)									
Interest-earning assets:									
Loans receivable(1)	\$ 1,013,713	5.64%	\$ 1,030,287	\$ 58,129	5.64%	\$ 1,064,019	\$ 60,559	5.69%	\$ 9
Mortgage-backed securities(2)	675,114	4.29	677,496	30,450	4.49	696,672	34,944	5.02	6
Securities:(2)									
Tax-exempt	18,125	3.47	18,143	631	3.48	18,183	634	3.49	
Taxable	267,835	2.31	119,328	3,070	2.57	15,721	408	2.60	
Other interest-earning assets(3)	191,003	0.34	161,376	828	0.51	115,806	1,363	1.18	1
Total interest-earning assets	2,165,790	4.32	2,006,630	93,108	4.64	1,910,401	97,908	5.12	1,8
Non-interest-earning assets	174,023		207,239			169,408			1
Total assets	\$ 2,339,813		\$ 2,213,869			\$ 2,079,809			\$ 2,0
Interest-bearing liabilities:									
Interest-bearing demand	\$ 256,154	1.31	\$ 198,623	2,324	1.17	\$ 156,883	2,098	1.34	\$ 1
Savings and club Certificates of deposit	334,167	0.89	315,715	3,246	1.03	293,483	3,072	1.05	3
Federal Home Loan Bank advances	979,532	2.01	935,684	22,519	2.41	873,257	30,524	3.50	8
Total interest-bearing liabilities	210,000	3.87	210,000	8,232	3.92	215,077	8,506	3.95	1
Non-interest-bearing liabilities (4)	1,779,853	1.92	1,660,022	36,321	2.19	1,538,700	44,200	2.87	1,4
Total liabilities	74,034		74,423			68,441			1,5
Stockholders' equity	1,853,887		1,734,445			1,607,141			4
Total liabilities and stockholders' equity	485,926		479,424			472,668			\$ 2,0
Net interest income	\$ 2,339,813		\$ 2,213,869	\$ 56,787		\$ 2,079,809	\$ 53,708		
Interest rate spread(5)		2.40%			2.45%			2.25%	
					2.83%			2.81%	

Net interest  
margin(6)  
Ratio of  
interest-earning  
assets to  
interest-bearing  
liabilities

1.21x

1.21x

1.24x

- (1) Non-accruing loans have been included in loans receivable and the effect of such inclusion was not material. Allowance for loan losses has been included in non-interest-earning assets.
- (2) Mark to market valuation allowances have been excluded in the balances of interest-earning assets.
- (3) Includes interest-bearing deposits at other banks and Federal Home Loan Bank of New York capital stock.
- (4) Includes actual balance of non-interest-bearing deposits of \$53,709,000 at June 30, 2010 and average balances of non-interest-bearing deposits of \$55,436,000, \$51,132,000 and \$59,169,000 for the years ended June 30, 2010, 2009 and 2008, respectively.
- (5) Interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.
- (6) Net interest margin represents net interest income as a percentage of interest-earning assets.

Rate/Volume Analysis. The following table reflects the sensitivity of Kearny Financial Corp.'s interest income and interest expense to changes in volume and in prevailing interest rates during the periods indicated. Each category reflects the: (1) changes in volume (changes in volume multiplied by old rate); (2) changes in rate (changes in rate multiplied by old volume); and (3) net change. The net change attributable to the combined impact of volume and rate has been allocated proportionally to the absolute dollar amounts of change in each.

	Years Ended June 30, 2010 vs. 2009			Years Ended June 30, 2009 vs. 2008		
	Increase (Decrease)			Increase (Decrease)		
	Volume	Due to Rate	Net	Volume	Due to Rate	Net
			(In Thousands)			
Interest and dividend income:						
Net loans receivable	\$ (1,903)	\$ (527)	\$ (2,430)	\$ 6,492	\$ (1,056)	\$ 5,436
Mortgage-backed securities	(929)	(3,565)	(4,494)	(168)	339	171
Securities:						
Tax-exempt	(1)	(2)	(3)	(419)	(21)	(440)
Taxable	2,667	(5)	2,662	(308)	(470)	(778)
Other interest-earning assets	416	(951)	(535)	(818)	(3,030)	(3,848)
Total interest-earning assets	\$ 250	\$ (5,050)	\$ (4,800)	\$ 4,779	\$ (4,238)	\$ 541
Interest expense:						
Interest-bearing demand	\$ 514	\$ (288)	\$ 226	\$ 121	\$ (737)	\$ (616)
Savings and club	233	(59)	174	(110)	(90)	(200)
Certificates of deposit	2,060	(10,065)	(8,005)	1,818	(8,616)	(6,798)
Federal Home Loan Bank advances	(207)	(67)	(274)	1,593	(307)	1,286
Total interest-bearing liabilities	\$ 2,600	\$ (10,479)	\$ (7,879)	\$ 3,422	\$ (9,750)	\$ (6,328)
Change in net interest income	\$ (2,350)	\$ 5,429	\$ 3,079	\$ 1,357	\$ 5,512	\$ 6,869

## Liquidity and Commitments

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 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. Liquidity may increase or decrease depending upon the availability of funds and comparative yields on investments in relation to the return on loans. We attempt to maintain adequate but not excessive liquidity and liquidity management is both a daily and long-term function of business management.

Cash and cash equivalents, consisting primarily of interest-bearing deposits in other banks decreased \$30.1 million to \$181.4 million at June 30, 2010 from \$211.5 million at June 30, 2009. At June 30, 2010, interest-bearing deposits included \$5.9 million on deposit with a money center bank and \$172.2 million on deposit with the FHLB of New York. Management routinely transfers funds between the two depository institutions to maximize the return on the funds, with the former pricing off of 30-day Libor and the latter off of the federal funds rate.

Management reviews cash flow projections regularly and updates them quarterly in order to maintain liquid assets at levels believed to meet the requirements of normal operations, including loan commitments and potential deposit outflows from maturing certificates of deposit and savings withdrawals. Commitments at the close of fiscal 2010 were not materially different from commitments at the close of the prior fiscal year. At June 30, 2010, the Bank had outstanding commitments to originate loans of \$28.0 million compared to \$35.0 million at June 30, 2009. Construction loans in process and unused lines of credit were \$4.7 million and \$25.9 million, respectively, at June 30, 2010 compared to \$7.6 million and \$24.9 million, respectively, at June 30, 2009. At June 30, 2010, the Bank had \$716.3 million of certificates of deposit maturing in one year compared to \$740.4 million at June 30, 2009.

At June 30, 2010, the Bank had agreements to fund the purchase of loans on a flow basis of \$1.0 million compared to \$8.7 million at June 30, 2009. The Bank periodically enters into purchase agreements with a limited number of smaller, local mortgage companies to supplement the Bank's loan production pipeline. These agreements call for the purchase, on a flow basis, of mortgage loans with servicing released to the Bank.

Deposits increased \$202.4 million to \$1.62 billion at June 30, 2010 from \$1.42 billion at June 30, 2009. During the fiscal 2010, interest-bearing demand deposits increased \$92.5 million to \$256.2 million, savings deposits increased \$32.5 million to \$334.2 million, certificates of deposit increased \$74.8 million to \$979.5 million and non-interest-bearing demand deposits increased \$2.5 million to \$53.7 million.

Throughout fiscal 2010, the Bank priced deposit interest rates at levels management considered to be reasonably competitive in the marketplace. Despite the decline in the Bank's offering rates for deposits during the year, the Bank continued to experience inflows of deposits as customers continued to seek the safety of insured deposits as an alternative to uninsured investments. The growth in interest-bearing checking also reflected the promotion of the Bank's "High Yield Checking" product during the





latter half of fiscal 2010. As noted earlier, “High Yield Checking” is primarily designed to attract core deposits in the form of customers’ primary checking accounts through interest rate and fee reimbursement incentives to qualifying customers. The comparatively higher interest expense associated with the “High Yield Checking” product in relation to our other checking products is expected to be partially offset by an associated increase in transaction fee income.

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 us, management may replace the 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. The Bank borrowed \$200.0 million during fiscal 2008 to replenish liquidity previously depleted by loan originations and deposit outflows and make cash available for potential implementation of growth and diversification strategies related to execution of the Company’s business plan. As of June 30, 2010, the Bank’s borrowing potential was \$19.7 million without pledging additional collateral. With no advances maturing during the year, the Bank’s balance of FHLB advances remained unchanged at \$210.0 million at June 30, 2010 from June 30, 2009.

The following table discloses our contractual obligations and commitments as of June 30, 2010.

	Total (In Thousands)	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
Operating lease obligations	\$ 3,450	\$ 497	\$ 526	\$ 496	\$ 1,931
Certificates of deposit	979,532	716,289	241,508	21,734	1
Federal Home Loan Bank advances	210,000	10,000	—	—	200,000
<b>Total</b>	<b>\$ 1,192,982</b>	<b>\$ 726,786</b>	<b>\$ 242,034</b>	<b>\$ 22,230</b>	<b>\$ 201,932</b>

	Total Combined (In Thousands)	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
Undisbursed funds from approved lines of credit(1)	\$ 25,853	\$ 2,724	\$ —	\$ —	\$ 23,129
Construction loans in process(1)	4,708	4,708	—	—	—
Other commitments to extend credit(1)	27,997	27,561	436	—	—
<b>Total</b>	<b>\$ 58,558</b>	<b>\$ 34,993</b>	<b>\$ 436</b>	<b>\$ —</b>	<b>\$ 23,129</b>

(1) Represents amounts committed to customers.

Our material capital expenditure plans for the year ending June 30, 2011 include extensive renovations and improvements to one Bank property. We expect work to begin this year at our existing retail branch in Lyndhurst and anticipate approximately \$1.3 million in funds will be required for the plan related to this location. The general business purpose of these expenditures is to maintain and improve the Bank’s facilities. We anticipate that cash flows

from our normal operations will be sufficient for these expenditure plans.

#### Off-Balance Sheet Arrangements

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 June

30, 2010, we had no significant off-balance sheet commitments to purchase securities or for capital expenditures.

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. 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. At June 30, 2010, outstanding loan commitments totaled \$58.6 million compared to \$67.4 million at June 30 2009. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. For additional information regarding our outstanding lending commitments at June 30, 2010, see Note 16 to consolidated financial statements contained in this Annual Report on Form 10-K.

### Capital

Consistent with its goals to operate a sound and profitable financial organization, the Bank actively seeks to maintain its well capitalized status in accordance with regulatory standards. As of June 30, 2010, the Bank exceeded all capital requirements of the OTS. The Bank's regulatory capital ratios at June 30, 2010 were as follows: core capital 16.44%; Tier I risk-based capital 37.54%; and total risk-based capital 37.98%. The regulatory capital requirements to be considered well capitalized are 5.0%, 6.0% and 10.0%, respectively. For additional information regarding regulatory capital at June 30, 2010, see Note 14 to consolidated financial statements contained in this Annual Report on Form 10-K.

### Impact of Inflation

The financial statements included in this document have been prepared in accordance with accounting principles generally accepted in the United States of America. These principles require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation.

Our primary assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on our performance than the effects of general levels of inflation. Interest rates, however, do not necessarily move in the same direction or with the same magnitude as the price of goods and services, since such prices are affected by inflation. In a period of rapidly rising interest rates, the liquidity and maturities of our assets and liabilities are critical to the maintenance of acceptable performance levels.

The principal effect of inflation on earnings, as distinct from levels of interest rates, is in the area of non-interest expense. Expense items such as employee compensation, employee benefits and occupancy and equipment costs may be subject to increases as a result of inflation. An additional effect of inflation is the possible increase in the dollar value of the collateral securing loans that we have made. We are unable to determine the extent, if any, to which properties securing our loans have appreciated in dollar value due to inflation.

### 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 2 of the Notes to the Consolidated Financial Statements.



Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Management of Interest Rate Risk and 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 June 30, 2010, \$716.3 million or 73.1% of our certificates of deposit mature within one year with an additional \$173.0 million or 17.7% 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 June 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 fiscal 2011.

With respect to the maturity and re-pricing of the Company's interest-earning assets, at June 30, 2010, \$21.1 million, or 2.1% of our total loans will reach their contractual maturity dates within one year with the remaining \$992.1 million, or 97.9% of total loans having remaining terms to contractual maturity in excess of one year. Of loans maturing after one year, \$886.0 million or 89.3% had fixed rates of interest while the remaining \$106.0 million or 10.7% had adjustable rates of interest.

Regarding investment securities, at June 30, 2010, only \$4.8 million or 0.5% of our securities will reach their contractual maturity dates within one year with the remaining \$984.9 million, or 99.5% of total securities, having remaining terms to contractual maturity in excess of one year. Of the latter category, \$801.3 million comprising 81.0% of our total securities had fixed rates of interest while the remaining \$183.6 million comprising 18.5% of our total securities had adjustable or floating rates of interest.

At June 30, 2010, mortgage-related assets, including mortgage loans and mortgage-backed securities, total \$1.65 billion and comprise 76.4% 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.

While the Company retained its liability sensitivity during fiscal 2010, the degree of that sensitivity, as measured internally by the institution's one-year and three-year gap percentages, has declined during fiscal 2010. Specifically, the Company's cumulative one-year gap percentage improved from -5.17% at June 30, 2009 to +0.91% at June 30, 2010. Moreover, the Company's cumulative three-year gap percentage changed from +3.47% to +9.00% over those same comparative periods.

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.

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