

PRUDENTIAL BANCORP, INC.  
Form 10-Q  
February 11, 2019

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended December 31, 2018**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number: 000-55084**

**Prudential Bancorp, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

**Pennsylvania**

(State or Other Jurisdiction of Incorporation or Organization)

**46-2935427**

(I.R.S. Employer Identification No.)

**1834 West Oregon Avenue**

**Philadelphia, Pennsylvania**

(Address of Principal Executive Offices)

**19145**

(Zip Code)

**(215) 755-1500**

(Registrant's Telephone Number, Including Area Code)

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes  No

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practical date: as of January 31, 2019, 10,819,006 shares were issued and 8,897,508 were outstanding.

**PRUDENTIAL BANCORP, INC. AND SUBSIDIARIES**

**TABLE OF CONTENTS**

|   | <b>PAGE</b> |
|---|-------------|
| <b>PART I FINANCIAL INFORMATION:</b>  |             |
| Item 1. Consolidated Financial Statements   | 1           |
| <u>Unaudited Consolidated Statements of Financial Condition December 31, 2018 and September 30, 2018</u>                          | 2           |
| <u>Unaudited Consolidated Statements of Operations for the Three Months Ended December 31, 2018 and 2017</u>                      | 3           |
| <u>Unaudited Consolidated Statements of Comprehensive Income (Loss) for for the Three Months Ended December 31, 2018 and 2017</u> | 4           |
| <u>Unaudited Consolidated Statements of Changes in Stockholders' Equity for the Three Months Ended December 31, 2018 and 2017</u> | 5           |
| <u>Unaudited Consolidated Statements of Cash Flows for the Three Months Ended December 31, 2018 and 2017</u>                      | 6           |
| <u>Notes to Unaudited Consolidated Financial Statements</u>   | 7           |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                              | 38          |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>   | 51          |
| Item 4. <u>Controls and Procedures</u>  | 51          |
| <b>PART II OTHER INFORMATION</b>  |             |
| Item 1. <u>Legal Proceedings</u>  | 52          |
| Item 1A. <u>Risk Factors</u>  | 53          |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 53          |
| Item 3. <u>Defaults Upon Senior Securities</u>  | 53          |

|  |           |
|--|-----------|
| <u>Item 4. Mine Safety Disclosures</u> | <u>53</u> |
| <u>Item 5. Other Information</u>       | <u>53</u> |
| <u>Item 6. Exhibits</u>                | <u>54</u> |
| <u>SIGNATURES</u>                      | <u>54</u> |

**PRUDENTIAL BANCORP, INC. AND SUBSIDIARIES****UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

|  | December 31,<br>2018                             | September 30,<br>2018 |
|--|--|-----------------------|
|  | (Dollars in Thousands, Except Per Share<br>Data) |                       |
| <b>ASSETS</b>  |  |                       |
| Cash and amounts due from depository institutions  | \$ 2,220   | \$ 2,457              |
| Interest-bearing deposits  | 7,678  | 45,714                |
| Total cash and cash equivalents  | 9,898  | 48,171                |
| Certificates of deposit  | 1,604  | 1,604                 |
| Investment and mortgage-backed securities available for sale (amortized cost— December 31, 2018, \$400,283; September 30, 2018, \$316,719) | 393,152  | 306,187               |
| Investment and mortgage-backed securities held to maturity (fair value— December 31, 2018, \$54,969; September 30, 2018, \$55,927)         | 57,605   | 59,852                |
| Equity securities (amortized cost December 31, 2018, \$6)  | 28   | -                     |
| Loans receivable—net of allowance for loan losses (December 31, 2018, \$5,167; September 30, 2018, \$5,167)                                | 588,511  | 602,932               |
| Accrued interest receivable  | 4,140  | 3,825                 |
| Real estate owned  | 1,027  | 1,026                 |
| Restricted Bank stock—at cost  | 10,081   | 7,585                 |
| Office properties and equipment—net  | 7,310  | 7,439                 |
| Bank owned life insurance  | 28,048   | 28,691                |
| Deferred tax assets-net  | 4,216  | 4,655                 |
| Goodwill   | 6,102  | 6,102                 |
| Core deposit intangible  | 538  | 571                   |
| Prepaid expenses and other assets  | 2,902  | 2,530                 |
| <b>TOTAL ASSETS</b>  | <b>\$ 1,115,162</b>                              | <b>\$ 1,081,170</b>   |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |  |                       |
| <b>LIABILITIES:</b>  |  |                       |
| <b>Deposits:</b>   |  |                       |
| Noninterest-bearing  | \$ 14,306  | \$ 13,677             |
| Interest-bearing   | 738,057  | 770,581               |
| Total deposits   | 752,363  | 784,258               |

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|  |                     |   |                     |
|--|---------------------|---|---------------------|
| Advances from Federal Home Loan Bank (short-term)  | 68,500              |   | 10,000              |
| Advances from Federal Home Loan Bank (long-term)   | 148,901             |   | 144,683             |
| Accrued interest payable   | 1,557               |   | 3,232               |
| Advances from borrowers for taxes and insurance  | 3,410               |   | 2,083               |
| Accounts payable and accrued expenses  | 9,753               |   | 8,505               |
| <b>Total liabilities</b>   | <b>984,484</b>      |   | <b>952,761</b>      |
| <b>STOCKHOLDERS' EQUITY:</b>   |                     |   |                     |
| Preferred stock, \$.01 par value, 10,000,000 shares authorized, none issued  | -                   |   | -                   |
| Common stock, \$.01 par value, 40,000,000 shares authorized; 10,819,006 issued and 8,892,964 outstanding at December 31, 2018; 10,819,006 issued and 8,987,356 outstanding at September 30, 2018 | 108                 |   | 108                 |
| Additional paid-in capital   | 118,621             |   | 118,345             |
| Treasury stock, at cost: 1,926,042 shares at December 31, 2018 and 1,831,650 shares at September 30, 2018  | (29,399)            | ) | (27,744)            |
| Retained earnings  | 47,381              |   | 45,854              |
| Accumulated other comprehensive loss   | (6,033)             | ) | (8,154)             |
| <b>Total stockholders' equity</b>  | <b>130,678</b>      |   | <b>128,409</b>      |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>  | <b>\$ 1,115,162</b> |   | <b>\$ 1,081,170</b> |

See notes to unaudited consolidated financial statements.

PRUDENTIAL bancorp, inc. and subsidiarIES

## UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

|   | <b>Three Months Ended</b>                     |              |
|---|---|--------------|
|   | <b>December 31,</b>                           |              |
|   | 2018  | 2017         |
|   | (Dollars in Thousands, Except Per Share Data) |              |
| <b>INTEREST INCOME:</b>                                       |   |              |
| Interest on loans   | \$ 6,462                                      | \$ 6,107     |
| Interest on mortgage-backed securities                        | 1,755   | 842          |
| Interest and dividends on investments                         | 1,532   | 949          |
| Interest on interest-bearing assets                           | 252   | 138          |
| <b>Total interest income</b>                                  | <b>10,001</b>                                 | <b>8,036</b> |
| <b>INTEREST EXPENSE:</b>                                      |   |              |
| Interest on deposits  | 3,040   | 1,412        |
| Interest on advances from Federal Home Loan Bank (short-term) | 67  | 82           |
| Interest on advances from Federal Home Loan Bank (long-term)  | 879   | 406          |
| <b>Total interest expense</b>                                 | <b>3,986</b>                                  | <b>1,900</b> |
| <b>NET INTEREST INCOME</b>                                    | <b>6,015</b>                                  | <b>6,136</b> |
| <b>PROVISION FOR LOAN LOSSES</b>                              | <b>-</b>                                      | <b>210</b>   |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>    | <b>6,015</b>                                  | <b>5,926</b> |
| <b>NON-INTEREST INCOME:</b>                                   |   |              |
| Fees and other service charges                                | 178   | 167          |
| Income from bank owned life insurance                         | 154   | 164          |
| Other   | 48  | 84           |
| <b>Total non-interest income</b>                              | <b>380</b>                                    | <b>415</b>   |
| <b>NON-INTEREST EXPENSE:</b>                                  |   |              |
| Salaries and employee benefits                                | 2,174   | 1,974        |
| Data processing   | 183   | 176          |

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|                                |          |          |
|--------------------------------|----------|----------|
| Professional services          | 401      | 792      |
| Office occupancy               | 238      | 271      |
| Depreciation                   | 155      | 156      |
| Director compensation          | 65       | 59       |
| Advertising                    | 81       | 60       |
| Core deposit amortization      | 33       | 37       |
| Other                          | 662      | 518      |
| Total non-interest expense     | 3,992    | 4,043    |
| <br>                           |          |          |
| INCOME BEFORE INCOME TAXES     | 2,403    | 2,298    |
| <br>                           |          |          |
| INCOME TAXES:                  |          |          |
| Current expense                | 559      | 648      |
| Deferred tax (benefit) expense | (130)    | ) 1,616  |
| <br>                           |          |          |
| Total income tax expense       | 429      | 2,264    |
| <br>                           |          |          |
| NET INCOME                     | \$ 1,974 | \$ 34    |
| <br>                           |          |          |
| BASIC EARNINGS PER SHARE       | \$ 0.22  | \$ 0.004 |
| <br>                           |          |          |
| DILUTED EARNINGS PER SHARE     | \$ 0.22  | \$ 0.004 |
| <br>                           |          |          |
| DIVIDENDS PER SHARE            | \$ 0.05  | \$ 0.20  |

See notes to unaudited consolidated financial statements.



PRUDENTIAL bancorp, inc. and subsidiarIES

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

|  | Three months ended December 31, |           |
|--|---------------------------------|-----------|
|  | 2018                            | 2017      |
|  | (Dollars in Thousands)          |           |
| Net income   | \$ 1,974                        | \$ 34     |
| Unrealized holding gains (losses) on available-for-sale securities | 3,424                           | (1,107 )  |
| Tax effect   | (719 )                          | 376       |
| Unrealized holding (losses) gains on interest rate swaps           | (739 )                          | 44        |
| Tax effect   | 155                             | (15 )     |
| Total other comprehensive income (loss)                            | 2,121                           | (702 )    |
| Comprehensive income (loss)  | \$ 4,095                        | \$ (668 ) |

See notes to unaudited consolidated financial statements.

PRUDENTIAL bancorp, inc. and subsidiaries

## UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

|   | Common<br>Stock                               | Additional<br>Paid-In<br>Capital | Treasury<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Stockholders'<br>Equity |
|---|---|----------------------------------|-------------------|----------------------|---|----------------------------------|
|   | (Dollars in Thousands, Except Per Share Data) |                                  |                   |                      |   |                                  |
| BALANCE, October 1, 2018                                      | \$108   | \$118,345                        | \$(27,744)        | \$45,854             | \$ (8,154)                                    | ) \$ 128,409                     |
| Net income  |   |                                  |                   | 1,974                |   | 1,974                            |
| Other comprehensive income                                    |   |                                  |                   |                      | 2,121   | 2,121                            |
| Dividends paid (\$0.05 per share)                             |   |                                  |                   | (447 )               |   | (447 )                           |
| Purchase of treasury stock (96,165 shares)                    |   |                                  | (1,687 )          |                      |   | (1,687 )                         |
| Treasury stock used for employee benefit plans (1,773 shares) |   | (32 )                            | 32                |                      |   | -                                |
| Stock option expense  |   | 151                              |                   |                      |   | 151                              |
| Restricted shares award expense                               |   | 157                              |                   |                      |   | 157                              |
| BALANCE, December 31, 2018                                    | \$108   | \$118,621                        | \$(29,399)        | \$47,381             | \$ (6,033)                                    | ) \$ 130,678                     |

|  | Common<br>Stock                               | Additional<br>Paid-In<br>Capital | Treasury<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Stockholders'<br>Equity |
|--|---|----------------------------------|-------------------|----------------------|---|----------------------------------|
|  | (Dollars in Thousands, Except Per Share Data) |                                  |                   |                      |   |                                  |
| BALANCE, October 1, 2017                   | \$108   | \$118,751                        | \$(26,707)        | \$44,787             | \$ (760)                                      | ) \$ 136,179                     |
| Net income                                 |   |                                  |                   | 34                   |   | 34                               |
| Other comprehensive loss                   |   |                                  |                   |                      | (702 )  | (702 )                           |
| Dividends paid (\$0.20 per share)          |   |                                  |                   | (1,796 )             |   | (1,796 )                         |
| Purchase of treasury stock (48,541 shares) |   |                                  | (898 )            |                      |   | (898 )                           |

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|  |       |           |            |          |      |        |             |
|--|-------|-----------|------------|----------|------|--------|-------------|
| Treasury stock used for employee benefit plans (22,171 shares) |       |           | 309        |          |      |        | 309         |
| Stock option expense   |       | 169       |            |          |      |        | 169         |
| Restricted shares award expense                                |       | 119       |            |          |      |        | 119         |
| Reclassification due to change in federal income tax rate      |       |           |            | 303      | (303 | )      | -           |
| BALANCE, December 31, 2017                                     | \$108 | \$119,039 | \$(27,296) | \$43,328 | \$   | (1,765 | ) \$133,414 |

See notes to unaudited consolidated financial statements.

## PRUDENTIAL BANCORP, INC. AND SUBSIDIARIES

## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | Three Months Ended December |          |
|---|-----------------------------|----------|
|   | 31,                         | 31,      |
|   | 2018                        | 2017     |
|   | (Dollars in Thousands)      |          |
| <b>OPERATING ACTIVITIES:</b>  |                             |          |
| Net income  | \$ 1,974                    | \$ 34    |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                             |          |
| Depreciation  | 155                         | 156      |
| Net (accretion) amortization of premiums/discounts  | (435)                       | 53       |
| Provision for loan losses   | -                           | 210      |
| Net amortization of deferred loan fees and costs  | (7)                         | 3        |
| Share-based compensation expense for stock options and awards                               | 308                         | 288      |
| Income from bank owned life insurance   | (154)                       | (164)    |
| Deferred income tax (benefit) expense   | (130)                       | 1,616    |
| Changes in assets and liabilities which used cash:  |                             |          |
| Accrued interest receivable   | (315)                       | (627)    |
| Accrued interest payable  | (1,675)                     | (1,292)  |
| Net other   | 285                         | 24       |
| Net cash provided by operating activities   | 6                           | 301      |
| <b>INVESTING ACTIVITIES:</b>  |                             |          |
| Purchase of investment and mortgage-backed securities available for sale                    | (86,650)                    | (40,641) |
| Purchase of investment securities held for maturity   | -                           | (2,458)  |
| Loans originated or acquired  | (30,865)                    | (28,346) |
| Principal collected on loans  | 45,430                      | 19,475   |
| Principal payments received on investment and mortgage-backed securities:                   |                             |          |
| Held-to-maturity  | 2,230                       | 345      |
| Available-for-sale  | 3,978                       | 3,332    |
| Purchase of FHLB stock  | (3,270)                     | (857)    |
| Proceeds from redemption of Federal Home Loan Bank stock                                    | 774                         | -        |
| Purchases of equipment  | (26)                        | (63)     |
| Net cash used in investing activities   | (68,399)                    | (49,213) |
| <b>FINANCING ACTIVITIES:</b>  |                             |          |
| Net decrease in demand deposits, NOW accounts, and savings accounts                         | (3,125)                     | (5,691)  |
| Net (decrease) increase in certificates of deposit  | (28,716)                    | 21,741   |
| Net proceeds from FHLB advances (short-term)  | 58,500                      | 10,000   |
| Proceeds from FHLB advances (long-term)   | 23,500                      | 26,000   |
| Repayment of FHLB advances (long-term)  | (19,232)                    | (13,287) |

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|  |          |   |           |   |
|--|----------|---|-----------|---|
| Increase in advances from borrowers for taxes and insurance        | 1,327    |   | 1,290     |   |
| Cash dividends paid  | (447     | ) | (1,796    | ) |
| Treasury stock used for employee benefit plans                     | -        |   | 309       |   |
| Purchase of treasury stock   | (1,687   | ) | (898      | ) |
| Net cash provided by financing activities                          | 30,120   |   | 37,668    |   |
| <br>   |          |   |           |   |
| NET DECREASE IN CASH AND CASH EQUIVALENTS                          | (38,273  | ) | (11,244   | ) |
| <br>   |          |   |           |   |
| CASH AND CASH EQUIVALENTS—Beginning of period                      | 48,171   |   | 27,903    |   |
| <br>   |          |   |           |   |
| CASH AND CASH EQUIVALENTS—End of period                            | \$ 9,898 |   | \$ 16,659 |   |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:                 |          |   |           |   |
| Interest paid on deposits and advances from Federal Home Loan Bank | \$ 5,661 |   | \$ 3,192  |   |
| <br>   |          |   |           |   |
| Income taxes paid  | \$ -     |   | \$ -      |   |
| <br>   |          |   |           |   |
| SUPPLEMENTAL DISCLOSURE OF NONCASH ITEMS:                          |          |   |           |   |
| Real estate acquired in settlement of loans                        | \$ -     |   | \$ 171    |   |

See notes to unaudited consolidated financial statements.

PRUDENTIAL BANCORP, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

Prudential Bancorp, Inc. (the “Company”) is a Pennsylvania corporation and the parent holding company for Prudential Bank (the “Bank”). The Company is a registered bank holding company.

The Bank is a community-oriented, Pennsylvania-chartered savings bank headquartered in South Philadelphia. The banking office network currently consists of the headquarters and main office (which includes a branch office), administrative office, and nine additional full-service branch offices. Eight of the branch offices are located in Philadelphia (Philadelphia County), one is in Drexel Hill, Delaware County, and one is in Huntingdon Valley, Montgomery County (both Pennsylvania counties). The Bank maintains ATMs at all 10 of the banking offices. The Bank also provides on-line and mobile banking services.

The Bank is subject to regulation by the Pennsylvania Department of Banking and Securities (the “Department”), as its chartering authority and primary regulator, and by the Federal Deposit Insurance Corporation (the “FDIC”), which insures the Bank’s deposits up to applicable limits. As a bank holding company, the Company is subject to the regulation of the Board of Governors of the Federal Reserve System.

On June 2, 2016, the Company announced the entering into of a definitive merger agreement with Polonia Bancorp, Inc. (“Polonia Bancorp”); effective January 1, 2017, Polonia Bancorp merged with and into the Company, and Polonia Bank, Polonia’s wholly owned subsidiary, merged with and into the Bank.

***Basis of presentation*** – The accompanying unaudited consolidated financial statements were prepared pursuant to the rules and regulations of the U. S. Securities and Exchange Commission (“SEC”) for interim information and therefore do not include all the information or footnotes necessary for a complete presentation of financial condition, results of operations, comprehensive income, changes in equity and cash flows in conformity with accounting principles generally accepted in the United States of America (“GAAP”). However, all normal recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the financial statements have been included. The results for the three months ended December 31, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2019, or any other period. These financial statements should be read

in conjunction with the audited consolidated financial statements of the Company and the accompanying notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2018. The significant accounting policies followed in the presentation of interim financial results are the same as those followed on an annual basis. These policies are presented on pages 84 through 88 of the Form 10-K for the year ended September 30, 2018.

***Use of Estimates in the Preparation of Financial Statements***—The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. The most significant estimates and assumptions in the Company's consolidated financial statements are recorded in the allowance for loan losses, deferred income taxes, other-than-temporary impairment, and the fair value measurement for financial instruments. Actual results could differ from those estimates.

### ***Recently Adopted Accounting Pronouncements***

Effective October 1, 2018, the Company adopted ASU 2014-09 *Revenue from Contracts with Customers – Topic 606* and all subsequent ASUs that modified ASC 606. The Company has elected to apply the standard utilizing the modified retrospective approach with a cumulative effect of adoption for the impact from uncompleted contracts at the date of adoption. The adoption of this guidance did not result in a change to the accounting for any of the in-scope revenue streams; as such, no cumulative effect adjustments were recorded.

Management determined that the primary sources of revenue emanating from interest and dividend income on loans and securities along with noninterest revenue resulting from investment security gains, loan servicing, gains on the sale of loans, commitment fees, fees from financial guarantees, certain credit cards fees, and income on bank-owned life insurance are not within the scope of ASC 606. As a result, no changes were made during the period related to these sources of revenue, which cumulatively comprise 98 percent of the total revenue of the Company. Services within the scope of ASC 606 include income from service charges on deposit accounts, other service income, ATM fees and gain on sale of OREO, net. For these accounts, fees are related to specific customer transactions and are attributable to specific performance obligations of the Bank where the revenue is recognized at a defined point in time, completion of the requested service/transaction.

ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This Update applies to all entities that hold financial assets or owe financial liabilities and is intended to provide more useful information on the recognition, measurement, presentation, and disclosure of financial instruments. Among other things, this Update (a) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (b) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (c) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (d) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (e) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (f) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (g) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The adoption of this Update did not have a significant impact on the Company's financial statements.

### ***Recent Accounting Pronouncements***



In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The standard requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. A short-term lease is defined as one in which (a) the lease term is 12 months or less and (b) there is not an option to purchase the underlying asset that the lessee is reasonably certain to exercise. For short-term leases, lessees may elect to recognize lease payments over the lease term on a straight-line basis. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2018 and interim periods within those years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020. The amendments should be applied at the beginning of the earliest period presented using a modified retrospective approach with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently assessing the practical expedients it may elect at adoption, but does not anticipate the amendments will have a significant impact on the financial statements. Based on the Company's preliminary analysis of its current portfolio, the impact to the Company's balance sheet is estimated to result in less than a one percent increase in assets and liabilities. The Company also anticipates additional disclosures to be provided at adoption.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments*, which changes the impairment model for most financial assets. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the Update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management's current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be affected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019, and early adoption is permitted for annual and interim periods beginning after December 15, 2018. With certain exceptions, transition to the new requirements will be through a cumulative effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the guidance is adopted. We expect to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, but cannot yet determine the magnitude of any such one-time adjustment or the overall impact of the new guidance on the consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20)*. The amendments in this Update shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity should apply the amendments in this Update on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Additionally, in the period of adoption, an entity should provide disclosures about a change in accounting principle. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position and results of operations.

In June 2018, the FASB issued ASU 2018-07, *Compensation – Stock Compensation (Topic 718)*, which simplified the accounting for nonemployee share-based payment transactions. The amendments in this update expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. The amendments in this Update improve the following areas of nonemployee share-based payment accounting; (a) the overall measurement objective, (b) the measurement date, (c) awards with performance conditions, (d) classification reassessment of certain equity-classified awards, (e) calculated value (nonpublic entities only), and (f) intrinsic value (nonpublic entities only). The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes the Disclosure Requirements for Fair Value Measurements*. The Update removes the requirement to disclose the amount of and reasons for transfers between Level I and Level II of the fair value hierarchy; the policy for timing of transfers between levels; and the valuation processes for Level III fair value measurements. The Update requires disclosure of changes in unrealized gains and losses for the period included in other comprehensive income (loss) for recurring Level III fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level III fair value measurements. This Update is effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

**2. EARNINGS PER SHARE**

Basic earnings per common share is computed by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding, net of any treasury shares, during the period. Diluted earnings per share is calculated by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding, net of any treasury shares, after consideration of the potential dilutive effect of common stock equivalents, based upon the treasury stock method using an average market price for the period.

The calculated basic and diluted earnings per share are as follows:

|   | Three Months Ended December 31,               |           |           |           |
|---|---|-----------|-----------|-----------|
|   | 2018  |           | 2017      |           |
|   | Basic   | Diluted   | Basic     | Diluted   |
|   | (Dollars in Thousands, Except Per Share Data) |           |           |           |
| Net income  | \$1,974                                       | \$1,974   | \$34      | \$34      |
| Weighted average shares outstanding                                     | 8,804,096                                     | 8,804,096 | 8,855,116 | 8,855,116 |
| Effect of common stock equivalents                                      | -   | 189,276   | -         | 357,871   |
| Adjusted weighted average shares used in earnings per share computation | 8,804,096                                     | 8,993,372 | 8,855,116 | 9,212,987 |
| Earnings per share - basic and diluted                                  | \$0.22  | \$0.22    | \$0.004   | \$0.004   |

As of December 31, 2018 and 2017, there were 666,526 and 890,616 shares of common stock, respectively, subject to options with an exercise price less than the then current market and which were included in the computation of diluted earnings per share. At December 31, 2018 and 2017, there were 198,084 and 1,413 shares that had exercise prices greater than the current market value and were considered anti-dilutive at such dates.

**3. ACCUMULATED OTHER COMPREHENSIVE LOSS**

The following table presents the changes in accumulated other comprehensive (loss) income by component net of tax:

| Three Months Ended December 31, |      |      | Three Months Ended December 31, |      |      |
|---------------------------------|------|------|---------------------------------|------|------|
| 2018                            | 2018 | 2018 | 2017                            | 2017 | 2017 |

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|   | Unrealized<br>gain<br>(loss)<br>on AFS<br>securities<br>(a) | Unrealized<br>gain<br>(loss)<br>on interest<br>rate swaps<br>(a) | Total<br>accumulated<br>other<br>comprehensive<br>income<br>(loss) | Unrealized<br>gain<br>(loss)<br>on AFS<br>securities<br>(a) | Unrealized<br>gain<br>(loss)<br>on interest<br>rate<br>swaps (a) | Total<br>accumulated<br>other<br>comprehensive<br>income<br>(loss) |
|---|---|--|--|---|--|--|
| Beginning balance, October 1                              | \$(8,320)   | \$ 166   | \$ (8,154 )  | \$(1,091)   | \$ 331   | \$ (760 )  |
| Other comprehensive (loss) income before reclassification | 2,705   | (584)  | ) 2,121  | (731 )  | 29   | (702 )   |
| Total   | (5,615)   | (418)  | ) (6,033 )   | (1,822)   | 360  | (1,462 )   |
| Reclassification due to change in federal income tax rate | -   | -  | -  | (303 )  | -  | (303 )   |
| Ending balance, December 31                               | \$(5,615)   | \$ (418)   | ) \$ (6,033 )  | \$(2,125)   | \$ 360   | \$ (1,765 )  |

(a) All amounts are net of tax. Amounts in parentheses indicate losses.

#### 4. INVESTMENT AND MORTGAGE-BACKED SECURITIES

The amortized cost and fair value of investment and mortgage-backed securities, with gross unrealized gains and losses, are as follows:

|   | December 31, 2018      |                              |                               |               |
|---|------------------------|------------------------------|-------------------------------|---------------|
|   | Amortized<br>Cost      | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|   | (Dollars in Thousands) |                              |                               |               |
| <b>Securities Available for Sale:</b>                 |                        |                              |                               |               |
| U.S. government and agency obligations                | \$25,280               | \$ -                         | \$ (816)                      | ) \$24,464    |
| State and political subdivisions                      | 22,717                 | 69                           | (848)                         | ) 21,938      |
| Mortgage-backed securities - U.S. government agencies | 272,717                | 1,029                        | (4,495)                       | ) 269,251     |
| Corporate bonds                                       | 79,569                 | 260                          | (2,330)                       | ) 77,499      |
| Total debt securities available for sale              | 400,283                | 1,358                        | (8,489)                       | ) 393,152     |
| <br>  |                        |                              |                               |               |
| Total securities available for sale                   | \$400,283              | \$ 1,358                     | \$ (8,489)                    | ) \$393,152   |
| <br>  |                        |                              |                               |               |
| <b>Securities Held to Maturity:</b>                   |                        |                              |                               |               |
| U.S. government and agency obligations                | \$31,500               | \$ 102                       | \$ (2,507)                    | ) \$29,095    |
| Mortgage-backed securities - U.S. government agencies | 5,556                  | 135                          | (80)                          | ) 5,611       |
| State and political subdivisions                      | 20,549                 | 58                           | (344)                         | ) 20,263      |
| <br>  |                        |                              |                               |               |
| Total securities held to maturity                     | \$57,605               | \$ 295                       | \$ (2,931)                    | ) \$54,969    |

|   | September 30, 2018     |            |              |           |
|---|------------------------|------------|--------------|-----------|
|   | Amortized              | Gross      | Gross        | Fair      |
|   | Cost                   | Unrealized | Unrealized   | Value     |
|   |                        | Gains      | Losses       |           |
|   | (Dollars in Thousands) |            |              |           |
| <b>Securities Available for Sale:</b>                 |                        |            |              |           |
| U.S. government and agency obligations                | \$25,562               | \$ -       | \$ (1,391 )  | \$24,171  |
| State and political subdivisions                      | 22,078                 | -          | (542 )       | 21,536    |
| Mortgage-backed securities - U.S. government agencies | 193,451                | 77         | (6,168 )     | 187,360   |
| Corporate debt securities                             | 75,622                 | -          | (2,539 )     | 73,083    |
| Total debt securities available for sale              | 316,713                | 77         | (10,640 )    | 306,150   |
| <br>  |                        |            |              |           |
| FHLMC preferred stock                                 | 6                      | 31         | -            | 37        |
| <br>  |                        |            |              |           |
| Total securities available for sale                   | \$316,719              | \$ 108     | \$ (10,640 ) | \$306,187 |
| <br>  |                        |            |              |           |
| <b>Securities Held to Maturity:</b>                   |                        |            |              |           |
| U.S. government and agency obligations                | \$33,500               | \$ 85      | \$ (3,311 )  | \$30,274  |
| State and political subdivisions                      | 20,574                 | 2          | (696 )       | 19,880    |
| Mortgage-backed securities - U.S. government agencies | 5,778                  | 148        | (153 )       | 5,773     |
| <br>  |                        |            |              |           |
| Total securities held to maturity                     | \$59,852               | \$ 235     | \$ (4,160 )  | \$55,927  |

As of December 31, 2018, the Bank maintained \$142.0 million in a safekeeping account at the FHLB of Pittsburgh used for collateral as a convenience. The Bank is not required to maintain any specific collateral for its borrowings; therefore these securities are not restricted and could be sold or transferred if needed.

The following table shows the gross unrealized losses and related fair values of the Company's investment securities, aggregated by investment category and length of time that individual securities had been in a continuous loss position at December 31, 2018:

|   | Less than 12 months     |                  | More than 12 months     |                  | Total                   |                  |
|---|-------------------------|------------------|-------------------------|------------------|-------------------------|------------------|
|   | Gross Unrealized Losses | Fair Value       | Gross Unrealized Losses | Fair Value       | Gross Unrealized Losses | Fair Value       |
| (Dollars in Thousands)                              |                         |                  |                         |                  |                         |                  |
| <b>Securities Available for Sale:</b>               |                         |                  |                         |                  |                         |                  |
| U.S. government and agency obligations              | \$-                     | \$-              | \$(816 )                | \$24,464         | \$(816 )                | \$24,464         |
| Mortgage-backed securities - US government agencies | (638 )                  | 65,310           | (3,857 )                | 93,540           | (4,495 )                | 158,850          |
| State and political subdivisions                    | (848 )                  | 16,552           | -                       | -                | (848 )                  | 16,552           |
| Corporate bonds                                     | (136 )                  | 14,780           | (2,194 )                | 44,850           | (2,330 )                | 59,630           |
| <b>Total securities available for sale</b>          | <b>\$(1,622)</b>        | <b>\$96,642</b>  | <b>\$(6,867 )</b>       | <b>\$162,854</b> | <b>\$(8,489 )</b>       | <b>\$259,496</b> |
| <b>Securities Held to Maturity:</b>                 |                         |                  |                         |                  |                         |                  |
| U.S. government and agency obligations              | \$-                     | \$-              | \$(2,507 )              | \$27,993         | \$(2,507 )              | \$27,993         |
| Mortgage-backed securities - US government agencies | (80 )                   | 2,095            | -                       | -                | (80 )                   | 2,095            |
| State and political subdivisions                    | (344 )                  | 11,475           | -                       | -                | (344 )                  | 11,475           |
| <b>Total securities held to maturity</b>            | <b>\$(424 )</b>         | <b>\$13,570</b>  | <b>\$(2,507 )</b>       | <b>\$27,993</b>  | <b>\$(2,931 )</b>       | <b>\$41,563</b>  |
| <b>Total</b>  | <b>\$(2,046)</b>        | <b>\$110,212</b> | <b>\$(9,374 )</b>       | <b>\$190,847</b> | <b>\$(11,420)</b>       | <b>\$301,059</b> |



The following table shows the gross unrealized losses and related fair values of the Company's investment securities, aggregated by investment category and length of time that individual securities had been in a continuous loss position at September 30, 2018:

|   | Less than 12 months     |                  | More than 12 months     |                  | Total                   |                  |
|---|-------------------------|------------------|-------------------------|------------------|-------------------------|------------------|
|   | Gross Unrealized Losses | Fair Value       | Gross Unrealized Losses | Fair Value       | Gross Unrealized Losses | Fair Value       |
| (Dollars in Thousands)                              |                         |                  |                         |                  |                         |                  |
| <b>Securities Available for Sale:</b>               |                         |                  |                         |                  |                         |                  |
| U.S. government and agency obligations              | \$(89 )                 | \$4,479          | \$(1,302 )              | \$19,692         | \$(1,391 )              | \$24,171         |
| Mortgage-backed securities - US government agencies | (1,821 )                | 92,851           | (4,347 )                | 86,268           | (6,168 )                | 179,119          |
| State and political subdivisions                    | (542 )                  | 21,536           | -                       | -                | (542 )                  | 21,536           |
| Corporate bonds                                     | (1,719)                 | 58,753           | (820 )                  | 14,330           | (2,539 )                | 73,083           |
| <b>Total securities available for sale</b>          | <b>\$(4,171)</b>        | <b>\$177,619</b> | <b>\$(6,469 )</b>       | <b>\$120,290</b> | <b>\$(10,640)</b>       | <b>\$297,909</b> |
| <b>Securities Held to Maturity:</b>                 |                         |                  |                         |                  |                         |                  |
| U.S. government and agency obligations              | \$-                     | \$-              | \$(3,311 )              | \$27,190         | \$(3,311 )              | \$27,190         |
| Mortgage-backed securities - US government agencies | (106 )                  | 2,630            | (46 )                   | 930              | (152 )                  | 3,560            |
| State and political subdivisions                    | (234 )                  | 11,238           | (463 )                  | 6,618            | (697 )                  | 17,856           |
| <b>Total securities held to maturity</b>            | <b>\$(340 )</b>         | <b>\$13,868</b>  | <b>\$(3,820 )</b>       | <b>\$34,738</b>  | <b>\$(4,160 )</b>       | <b>\$48,606</b>  |
| <b>Total</b>  | <b>\$(4,511)</b>        | <b>\$191,487</b> | <b>\$(10,289 )</b>      | <b>\$155,028</b> | <b>\$(14,800)</b>       | <b>\$346,515</b> |

Management evaluates securities for other-than-temporary impairment ("OTTI") at least once each quarter, and more frequently when economic or market concerns warrant such evaluation. The evaluation is based upon factors such as the creditworthiness of the issuers/guarantors, the underlying collateral, if applicable, and the continuing performance of the securities. Management also evaluates other facts and circumstances that may be indicative of an OTTI condition. This includes, but is not limited to, an evaluation of the type of security, the length of time and extent to which the fair value of the security has been less than cost, and the near-term prospects of the issuer.

The Company assesses whether a credit loss exists with respect to a security by considering whether (1) the Company has the intent to sell the security, (2) it is more likely than not that it will be required to sell the security before recovery has occurred, or (3) it does not expect to recover the entire amortized cost basis of the security. The Company bifurcates the OTTI impact on impaired securities where impairment in value was deemed to be other than temporary between the component representing credit loss and the component representing loss related to other factors. The portion of the fair value decline attributable to credit loss must be recognized through a charge to

earnings. The credit component is determined by comparing the present value of the cash flows expected to be collected, discounted at the rate in effect before recognizing any OTTI, with the amortized cost basis of the debt security. The Company uses the cash flows expected to be realized from the security, which includes assumptions about interest rates, timing and severity of defaults, estimates of potential recoveries, the cash flow distribution from the security and other factors, then applies a discount rate equal to the effective yield of the security. The difference between the present value of the expected cash flows and the amortized book value is considered a credit loss. The fair value of the security is determined using the same expected cash flows; the discount rate is a rate the Company determines from open market and other sources as appropriate for the particular security. The difference between the fair value and the security's remaining amortized cost is recognized in other comprehensive income (loss).

For both the three months ended December 31, 2018 and 2017, the Company did not record any credit losses on investment securities through earnings.

**U.S. Government and Agency Obligations** - At December 31, 2018, there were no securities in a gross unrealized loss position for less than 12 months while there were 14 securities in a gross unrealized loss position for more than 12 months at such date. These securities represent asset-backed issues that are issued or guaranteed by a U.S. Government sponsored agency or carry the full faith and credit of the United States through a government agency and are currently rated AAA by at least one bond credit rating agency. As a result, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2018.

**Mortgage-Backed Securities** – At December 31, 2018, there were 23 mortgage-backed securities in a gross unrealized loss position for less than 12 months, while there were 56 securities in a gross unrealized loss position for more than 12 months at such date. These securities represent asset-backed issues that are issued or guaranteed by a U.S. Government sponsored agency or carry the full faith and credit of the United States through a government agency and are currently rated AAA by at least one bond credit rating agency. As a result, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2018.

**Corporate Debt Securities** – At December 31, 2018, there were four securities in a gross unrealized loss for less than 12 months, while there were twenty-eight securities in a gross unrealized loss position for more than 12 months at such date. These securities were issued by publicly traded companies with an investment grade rating by at least one bond credit rating agency. As a result, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2018.

**State and political subdivisions** – At December 31, 2018, there were five securities in a gross unrealized loss for less than 12 months, while there were eight securities in a gross unrealized loss position for more than 12 months at such date. These securities were issued by local municipalities/school districts located in the Commonwealth of Pennsylvania with an investment grade rating by at least one bond credit rating agency. As a result, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2018.

The amortized cost and fair value of debt securities, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

The maturity table below excludes mortgage-backed securities because the contractual maturities of such securities are not indicative of actual maturities due to significant prepayments.

|                                  | December 31, 2018      |            |                    |            |
|----------------------------------|------------------------|------------|--------------------|------------|
|                                  | Held to Maturity       |            | Available for Sale |            |
|                                  | Amortized Cost         | Fair Value | Amortized Cost     | Fair Value |
|                                  | (Dollars in Thousands) |            |                    |            |
| Due after one through five years | \$ 1,703               | \$ 1,702   | \$ 8,527           | \$ 8,334   |
| Due after five through ten years | 23,759                 | 23,130     | 95,221             | 92,642     |
| Due after ten years              | 26,587                 | 24,526     | 23,818             | 22,925     |
| Total                            | \$52,049               | \$49,358   | \$127,566          | \$123,901  |

During the three month periods ended December 31, 2018 and 2017, the Company did not sell any securities.

## 5. LOANS RECEIVABLE

Loans receivable consist of the following:

|   | December 31, 2018      | September 30, 2018 |
|---|------------------------|--------------------|
|   | (Dollars in Thousands) |                    |
| One-to-four family residential          | \$ 322,525             | \$ 324,865         |
| Multi-family residential                | 34,556                 | 34,355             |
| Commercial real estate                  | 113,145                | 119,511            |
| Construction and land development       | 147,669                | 160,228            |
| Loans to financial institutions         | 6,000                  | 6,000              |
| Commercial business                     | 17,474                 | 17,792             |
| Leases                                  | 1,472                  | 1,687              |
| Consumer                                | 898                    | 953                |
| Total loans                             | 643,739                | 665,391            |
| Undisbursed portion of loans-in-process | (47,190 )              | (54,474 )          |
| Deferred loan fees                      | (2,871 )               | (2,818 )           |
| Allowance for loan losses               | (5,167 )               | (5,167 )           |

|           |            |            |
|-----------|------------|------------|
| Net loans | \$ 588,511 | \$ 602,932 |
|-----------|------------|------------|

The following table summarizes by loan segment the balance in the allowance for loan losses and the loans individually and collectively evaluated for impairment by loan segment at December 31, 2018:

|   | One- to<br>four -<br>family<br>residential | Multi-family<br>residential | Commercial<br>real<br>estate | Construction<br>and land<br>development | Commercial<br>business | Loans to<br>financial<br>institutions | Leases  | Consumer | Unallocated | Total     |
|---|--|-----------------------------|------------------------------|---|------------------------|---------------------------------------|---------|----------|-------------|-----------|
| (Dollars in Thousands)                      |  |                             |                              |   |                        |                                       |         |          |             |           |
| Allowance<br>for Loan<br>Losses:            |  |                             |                              |   |                        |                                       |         |          |             |           |
| Individually<br>evaluated for<br>impairment | \$-  | \$-                         | \$-                          | \$-                                     | \$-                    | \$-                                   | \$-     | \$-      | \$-         | \$-       |
| Collectively<br>evaluated for<br>impairment | 1,427                                      | 372                         | 1,147                        | 1,445                                   | 193                    | 67                                    | 16      | 13       | 487         | 5,167     |
| Total ending<br>allowance<br>balance        | \$1,427                                    | \$372                       | \$1,147                      | \$1,445                                 | \$193                  | \$67                                  | \$16    | \$13     | \$487       | \$5,167   |
| Loans:                                      |  |                             |                              |   |                        |                                       |         |          |             |           |
| Individually<br>evaluated for<br>impairment | \$5,234                                    | \$293                       | \$2,208                      | \$8,753                                 | \$-                    | \$-                                   | \$-     | \$10     |             | \$16,498  |
| Collectively<br>evaluated for<br>impairment | 317,291                                    | 34,263                      | 110,937                      | 138,916                                 | 17,474                 | 6,000                                 | 1,472   | 888      |             | 627,241   |
| Total loans                                 | \$322,525                                  | \$34,556                    | \$113,145                    | \$147,669                               | \$17,474               | \$6,000                               | \$1,472 | \$898    |             | \$643,739 |

The following table summarizes by loan segment the balance in the allowance for loan losses and the loans individually and collectively evaluated for impairment by loan segment at September 30, 2018:

|                                  | One- to<br>four -<br>family<br>residential | Multi-family<br>residential | Commercial<br>real<br>estate | Construction<br>and land<br>development | Commercial<br>business | Loans<br>to<br>financial<br>institutions | Leases | Consumer | Unallocated | Total |
|----------------------------------|--|-----------------------------|------------------------------|---|------------------------|--|--------|----------|-------------|-------|
| (Dollars in Thousands)           |  |                             |                              |   |                        |  |        |          |             |       |
| Allowance<br>for Loan<br>Losses: |  |                             |                              |   |                        |  |        |          |             |       |
|                                  | \$-  | \$-                         | \$-                          | \$-                                     | \$-                    | \$-                                      | \$-    | \$-      | \$-         | \$-   |

|   |           |          |           |           |          |         |         |       |       |           |
|---|-----------|----------|-----------|-----------|----------|---------|---------|-------|-------|-----------|
| Individually<br>evaluated for<br>impairment |           |          |           |           |          |         |         |       |       |           |
| Collectively<br>evaluated for<br>impairment | 1,343     | 347      | 1,154     | 1,554     | 187      | 64      | 18      | 18    | 482   | 5,167     |
| Total ending<br>allowance<br>balance        | \$1,343   | \$347    | \$1,154   | \$1,554   | \$187    | \$64    | \$18    | \$18  | \$482 | \$5,167   |
| Loans:                                      |           |          |           |           |          |         |         |       |       |           |
| Individually<br>evaluated for<br>impairment | \$5,081   | \$298    | \$1,919   | \$8,750   | \$-      | \$-     | \$-     | \$-   |       | \$16,048  |
| Collectively<br>evaluated for<br>impairment | 319,784   | 34,057   | 117,592   | 151,478   | 17,792   | 6,000   | 1,687   | 953   |       | 649,343   |
| Total loans                                 | \$324,865 | \$34,355 | \$119,511 | \$160,228 | \$17,792 | \$6,000 | \$1,687 | \$953 |       | \$665,391 |

The loan portfolio is segmented at a level that allows management to monitor both risk and performance. Management evaluates for potential impairment all construction, multi-family, commercial real estate, commercial business loans, all leases and all loans and leases more than 90 days delinquent as to principal and/or interest. Loans are considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect in full the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement.

Once the determination is made that a loan is impaired, the determination of whether a specific allocation of the allowance is necessary is generally measured by comparing the recorded investment in the loan to the fair value of the loan using one of the following three methods: (a) the present value of the expected future cash flows discounted at the loan's effective interest rate; (b) the loan's observable market price; or (c) the fair value of the collateral less selling costs. Management primarily utilizes the fair value of collateral method as a practically expedient alternative. On collateral method evaluations, any portion of the loan deemed uncollectible is charged-off against the loan loss allowance.

The following table presents impaired loans by class as of December 31, 2018, segregated by those for which a specific allowance was required and those for which a specific allowance was not required.

|                                   | Impaired Loans with Specific Allowance |                   | Impaired Loans with No Specific Allowance |                     | Total Impaired Loans | Unpaid Principal Balance |
|-----------------------------------|--|-------------------|---|---------------------|----------------------|--------------------------|
|                                   | Recorded Investment                    | Related Allowance | Recorded Investment                       | Recorded Investment |                      |                          |
| One-to-four family residential    | \$-                                    | \$ -              | \$ 5,234                                  | \$ 5,234            | \$ 5,234             | \$ 5,591                 |
| Multi-family residential          | -                                      | -                 | 293                                       | 293                 | 293                  | 293                      |
| Commercial real estate            | -                                      | -                 | 2,208                                     | 2,208               | 2,208                | 2,367                    |
| Construction and land development | -                                      | -                 | 8,753                                     | 8,753               | 8,753                | 11,134                   |
| Consumer                          | -                                      | -                 | 10  | 10                  | 10                   | 10                       |
| Total loans                       | \$-                                    | \$ -              | \$ 16,498                                 | \$ 16,498           | \$ 16,498            | \$ 19,395                |

The following table presents impaired loans by class as of September 30, 2018, segregated by those for which a specific allowance was required and those for which a specific allowance was not required.

|                                   | Impaired Loans with Specific Allowance |                   | Impaired Loans with No Specific Allowance |                     | Total Impaired Loans | Unpaid Principal Balance |
|-----------------------------------|--|-------------------|---|---------------------|----------------------|--------------------------|
|                                   | Recorded Investment                    | Related Allowance | Recorded Investment                       | Recorded Investment |                      |                          |
| One-to-four family residential    | \$-                                    | \$ -              | \$ 5,081                                  | \$ 5,081            | \$ 5,081             | \$ 5,432                 |
| Multi-family                      | -                                      | -                 | 298                                       | 298                 | 298                  | 298                      |
| Commercial real estate            | -                                      | -                 | 1,919                                     | 1,919               | 1,919                | 2,057                    |
| Construction and land development | -                                      | -                 | 8,750                                     | 8,750               | 8,750                | 11,131                   |
| Total loans                       | \$-                                    | \$ -              | \$ 16,048                                 | \$ 16,048           | \$ 16,048            | \$ 18,918                |





The following tables present the average recorded investment in impaired loans and related interest income recognized for the periods indicated:

|                                   | Three Months Ended December 31, 2018                        |  |                                       |
|-----------------------------------|---|--|---------------------------------------|
|                                   | Average<br>Recorded<br>Investment<br>(Dollars in Thousands) | Income<br>Recognized on<br>Accrual Basis | Income<br>Recognized on<br>Cash Basis |
| One-to-four family residential    | \$ 5,158  | \$ 15                                    | \$ 5                                  |
| Multi-family residential          | 296   | 5  | -                                     |
| Commercial real estate            | 2,064   | 10                                       | 1                                     |
| Construction and land development | 8,752   | -  | -                                     |
| Consumer                          | 5   | -  | -                                     |
| Total loans                       | \$ 16,274   | \$ 30                                    | \$ 6                                  |

|                                   | Three Months Ended December 31, 2017                        |  |                                       |
|-----------------------------------|---|--|---------------------------------------|
|                                   | Average<br>Recorded<br>Investment<br>(Dollars in Thousands) | Income<br>Recognized on<br>Accrual Basis | Income<br>Recognized on<br>Cash Basis |
| One-to-four family residential    | \$ 9,690  | \$ 34                                    | \$ 4                                  |
| Multi-family residential          | 315   | 6  | -                                     |
| Commercial real estate            | 3,051   | 29                                       | -                                     |
| Construction and land development | 8,729   | -  | -                                     |
| Consumer                          | 10  | -  | -                                     |
| Total loans                       | \$ 21,795   | \$ 69                                    | \$ 4                                  |

Federal regulations and our loan policy require that the Company utilize an internal asset classification system as a means of reporting problem and potential problem assets. The Company has incorporated an internal asset classification system, consistent with Federal banking regulations, as a part of its credit monitoring system. Management currently classifies problem and potential problem assets as “special mention”, “substandard,” “doubtful” or “loss” assets. An asset is considered “substandard” if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. “Substandard” assets include those characterized by the “distinct possibility” 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 “substandard” with the added characteristic that the weaknesses present make “collection or liquidation in full,” on the basis of currently existing facts, conditions, and values, “highly questionable and improbable.” Assets classified as “loss” are those considered “uncollectible” and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets which do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated “special mention.”



The following tables present the classes of the loan portfolio in which a formal risk weighting system is utilized summarized by the aggregate “Pass” and the criticized category of “special mention”, and the classified categories of “substandard”, “doubtful” and “loss” within the Company’s risk rating system as applied to the loan portfolio. The Company had no loans classified as “doubtful” or “loss” at either of the dates presented.

|                                   | December 31, 2018      |                    |             | Total<br>Loans |
|-----------------------------------|------------------------|--------------------|-------------|----------------|
|                                   | Pass                   | Special<br>Mention | Substandard |                |
|                                   | (Dollars in Thousands) |                    |             |                |
| One-to-four family residential    | \$315,040              | \$ 2,251           | \$ 5,234    | \$322,525      |
| Multi-family residential          | 33,935                 | 328                | 293         | 34,556         |
| Commercial real estate            | 106,805                | 4,132              | 2,208       | 113,145        |
| Construction and land development | 138,916                | -                  | 8,753       | 147,669        |
| Loans to financial institutions   | 6,000                  | -                  | -           | 6,000          |
| Commercial business               | 17,474                 | -                  | -           | 17,474         |
| Total loans                       | \$618,170              | \$ 6,711           | \$ 16,488   | \$641,369      |

|                                   | September 30, 2018     |                    |             | Total<br>Loans |
|-----------------------------------|------------------------|--------------------|-------------|----------------|
|                                   | Pass                   | Special<br>Mention | Substandard |                |
|                                   | (Dollars in Thousands) |                    |             |                |
| One-to-four family residential    | \$317,033              | \$ 2,751           | \$ 5,081    | \$324,865      |
| Multi-family residential          | 34,057                 | -                  | 298         | 34,355         |
| Commercial real estate            | 115,670                | 1,922              | 1,919       | 119,511        |
| Construction and land development | 151,478                | -                  | 8,750       | 160,228        |
| Loans to financial institutions   | 6,000                  | -                  | -           | 6,000          |
| Commercial business               | 17,792                 | -                  | -           | 17,792         |
| Total loans                       | \$642,030              | \$ 4,673           | \$ 16,048   | \$662,751      |

The Company evaluates the classification of one-to-four family residential and consumer loans primarily on a pooled basis. If the Company becomes aware that adverse or distressed conditions exist that may affect a particular single-family residential loan, the loan is downgraded following the above definitions of special mention, substandard, doubtful and loss.

The following tables represent loans in which a formal risk rating system is not utilized, but loans are segregated between performing and non-performing based primarily on delinquency status. Non-performing loans that would be included in the table are those loans greater than 90 days past due as to principal and/or interest that do not have a designated risk rating.

|                                | December 31, 2018      |            |           |
|--------------------------------|------------------------|------------|-----------|
|                                | Non-                   |            | Total     |
|                                | Performing             | Performing | Loans     |
|                                | (Dollars in Thousands) |            |           |
| One-to-four family residential | \$319,088              | \$ 3,437   | \$322,525 |
| Leases                         | 1,472                  | -          | 1,472     |
| Consumer                       | 898                    | -          | 898       |
| Total loans                    | \$321,458              | \$ 3,437   | \$324,895 |

|                                | September 30, 2018     |            |           |
|--------------------------------|------------------------|------------|-----------|
|                                | Non-                   |            | Total     |
|                                | Performing             | Performing | Loans     |
|                                | (Dollars in Thousands) |            |           |
| One-to-four family residential | \$321,853              | \$ 3,012   | \$324,865 |
| Leases                         | 1,687                  | -          | 1,687     |
| Consumer                       | 953                    | -          | 953       |
| Total loans                    | \$324,493              | \$ 3,012   | \$327,505 |

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is due or overdue, as the case may be. The following table presents the loan categories of the loan portfolio summarized by the aging categories of performing and delinquent loans and nonaccrual loans:

|                                      | December 31, 2018      |          |           |          | Total<br>Loans | Non-<br>Accrual | 90 Days+<br>Past Due<br>and<br>Accruing |
|--------------------------------------|------------------------|----------|-----------|----------|----------------|-----------------|---|
|                                      | 30-89<br>Days          |          | 90 Days + | Total    |                |                 |   |
|                                      | Current                | Past Due | Past Due  | Past Due |                |                 |   |
|                                      | (Dollars in Thousands) |          |           |          |                |                 |   |
| One-to-four family residential       | \$317,547              | \$ 2,514 | \$ 2,464  | \$ 4,978 | \$322,525      | \$3,437         | \$ -                                    |
| Multi-family residential             | 34,395                 | 161      | -         | 161      | 34,556         | -               | -                                       |
| Commercial real estate               | 111,727                | 88       | 1,330     | 1,418    | 113,145        | 1,478           | -                                       |
| Construction and land<br>development | 138,916                | -        | 8,753     | 8,753    | 147,669        | 8,753           | -                                       |
| Commercial business                  | 17,474                 | -        | -         | -        | 17,474         | -               | -                                       |

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|                                 |           |          |           |           |           |          |      |
|---------------------------------|-----------|----------|-----------|-----------|-----------|----------|------|
| Loans to financial institutions | 6,000     | -        | -         | -         | 6,000     | -        | -    |
| Leases                          | 1,472     | -        | -         | -         | 1,472     | -        | -    |
| Consumer                        | 841       | 57       | -         | 57        | 898       | -        | -    |
| Total loans                     | \$628,372 | \$ 2,820 | \$ 12,547 | \$ 15,367 | \$643,739 | \$13,668 | \$ - |

|                                      | September 30, 2018     |                           |                       |                   |                |                 | 90 Days+<br>Past Due<br>and<br>Accruing |
|--------------------------------------|------------------------|---------------------------|-----------------------|-------------------|----------------|-----------------|---|
|                                      | Current                | 30-89<br>Days<br>Past Due | 90 Days +<br>Past Due | Total<br>Past Due | Total<br>Loans | Non-<br>Accrual |   |
|                                      | (Dollars in Thousands) |                           |                       |                   |                |                 |   |
| One-to-four family residential       | \$321,749              | \$ 1,037                  | \$ 2,079              | \$ 3,116          | \$324,865      | \$3,012         | \$ -                                    |
| Multi-family residential             | 34,355                 | -                         | -                     | -                 | 34,355         | -               | -                                       |
| Commercial real estate               | 117,335                | 722                       | 1,454                 | 2,176             | 119,511        | 1,627           | -                                       |
| Construction and land<br>development | 151,478                | -                         | 8,750                 | 8,750             | 160,228        | 8,750           | -                                       |
| Commercial business                  | 17,792                 | -                         | -                     | -                 | 17,792         | -               | -                                       |
| Loans to financial institutions      | 6,000                  | -                         | -                     | -                 | 6,000          | -               | -                                       |
| Leases                               | 1,687                  | -                         | -                     | -                 | 1,687          | -               | -                                       |
| Consumer                             | 837                    | 116                       | -                     | 116               | 953            | -               | -                                       |
| Total loans                          | \$651,233              | \$ 1,875                  | \$ 12,283             | \$ 14,158         | \$665,391      | \$13,389        | \$ -                                    |

The allowance for loan losses is established through a provision for loan losses charged to expense. The Company maintains the allowance at a level believed to cover all known and inherent losses in the portfolio that are both probable and reasonable to estimate at each reporting date. Management reviews the allowance for loan losses no less than quarterly in order to identify these inherent losses and to assess the overall collection probability for the loan portfolio in view of these inherent losses. For each primary type of loan, a loss factor is established reflecting an estimate of the known and inherent losses in such loan type contained in the portfolio using both a quantitative analysis as well as consideration of qualitative factors. The evaluation process includes, among other things, an analysis of delinquency trends, non-performing loan trends, the level of charge-offs and recoveries, prior loss experience, total loans outstanding, the volume of loan originations, the type, size and geographic concentration of the Company's loans, the value of collateral securing the loans, the borrowers' ability to repay and repayment performance, the number of loans requiring heightened management oversight, local economic conditions and industry experience.

Commercial real estate loans entail significant additional credit risks compared to owner-occupied one-to-four family residential mortgage loans, as they generally involve large loan balances concentrated with single borrowers or groups of related borrowers. In addition, the payment experience on loans secured by income-producing properties typically depends on the successful operation of the related real estate project and/or business operation of the borrower who is, in some cases, also the primary occupant, and thus may be subject to a greater extent to the effects of adverse conditions in the real estate market and in the economy in general. Commercial business loans typically involve a higher risk of default than residential loans of like duration since their repayment is generally dependent on the successful operation of the borrower's business and the sufficiency of collateral, if any. Land acquisition, development and construction lending exposes the Company to greater credit risk than permanent mortgage financing. The repayment of land acquisition, development and construction loans depends upon the sale of the property to third parties or the availability of permanent financing upon completion of all improvements. These events may adversely affect the sale of the properties, potentially reducing both the borrowers' ability to make required payments as well as reducing the value of the collateral property. Such lending is additionally subject to the risk that if the estimate of construction cost proves to be inaccurate, the Company potentially will be compelled to advance additional funds to

allow completion of the project. In addition, if the estimate of value proves to be inaccurate, the Company may be confronted with a project, when completed, having less value than the loan amount. If the Company is forced to foreclose on a project prior to completion, there is no assurance that the Company would be able to recover the entire unpaid portion of the loan.



The following tables summarize the primary segments of the allowance for loan losses. Activity in the allowance is presented for the three month periods ended December 31, 2018 and 2017:

|                                       | Three Months Ended December 31, 2018 |                                 |                           |   |                        |                                       |        |          |             | Total    |
|---------------------------------------|--------------------------------------|---------------------------------|---------------------------|---|------------------------|---------------------------------------|--------|----------|-------------|----------|
|                                       | One-<br>four-family<br>residential   | Multi-<br>family<br>residential | Commercial<br>real estate | Construction<br>and land<br>development | Commercial<br>business | Loans to<br>financial<br>institutions | Leases | Consumer | Unallocated |          |
| ALLL balance at<br>September 30, 2018 | \$ 1,343                             | \$ 347                          | \$ 1,154                  | \$ 1,554                                | \$ 187                 | \$ 64                                 | \$ 18  | \$ 18    | \$ 482      | \$ 5,167 |
| Charge-offs                           | -                                    | -                               | -                         | -                                       | -                      | -                                     | -      | -        | -           | -        |
| Recoveries                            | -                                    | -                               | -                         | -                                       | -                      | -                                     | -      | -        | -           | -        |
| Provision                             | 84                                   | 25                              | (7 )                      | (109 )                                  | 6                      | 3                                     | (2 )   | (5 )     | 5           | -        |
| ALLL balance at<br>December 31, 2018  | \$ 1,427                             | \$ 372                          | \$ 1,147                  | \$ 1,445                                | \$ 193                 | \$ 67                                 | \$ 16  | \$ 13    | \$ 487      | \$ 5,167 |

|                                       | Three Months Ended December 31, 2017     |                                 |                              |   |                        |  |        |          |             | Total    |
|---------------------------------------|--|---------------------------------|------------------------------|---|------------------------|--|--------|----------|-------------|----------|
|                                       | One-<br>to<br>four-family<br>residential | Multi-<br>family<br>residential | Commercial<br>real<br>estate | Construction<br>and land<br>development | Commercial<br>business | Loans<br>to<br>financial<br>institutions | Leases | Consumer | Unallocated |          |
| ALLL balance at<br>September 30, 2017 | \$ 1,241                                 | \$ 205                          | \$ 1,201                     | \$ 1,358                                | \$ 4                   | \$ -                                     | \$ 23  | \$ 24    | \$ 410      | \$ 4,466 |
| Charge-offs                           | -  | -                               | -                            | -                                       | -                      | -  | -      | -        | -           | -        |
| Recoveries                            | -  | -                               | -                            | -                                       | -                      | -  | -      | -        | -           | -        |
| Provision                             | 29                                       | (47 )                           | (137 )                       | 263                                     | 22                     | -  | (3 )   | -        | 83          | 210      |
| ALLL balance at<br>December 31, 2017  | \$ 1,270                                 | \$ 158                          | \$ 1,064                     | \$ 1,621                                | \$ 26                  | \$ -                                     | \$ 20  | \$ 24    | \$ 493      | \$ 4,676 |

The Company recorded no provision for loan losses in the three months period ended December 31, 2018, compared to \$210,000 for the same period in 2017.

At December 31, 2018, the Company had nine loans aggregating \$6.0 million that were classified as troubled debt restructurings (“TDRs”). Five of such loans aggregating \$644,000 as of December 31, 2018 were performing in accordance with the restructured terms and accruing interest. Three of the TDRs, totaling \$4.9 million, which are classified as non-accrual are a part of a troubled lending relationship totaling \$10.6 million (after taking into account the previously disclosed \$1.9 million write-down recognized during the quarter ending March 31, 2017 related to this borrowing relationship). The remaining TDR is also on non-accrual and consists of a \$445,000 loan secured by various commercial and residential properties.

The Company did not restructure any loans during the three months ended December 31, 2018, while one loan was restructured with a balance of \$77,000, during the three month period ended December 31, 2017. The restructuring entailed extending the loan maturity date to February 2018, at which time the loan was paid off.

| As of and for the Three months Ended December 31, 2017 |                        |              |              |
|--|------------------------|--------------|--------------|
|  | Number                 | Pre-         | Post-        |
|  | of                     | Modification | Modification |
|  | Loans                  | Outstanding  | Outstanding  |
|  |                        | Recorded     | Recorded     |
|  |                        | Investment   | Investment   |
|  | (Dollars in Thousands) |              |              |
| One-to-four family residential                         | 1                      | \$ 77        | \$ 77        |
|  | 1                      | \$ 77        | \$ 77        |

No TDRs defaulted during the three month periods ending December 31, 2018 and 2017.

## 6. DEPOSITS

Deposits consist of the following major classifications:

|   | December 31,<br>2018   |         | September 30,<br>2018 |         |
|---|------------------------|---------|-----------------------|---------|
|   | Amount                 | Percent | Amount                | Percent |
|   | (Dollars in Thousands) |         |                       |         |
| Money market deposit accounts                 | \$65,752               | 8.7 %   | \$66,120              | 8.4 %   |
| Interest-bearing checking accounts            | 49,273                 | 6.6 %   | 49,209                | 6.3 %   |
| Non interest-bearing checking accounts        | 14,306                 | 1.9 %   | 13,620                | 1.7 %   |
| Passbook, club and statement savings          | 87,975                 | 11.7 %  | 91,489                | 11.7 %  |
| Certificates maturing in six months or less   | 287,001                | 38.1 %  | 301,184               | 38.4 %  |
| Certificates maturing in more than six months | 248,056                | 33.0 %  | 262,636               | 33.5 %  |
| Total   | \$752,363              | 100.0 % | \$784,258             | 100.0 % |

Certificates of \$250,000 and over totaled \$50.9 million as of December 31, 2018 and \$81.9 million as of September 30, 2018.

**7. ADVANCES FROM FEDERAL HOME LOAN BANK – SHORT TERM**

The periods ended December 31, 2018 and September 30, 2018 outstanding balances and related information of short-term borrowings from the FHLB are summarized follows:

| Type                   | Maturity Date | Coupon | Call Date        | December  | September 30,  |
|------------------------|---------------|--------|------------------|---|----------------|
|                        |               |        |                  | 31,<br>2018<br>Amount<br>(Dollars in Thousands) | 2018<br>Amount |
| Fixed Rate - Repo Plus | 12-Oct-18     | 2.31   | % Not Applicable | \$ -  | \$ 10,000      |
| Weighted average rate  |               | 2.31   | %                |   |                |
| Fixed Rate - Repo Plus | 2-Jan-19      | 2.62   | % Not Applicable | \$ 58,500                                       | \$ -           |
| Fixed Rate - Repo Plus | 14-Jan-19     | 2.64   | % Not Applicable | 10,000  | -              |
| Weighted average rate  |               | 2.62   | %                | \$ 68,500                                       | \$ 10,000      |

As of December 31, 2018 and September 30, 2018, included a \$10.0 million 30 day FHLB advance associated with an interest rate swap contract with a weighted average effective cost of 270 basis points. The additional \$58.5 million at December 31, 2018 consisted of an overnight borrowing to provide additional short-term liquidity.

**8. ADVANCES FROM FEDERAL HOME LOAN BANK – LONG TERM**

Pursuant to collateral agreements with the FHLB of Pittsburgh, advances are secured by a blanket collateral of loans held by the Company and qualifying fixed-income securities and FHLB stock. The long-term advances outstanding as of December 31, 2018 and September 30, 2018 are as follows:

| Long-term FHLB<br>advances:<br>Description | Maturity range |           | Weighted<br>average<br>interest<br>rate | Stated interest rate<br>range |        | December<br>31,<br>2018<br>(Dollars in Thousands) | September<br>30,<br>2018 |
|--|----------------|-----------|---|-------------------------------|--------|---|--------------------------|
|  | from           | to        |   | from                          | to     |   |                          |
| Fixed Rate -<br>Amortizing                 | 1-Oct-18       | 30-Sep-19 | 1.53                                    | % 1.53                        | % 1.53 | % \$ 1,290  | \$ 1,639                 |
| Fixed Rate -<br>Amortizing                 | 1-Oct-20       | 30-Sep-21 | 2.68                                    | % 1.94                        | % 2.83 | % 21,077  | 23,288                   |
| Fixed Rate -<br>Amortizing                 | 1-Oct-21       | 30-Sep-22 | 2.80                                    | % 1.99                        | % 3.05 | % 11,076  | 11,848                   |

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|                         |          |           |      |   |      |   |              |   |            |            |
|-------------------------|----------|-----------|------|---|------|---|--------------|---|------------|------------|
| Fixed Rate - Amortizing | 1-Oct-22 | 30-Sep-23 | 2.88 | % | 1.94 | % | 3.11         | % | 8,150      | 8,550      |
| Total                   |          |           | 2.72 | % |      |   |              |   | \$ 41,593  | \$ 45,325  |
| Fixed Rate - Advances   | 1-Oct-18 | 30-Sep-19 | 2.66 | % | 1.40 | % | 2.66         | % | \$ 3,018   | \$ 18,528  |
| Fixed Rate - Advances   | 1-Oct-19 | 30-Sep-20 | 2.62 | % | 1.38 | % | 3.06         | % | 12,389     | 12,413     |
| Fixed Rate - Advances   | 1-Oct-20 | 30-Sep-21 | 2.45 | % | 1.42 | % | 2.92         | % | 3,032      | 3,037      |
| Fixed Rate - Advances   | 1-Oct-21 | 30-Sep-22 | 2.28 | % | 1.94 | % | 3.23         | % | 23,369     | 23,380     |
| Fixed Rate - Advances   | 1-Oct-22 | 30-Sep-23 | 2.70 | % | 2.18 | % | 3.15         | % | 37,000     | 37,000     |
| Fixed Rate - Advances   | 1-Oct-23 | 30-Sep-24 | 3.13 | % | 2.98 | % | 3.20         | % | 28,500     | 5,000      |
| Total                   |          |           | 2.71 | % |      |   |              |   | \$ 107,308 | \$ 99,358  |
|                         |          |           | 2.71 | % |      |   | <b>Total</b> |   | \$ 148,901 | \$ 144,683 |

## 9.

## DERIVATIVES

The Company has contracted with a third party to participate in interest rate swap contracts. One of the swaps is a cash flow hedge associated with \$10.0 million of FHLB advances at both December 31, 2018 and September 30, 2018, while there are two additional cash flow hedges tied to 90 day wholesale funding at December 31, 2018. These interest rate swaps involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed rate payments. During the quarter ended December 31, 2018, \$3,000 of expense was recognized as ineffectiveness through earnings, while \$42,000 of income was recognized as ineffectiveness through earnings during the comparable period in 2017. There were nine interest rate swaps designated as fair value hedges involving the receipt of variable-rate payments from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements that were applicable to two loans and seven investment securities as of both December 31, 2018 and September 30, 2018. The fair value is recorded in the other assets section of the statement of financial condition.

Below is a summary of the interest rate swap agreements and their terms as of December 31, 2018.

|                             | Hedged Item                     | Notional Amount<br>(Dollars in thousands) | Pay Rate | Receive Rate        | Maturity Date | Unrealized Loss |
|-----------------------------|---------------------------------|---|----------|---------------------|---------------|-----------------|
| Interest rate swap contract | FHLB Advance                    | \$10,000                                  | 2.70 %   | 1 Mth Libor         | 10-Apr-25     | \$ (144 )       |
| Interest rate swap contract | State and political subdivision | 1,705                                     | 3.06 %   | 3 Mth Libor         | 15-Feb-27     | (51 )           |
| Interest rate swap contract | State and political subdivision | 2,825                                     | 3.06 %   | 3 Mth Libor         | 1-Apr-27      | (85 )           |
| Interest rate swap contract | State and political subdivision | 5,000                                     | 3.07 %   | 3 Mth Libor         | 1-Jan-28      | (154 )          |
| Interest rate swap contract | State and political subdivision | 1,235                                     | 3.07 %   | 3 Mth Libor         | 1-Mar-28      | (38 )           |
| Interest rate swap contract | State and political subdivision | 4,500                                     | 3.07 %   | 3 Mth Libor         | 1-May-28      | (139 )          |
| Interest rate swap contract | State and political subdivision | 3,305                                     | 3.05 %   | 3 Mth Libor         | 1-Feb-27      | (93 )           |
| Interest rate swap contract | State and political subdivision | 3,000                                     | 3.06 %   | 3 Mth Libor         | 15-Oct-27     | (90 )           |
| Interest rate swap contract | Commercial loan                 | 8,300                                     | 5.74 %   | 1 Mth Libor +250 bp | 13-Jun-25     | -               |
| Interest rate swap contract | Commercial loan                 | 1,100                                     | 4.10 %   | 1 Mth Libor +276 bp | 1-Aug-26      | -               |
| Interest rate swap contract | 90 Day wholesale funding        | 20,000                                    | 2.78 %   | 3 Mth Libor         | 11-Jan-24     | (234 )          |

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|                             |                          |        |                    |           |             |
|-----------------------------|--------------------------|--------|--------------------|-----------|-------------|
| Interest rate swap contract | 90 Day wholesale funding | 15,000 | 2.75 % 3 Mth Libor | 18-Jan-24 | (150 )      |
| Total                       |                          |        |                    |           | \$ (1,178 ) |

Below is a summary of the interest rate swap agreements and their terms as of September 30, 2018.

|                             | Hedged<br>Item                  | Notional<br>Amount | Pay<br>Rate | Receive<br>Rate     | Maturity<br>Date | Unrealized<br>Gain<br>(Loss) |
|-----------------------------|---------------------------------|--------------------|-------------|---------------------|------------------|------------------------------|
| (Dollars in thousands)      |                                 |                    |             |                     |                  |                              |
| Interest rate swap contract | FHLB Advance                    | \$ 10,000          | 2.70%       | 1 Mth Libor         | 10-Apr-25        | \$ 35                        |
| Interest rate swap contract | State and political subdivision | 1,705              | 3.06%       | 3 Mth Libor         | 15-Feb-27        | (19 )                        |
| Interest rate swap contract | State and political subdivision | 2,825              | 3.06%       | 3 Mth Libor         | 1-Apr-27         | (31 )                        |
| Interest rate swap contract | State and political subdivision | 5,000              | 3.07%       | 3 Mth Libor         | 1-Jan-28         | (57 )                        |
| Interest rate swap contract | State and political subdivision | 1,235              | 3.07%       | 3 Mth Libor         | 1-Mar-28         | (14 )                        |
| Interest rate swap contract | State and political subdivision | 4,500              | 3.07%       | 3 Mth Libor         | 1-May-28         | (52 )                        |
| Interest rate swap contract | State and political subdivision | 3,305              | 3.05%       | 3 Mth Libor         | 1-Feb-27         | (32 )                        |
| Interest rate swap contract | State and political subdivision | 3,000              | 3.06%       | 3 Mth Libor         | 15-Oct-27        | (32 )                        |
| Interest rate swap contract | Commercial loan                 | 8,300              | 5.74%       | 1 Mth Libor +250 bp | 13-Jun-25        | -                            |
| Interest rate swap contract | Commercial loan                 | 1,100              | 4.10%       | 1 Mth Libor +276 bp | 1-Aug-26         | -                            |
| Total                       |                                 |                    |             |                     |                  | \$ (202 )                    |

All interest swaps are carried at fair value in accordance with FASB ASC 815 "Derivatives and Hedging."



10.

## INCOME TAXES

Items that gave rise to significant portions of deferred income taxes are as follows:

|   | December<br>31,<br>2018 | September 30,<br>2018 |
|---|-------------------------|-----------------------|
|   | (Dollars in Thousands)  |                       |
| Deferred tax assets:                                  |                         |                       |
| Allowance for loan losses                             | \$ 1,447                | \$ 1,445              |
| Nonaccrual interest                                   | 371                     | 312                   |
| Accrued vacation                                      | 4                       | 29                    |
| Capital loss carryforward                             | 356                     | 356                   |
| Split dollar life insurance                           | 8                       | 10                    |
| Post-retirement benefits                              | 79                      | 85                    |
| Unrealized losses on available for sale securities    | 1,492                   | 2,212                 |
| Unrealized losses on interest rate swaps              | 111                     | -                     |
| Deferred compensation                                 | 854                     | 838                   |
| Goodwill  | 77                      | 80                    |
| Other   | 51                      | 55                    |
| Employee benefit plans                                | 286                     | 239                   |
| <br>  |                         |                       |
| Total deferred tax assets                             | 5,136                   | 5,661                 |
| Valuation allowance                                   | (356 )                  | (356 )                |
| Total deferred tax assets, net of valuation allowance | 4,780                   | 5,305                 |
| <br>  |                         |                       |
| Deferred tax liabilities:                             |                         |                       |
| Property  | 153                     | 179                   |
| Unrealized gains on interest rate swaps               | -                       | 44                    |
| Purchase accounting adjustments                       | 102                     | 59                    |
| Deferred loan fees                                    | 309                     | 368                   |
| <br>  |                         |                       |
| Total deferred tax liabilities                        | 564                     | 650                   |
| <br>  |                         |                       |
| Net deferred tax assets                               | \$ 4,216                | \$ 4,655              |

The Company establishes a valuation allowance for deferred tax assets when management believes that the use of the deferred tax assets is not likely to be fully realized through future reversals of existing taxable temporary differences and/or, to a lesser extent, future taxable income. The tax deduction generated by the redemption of the shares of a mutual fund held by the Bank and the subsequent impairment charge on the assets acquired through the redemption in kind are considered capital losses and can only be utilized to the extent of capital gains recognized over a five year period, resulting in the establishment of a valuation allowance for the carryforward period. The valuation allowance totaled \$356,000 at December 31, 2018 and September 30, 2018, respectively.

For the three-month period ended December 31, 2018, the Company recorded income tax expense of \$429,000 compared to income tax expense of \$2.3 million, for the period ended December 31, 2017, which included a \$1.8 million one-time charge related to a re-evaluation of the Company's deferred tax assets as a result of the enactment of the Tax Cuts and Jobs Act in December 2017. The re-evaluation reflected the effect of the significant decline in the federal corporate income tax rate applicable to the Company. During fiscal 2018, commencing with the quarter ended December 31, 2017, the Company's statutory income tax rate was 24.25% as compared to companies which are calendar year tax reporting companies whose statutory rate decreased to 21% starting January 1, 2018. Effective October 1, 2018, the Company's statutory tax rate was reduced to 21%.

There is currently no liability for uncertain tax positions and no known unrecognized tax benefits. The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the Consolidated Statements of Operations as a component of income tax expense. During fiscal 2017, the Internal Revenue Service conducted an audit of the Company's tax return for the year ended September 30, 2014, and no adverse findings were reported. The Company's federal and state income tax returns for taxable years through September 30, 2014 have been closed for purposes of examination by the Internal Revenue Service and the Pennsylvania Department of Revenue.

## 11. STOCK COMPENSATION PLANS

The Company maintains the 2008 Recognition and Retention Plan ("RRP") which is administered by a committee of the Board of Directors of the Company. The RRP provides for the grant of shares of common stock of the Company to officers, employees and directors of the Company. In order to fund the grant of shares under the RRP, the RRP Trust purchased 213,528 shares of the Company's common stock in the open market for approximately \$2.5 million, at an average purchase price per share of \$11.49, as part of the RRP. The Company made sufficient contributions to the RRP Trust to fund the RRP Trust's purchases. Shares subject to awards under the RRP generally vest at the rate of 20% per year over five years. During February 2015, shareholders approved the 2014 Stock Incentive Plan (the "2014 SIP"). As part of the 2014 SIP, a maximum of 285,655 shares can be awarded as restricted stock awards or units, of which 235,500 shares were awarded during February 2015. In August 2016, the Company granted 7,473 shares under the 2008 RRP and 3,027 shares under the 2014 SIP. In March 2017, the Company granted 17,128 shares under the 2014 SIP. In March 2018, the Company granted 8,209 shares under the 2008 RRP and 18,291 shares under the 2014 SIP.

Compensation expense related to the shares subject to restricted stock awards granted is recognized ratably over the five-year vesting period in an amount which totals the grant date fair value multiplied by the number of shares subject to the grant. During the three months ended December 31, 2018 and 2017, \$157,000 and \$151,000, respectively, was recognized in compensation expense for the RRP and the 2014 SIP. At December 31, 2018, approximately \$1.2 million in additional compensation expense for the shares awarded which remained outstanding related to the RRP and the 2014 SIP remained unrecognized

A summary of the Company's non-vested stock award activity for the three months ended December 31, 2018 and 2017 is presented in the following tables:

### Three Months Ended

#### December 31, 2018

| Number of<br>Shares | Weighted Average<br>Grant Date Per |
|---------------------|------------------------------------|
|---------------------|------------------------------------|

|   |         | Share Fair Value |
|---|---------|------------------|
| Nonvested stock awards at October 1, 2018       | 116,916 | \$ 14.36         |
| Granted   | -       | -                |
| Forfeited                                       | -       | -                |
| Vested  | -       | -                |
| Nonvested stock awards at the December 31, 2018 | 116,916 | \$ 14.36         |

|   | <b>Three Months Ended<br/>December 31, 2017</b> |   |
|---|---|---|
|   | <b>Number of<br/>Shares</b>                     | <b>Weighted Average<br/>Grant Date Per<br/>Share Fair Value</b> |
| Nonvested stock awards at October 1, 2017       | 142,594   | \$ 12.79  |
| Granted   | -   | -   |
| Forfeited                                       | (3,736 )  | \$ 11.84  |
| Vested  | -   | -   |
| Nonvested stock awards at the December 31, 2017 | 138,858   | \$ 12.82  |

The Company maintains the 2008 Stock Option Plan (the “Option Plan”) which authorizes the grant of stock options to officers, employees and directors of the Company to acquire shares of common stock with an exercise price at least equal to the fair market value of the common stock on the grant date. Options generally become vested and exercisable at the rate of 20% per year over five years and are generally exercisable for a period of ten years after the grant date. A total of 533,808 shares of common stock were approved for future issuance pursuant to the Option Plan. As of December 31, 2018, all of the options had been awarded under the Option Plan. As of December 31, 2018, 524,267 options were vested under the Option Plan. The 2014 SIP reserved up to 714,145 shares for issuance pursuant to options. Options to purchase 605,000 shares were awarded during February 2015. During August 2016, the Company granted 18,867 shares under the Option Plan and 8,633 shares under the 2014 SIP. In March 2017, the Company granted 22,828 shares under the 2014 SIP. In May 2017, the Company granted 24,717 shares under the 2014 SIP and 283 shares under the Option Plan. In March 2018, the Company granted 159,265 shares under the 2014 SIP and 18,235 shares under the Option Plan.

A summary of the status of the Company’s stock options under the 2008 Option Plan and the 2014 SIP as of December 31, 2018 and 2017 are presented below:

|                                  | <b>Three Months Ended<br/>December 31, 2018</b> |  |
|----------------------------------|---|--|
|                                  | <b>Number of<br/>Shares</b>                     | <b>Weighted Average<br/>Exercise Price</b> |
| Outstanding at October 1, 2018   | 869,026   | \$ 13.32                                   |
| Granted                          | -   | -  |
| Exercised                        | (4,416 )  | 10.77                                      |
| Forfeited                        | -   | -  |
| Outstanding at December 31, 2018 | 864,610   | \$ 13.33                                   |
| Exercisable at December 31, 2018 | 447,483   | \$ 11.46                                   |

|                                  | <b>Three Months Ended</b> |                                 |
|----------------------------------|---------------------------|---------------------------------|
|                                  | <b>December 31, 2017</b>  |                                 |
|                                  | <b>Number of</b>          | <b>Weighted Average</b>         |
|                                  | <b>Shares</b>             | <b>Exercise Price Per Share</b> |
| Outstanding at October 1, 2017   | 922,564                   | \$ 12.04                        |
| Granted                          | -                         | -                               |
| Exercised                        | (22,171 )                 | 11.27                           |
| Forfeited                        | (8,364 )                  | 11.76                           |
| Outstanding at December 31, 2017 | 892,029                   | \$ 12.28                        |
| Exercisable at December 31, 2017 | 524,267                   | \$ 11.47                        |

The weighted average remaining contractual term was approximately 6.2 years for options outstanding as of December 31, 2018.

The estimated fair value of options granted during fiscal 2009 was \$2.98 per share, \$2.92 for options granted during fiscal 2010, \$3.34 for options granted during fiscal 2013, \$4.67 for options granted during fiscal 2014, \$4.58 for options granted during fiscal 2015, \$2.13 for options granted during fiscal 2016, \$3.18 for options granted during fiscal 2017 and \$3.63 for options granted in fiscal 2018. The fair value for grants made in fiscal 2017 was estimated on the date of grant using the Black-Scholes pricing model with the following assumptions: an exercise and fair value of \$17.43 to \$18.39, a term of seven years, a volatility rate of 14.37%, an interest rate of 2.22% and a yield rate of 0.69%. The fair value for grants made in fiscal 2018 was estimated on the date of grant using the Black-Scholes pricing model with the following assumptions: an exercise and fair value based on grant date market value and range from \$18.46, a term of seven years, a volatility rate of 15.9%, an interest rate of 2.82% and a yield rate of 1.08%.

During the three months ended December 31, 2018 and 2017, \$150,000 and \$137,000, respectively, was recognized in compensation expense for options granted pursuant to the Option Plan and the 2014 SIP.

At December 31, 2018, there was approximately \$1.2 million in additional compensation expense to be recognized for awarded options which remained outstanding and unvested at such date. The weighted average period over which this expense will be recognized is approximately 1.8 years.

## 12.

## COMMITMENTS AND CONTINGENT LIABILITIES

At December 31, 2018, the Company had \$39.7 million in outstanding commitments to originate loans with market interest rates ranging from 5.50% to 6.50%. At September 30, 2018, the Company had \$40.4 million in outstanding commitments to originate loans with market interest rates ranging from 4.25% to 6.25%. The aggregate undisbursed

portion of loans-in-process amounted to \$55.9 million at December 31, 2018 and \$54.5 million at September 30, 2018.

The Company also had commitments under unused lines of credit of \$56.7 million as of December 31, 2018 and \$51.9 million as of September 30, 2018 and letters of credit outstanding of \$1.6 million as of both December 31, 2018 and September 30, 2018.

Among the Company's contingent liabilities are exposures to limited recourse arrangements with respect to the Company's sales of whole loans and participation interests. At December 31, 2018, the exposure, which represents a portion of credit risk associated with the interests sold, amounted to \$1.5 million. This exposure is for the life of the related loans and payables, on our proportionate share, as actual losses are incurred.

The Company is involved in various legal proceedings occurring in the ordinary course of business. Management of the Company, based on discussions with litigation counsel, believes that such proceedings will not have a material adverse effect on the financial condition, operations or cash flows of the Company. However, there can be no assurance that any of the outstanding legal proceedings to which the Company is a party will not be decided adversely to the Company's interests and not have a material adverse effect on the financial condition and operations of the Company.

### 13. FAIR VALUE MEASUREMENT

The fair value estimates presented herein are based on pertinent information available to management as of December 31, 2018 and September 30, 2018, respectively. Although management is not aware of any factors that would significantly affect the fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

Generally accepted accounting principles used in the United States establish a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

The three broad levels of hierarchy are as follows:

- Level 1 Quoted prices in active markets for identical assets or liabilities.
- Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Those assets and liabilities as of December 31, 2018 which are measured at fair value on a recurring basis are as follows:



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Category Used for Fair Value  
Measurement

Level 1    Level 2    Level 3    Total

(Dollars in Thousands)

Assets:

Securities available for sale:

|   |      |           |      |           |
|---|------|-----------|------|-----------|
| U.S. Government and agency obligations                | \$-  | \$24,464  | \$ - | \$24,464  |
| State and political subdivisions                      | -    | 21,938    | -    | 21,938    |
| Mortgage-backed securities - U.S. Government agencies | -    | 269,251   | -    | 269,251   |
| Corporate bonds                                       | -    | 77,499    | -    | 77,499    |
| Equity security - FHLMC preferred stock               | 28   | -         | -    | 28        |
| Total   | \$28 | \$393,152 | \$ - | \$393,180 |

Liabilities:

|                              |     |       |      |       |
|------------------------------|-----|-------|------|-------|
| Interest rate swap contracts | \$- | \$517 | \$ - | \$517 |
| Total                        | \$- | \$517 | \$ - | \$517 |

Those assets as of September 30, 2018 which are measured at fair value on a recurring basis are as follows:

|   | Category Used for Fair Value Measurement |            |         |            |
|---|--|------------|---------|------------|
|   | Level 1                                  | Level 2    | Level 3 | Total      |
| <b>(Dollars in Thousands)</b>                         |  |            |         |            |
| Assets:   |  |            |         |            |
| Securities available for sale:                        |  |            |         |            |
| U.S. Government and agency obligations                | \$ -                                     | \$ 24,171  | \$ -    | \$ 24,171  |
| State and political subdivisions                      | -  | 21,536     | -       | 21,536     |
| Mortgage-backed securities - U.S. Government agencies | -  | 187,360    | -       | 187,360    |
| Corporate bonds                                       | -  | 73,083     | -       | 73,083     |
| Equity security - FHLMC preferred stock               | 37                                       | -          | -       | 37         |
| Interest rate swap contracts                          | -  | 225        | -       | 225        |
| Total   | \$ 37                                    | \$ 306,375 | \$ -    | \$ 306,412 |

Certain assets are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The Company measures impaired loans and real estate owned at fair value on a non-recurring basis.

#### Impaired Loans

The Company considers loans to be impaired when it becomes more likely than not that the Company will be unable to collect all amounts due in accordance with the contractual terms of the loan agreements. Collateral dependent impaired loans are based on the fair value of the collateral which is based on appraisals and would be categorized as Level 2 measurement. In some cases, adjustments are made to the appraised values for various factors including the age of the appraisal, age of the comparable included in the appraisal, and known changes in the market and in the collateral. These adjustments are based upon unobservable inputs, and therefore, the fair value measurement has been categorized as a Level 3 measurement. These loans are reviewed for impairment and written down to their net realizable value by charges against the allowance for loan losses. The collateral underlying these loans had a fair value of approximately \$16.5 million as of December 31, 2018.

#### Real Estate Owned

Once an asset is determined to be uncollectible, the underlying collateral is generally repossessed and reclassified to foreclosed real estate and repossessed assets. These repossessed assets are carried at the lower of cost or fair value of the collateral, based on independent appraisals, less cost to sell and would be categorized as a Level 2 measurement. In some cases, adjustments are made to the appraised values for various factors including age of the appraisal, age of the comparable included in the appraisal, and known changes in the market and in the collateral. As a result, the evaluations are based upon unobservable inputs, and therefore, the fair value measurement has been categorized as a Level 3 measurement.

**Summary of Non-Recurring Fair Value Measurements**

| <b>At December 31, 2018</b>   |                |                |                |              |
|-------------------------------|----------------|----------------|----------------|--------------|
| <b>(Dollars in Thousands)</b> |                |                |                |              |
|                               | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
| Impaired loans                | \$-            | \$ -           | \$16,498       | \$16,498     |
| Real estate owned             | -              | -              | 1,027          | 1,027        |
| Total                         | \$-            | \$ -           | \$17,525       | \$17,525     |

| <b>At September 30, 2018</b>  |                |                |                |              |
|-------------------------------|----------------|----------------|----------------|--------------|
| <b>(Dollars in Thousands)</b> |                |                |                |              |
|                               | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
| Impaired loans                | \$-            | \$ -           | \$16,048       | \$16,048     |
| Real estate owned             | -              | -              | 1,026          | 1,026        |
| Total                         | \$-            | \$ -           | \$17,074       | \$17,074     |

The following table provides information describing the valuation processes used to determine nonrecurring fair value measurements categorized within Level 3 of the fair value hierarchy:

| <b>At December 31, 2018</b>   |                   |                             |  |                             |
|-------------------------------|-------------------|-----------------------------|--|-----------------------------|
| <b>(Dollars in Thousands)</b> |                   |                             |  |                             |
|                               | <b>Fair Value</b> | <b>Valuation Technique</b>  | <b>Unobservable Input</b>  | <b>Range/ Weighted Ave.</b> |
| Impaired loans                | \$16,498          | Property appraisals (1) (3) | Management discount for selling costs, property type and market volatility (2) | 6% to 8% discount/<br>6%    |
| Real estate owned             | \$1,027           | Property appraisals (1)(3)  | Management discount for selling costs, property type and market volatility (2) | 18% discount                |

| <b>At September 30, 2018</b>  |                   |                             |  |                             |
|-------------------------------|-------------------|-----------------------------|--|-----------------------------|
| <b>(Dollars in Thousands)</b> |                   |                             |  |                             |
|                               | <b>Fair Value</b> | <b>Valuation Technique</b>  | <b>Unobservable Input</b>  | <b>Range/ Weighted Ave.</b> |
| Impaired loans                | \$16,048          | Property appraisals (1) (3) | Management discount for selling costs, property type and market volatility (2) | 6% to 8% discount/<br>6%    |
| Real estate owned             | \$1,026           | Property appraisals (1)(3)  | Management discount for selling costs, property type and market volatility (2) | 18% discount                |

- (1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally includes various Level 3 inputs, which are not identifiable.  
Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated
- (2) liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.
- (3) Includes qualitative adjustments by management and estimated liquidation expenses.

The fair value of financial instruments has been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

|  | Carrying<br>Amount | Fair<br>Value | Fair Value Measurements at<br>December 31, 2018 |           |           |
|--|--------------------|---------------|---|-----------|-----------|
|  |                    |               | (Level<br>1)                                    | (Level 2) | (Level 3) |
| <b>(Dollars in Thousands)</b>                                |                    |               |   |           |           |
| <b>Assets:</b>   |                    |               |   |           |           |
| Cash and cash equivalents                                    | \$9,898            | \$9,898       | \$9,898   | \$-       | \$-       |
| Certificates of deposit                                      | 1,604              | 1,604         | 1,604   | -         | -         |
| Investment and mortgage-backed securities available for sale | 393,152            | 393,152       | -   | 393,152   | -         |
| Investment and mortgage-backed securities held to maturity   | 57,605             | 54,969        | -   | 54,969    | -         |
| Equity securities  | 28                 | 28            | 28  | -         | -         |
| Loans receivable, net  | 588,511            | 581,180       | -   | -         | 581,180   |
| Accrued interest receivable                                  | 4,140              | 4,140         | 4,140   | -         | -         |
| Restricted Bank stock  | 10,081             | 10,081        | 10,081  | -         | -         |
| Bank owned life insurance                                    | 28,048             | 28,048        | 28,048  | -         | -         |
| <b>Liabilities:</b>  |                    |               |   |           |           |
| Checking accounts  | 63,579             | 63,579        | 63,579  | -         | -         |
| Money market deposit accounts                                | 65,752             | 65,752        | 65,752  | -         | -         |
| Passbook, club and statement savings accounts                | 87,975             | 87,975        | 87,975  | -         | -         |
| Certificates of deposit                                      | 535,057            | 540,867       | -   | -         | 540,867   |
| Advances from FHLB - short-term                              | 68,500             | 68,500        | 68,500  | -         | -         |
| Advances from FHLB - long-term                               | 148,901            | 148,901       | -   | -         | 148,901   |
| Accrued interest payable                                     | 1,557              | 1,557         | 1,557   | -         | -         |
| Advances from borrowers for taxes and Insurance              | 3,410              | 3,410         | 3,410   | -         | -         |
| Interest rate swap contracts                                 | 517                | 517           | -   | 517       | -         |

|  | Carrying<br>Amount | Fair<br>Value | Fair Value Measurements at<br>September 30, 2018 |           |           |
|--|--------------------|---------------|--|-----------|-----------|
|  |                    |               | (Level<br>1)                                     | (Level 2) | (Level 3) |
| <b>(Dollars in Thousands)</b>                                |                    |               |  |           |           |
| <b>Assets:</b>   |                    |               |  |           |           |
| Cash and cash equivalents                                    | \$48,171           | \$48,171      | \$48,171   | \$-       | \$-       |
| Certificates of deposit                                      | 1,604              | 1,604         | 1,604  | -         | -         |
| Investment and mortgage-backed securities available for sale | 306,187            | 306,187       | 37   | 306,150   | -         |
| Investment and mortgage-backed securities held to maturity   | 59,852             | 55,927        | -  | 55,927    | -         |
| Loans receivable, net  | 602,932            | 598,596       | -  | -         | 598,596   |
| Accrued interest receivable                                  | 3,825              | 3,825         | 3,825  | -         | -         |
| Restricted Bank stock  | 7,585              | 7,585         | 7,585  | -         | -         |
| Interest rate swap contracts                                 | 225                | 225           | -  | 225       | -         |
| Bank owned life insurance                                    | 28,691             | 28,691        | 28,691   | -         | -         |
| <b>Liabilities:</b>  |                    |               |  |           |           |
| Checking accounts  | 62,886             | 62,886        | 62,886   | -         | -         |
| Money market deposit accounts                                | 60,686             | 60,686        | 60,686   | -         | -         |
| Passbook, club and statement savings accounts                | 96,866             | 96,866        | 96,866   | -         | -         |
| Certificates of deposit                                      | 563,820            | 569,375       | -  | -         | 569,375   |
| Accrued interest payable                                     | 3,232              | 3,232         | 3,232  | -         | -         |
| Advances from FHLB -short-term                               | 10,000             | 10,000        | 10,000   | -         | -         |
| Advances from FHLB -long-term                                | 144,683            | 141,116       | -  | -         | 141,116   |
| Advances from borrowers for taxes and Insurance              | 2,083              | 2,083         | 2,083  | -         | -         |

**Cash and Cash Equivalents**—For cash and cash equivalents, the carrying amount is a reasonable estimate of fair value.

**Certificates of deposit**—For certificates of deposit, the carrying amount is a reasonable estimate of fair value.

**Investments and Mortgage-Backed Securities**—The fair value of investment securities and mortgage-backed securities is based on quoted market prices, dealer quotes, and prices obtained from independent pricing services.

**Loans Receivable**—On a prospective basis, the Company implemented changes to the measurement of the fair value of financial instruments using an exit price notion for disclosure purposes in the financial statements. The September 30, 2018, fair value of each class of financial instruments disclosure did not utilize the exit price notion when measuring fair value and, therefore, would not be comparable to the December 31, 2018 disclosure. The Company estimated the fair value based on guidance from ASC 820-10, *Fair Value Measurements*, which defines fair value as the price which would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. There is no active observable market for sale information on community

bank loans and, thus, Level 3 fair value procedures were utilized, primarily in the use of present value techniques incorporating assumptions that market participants would use in estimating fair values

***Accrued Interest Receivable*** – For accrued interest receivable, the carrying amount is a reasonable estimate of fair value.



**Restricted Bank (FHLB & ACBB) Stock**—Although FHLB and ACBB (Atlantic Community Bankers Bank) stock is an equity interest in the respective banks, it is carried at cost because it does not have a readily determinable fair value as its ownership is restricted and it lacks a market. The estimated fair value approximates the carrying amount and is classified within level 2 of the fair value hierarchy.

**Bank Owned Life Insurance**—The fair value of bank owned life insurance is based on the cash surrender value obtained from an independent advisor that is derivable from observable market inputs.

**Checking Accounts, Money Market Deposit Accounts, Passbook Accounts, Club Accounts, Statement Savings Accounts, and Certificates of Deposit**—The fair value of passbook accounts, club accounts, statement savings accounts, checking accounts, and money market deposit accounts is the amount reported in the financial statements. The fair value of certificates of deposit is based on market rates currently offered for deposits with similar remaining maturities.

**Short-term Advances from Federal Home Loan Bank**—The fair value of short-term advances from FHLB is the amount payable on demand at the reporting date.

**Long-term Advances from Federal Home Loan Bank** — The fair value of long-term advances from FHLB is based on market rates currently offered for advances with similar remaining maturities.

**Accrued Interest Payable** – For accrued interest payable, the carrying amount is a reasonable estimate of fair value.

**Interest rate swaps** – The fair values of the interest rate swap contracts are based upon the estimated amount the Company would receive or pay, as applicable, to terminate the contracts.

**Advances from borrowers for taxes and insurance** – For advances from borrowers for taxes and insurance, the carrying amount is a reasonable estimate of fair value.

**Commitments to Extend Credit and Letters of Credit**—The majority of the Bank's commitments to extend credit and letters of credit carry current market interest rates if converted to loans. Because commitments to extend credit and letters of credit are generally unassignable by either the Bank or the borrower, they only have value to the Bank and

the borrower. The estimated fair value approximates the recorded deferred fee amounts, which are not significant.

#### 14. GOODWILL AND OTHER INTANGIBLE ASSETS

The Company's goodwill and intangible assets are related to the acquisition of Polonia Bancorp as of January 1, 2017.

|                         | <b>Balance<br/>October 1,<br/>2018</b> | <b>Additions/<br/>Adjustments</b> | <b>Amortization</b> | <b>Balance<br/>December 31,<br/>2018</b> | <b>Amortization<br/>Period</b> |
|-------------------------|--|-----------------------------------|---------------------|--|--------------------------------|
| Goodwill                | \$ 6,102                               | \$ -                              | \$ -                | \$ 6,102                                 |                                |
| Core deposit intangible | 571                                    | -                                 | (33 )               | 538                                      | 10 years                       |
|                         | \$ 6,673                               | \$ -                              | \$ (33 )            | \$ 6,640                                 |                                |

As of December 31, 2018, the future fiscal periods amortization expense for the core deposit intangible is:

**(In thousands)**

|            |       |
|------------|-------|
| 2019       | \$90  |
| 2020       | 108   |
| 2021       | 93    |
| 2022       | 78    |
| 2023       | 64    |
| Thereafter | 105   |
| Total      | \$538 |

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

The following discussion should be read in conjunction with our unaudited consolidated financial statements included elsewhere in this Form 10-Q and with our Annual Report on Form 10-K for the year ended September 30, 2018 (the "Form 10-K").

**Overview.** Prudential Bancorp, Inc. (the "Company") was formed by Prudential Bancorp, Inc. of Pennsylvania to become the successor holding company for Prudential Bank (the "Bank") (formerly known as Prudential Savings Bank) as a result of the second-step conversion of Prudential Mutual Holding Company completed in October 2013. The Company's results of operations are primarily dependent on the results of the Bank, which is a wholly owned subsidiary of the Company. The Company's results of operations depend to a large extent on net interest income, which primarily is the difference between the income earned on its loan and securities portfolios and the cost of funds, which is the interest paid on deposits and borrowings. Results of operations are also affected by our provisions for loan losses, non-interest income (which includes impairment charges) and non-interest expense. Non-interest expense principally consists of salaries and employee benefits, office occupancy expense, depreciation, data processing expense, payroll taxes and other expense. Our results of operations are also significantly affected by general economic and competitive conditions, particularly changes in interest rates, government policies and actions of regulatory authorities. Future changes in applicable laws, regulations or government policies may materially impact our financial condition and results of operations. The Bank is subject to regulation by the Federal Deposit Insurance Corporation (the "FDIC") and the Pennsylvania Department of Banking and Securities (the "Department"). The Bank's main office is located in Philadelphia, Pennsylvania, with nine additional full-service banking offices located in Philadelphia, Delaware and Montgomery Counties in Pennsylvania. The Bank's primary business consists of attracting deposits from the general public and using those funds together with borrowings to originate loans and to invest primarily in U.S. Government and agency securities and mortgage-backed securities. In 2005, the Bank formed PSB Delaware, Inc., a Delaware corporation, as a subsidiary of the Bank. In 2006, all mortgage-backed securities then owned by the Company's predecessor were transferred to PSB Delaware, Inc. PSB Delaware, Inc.'s activities are included as part of the consolidated financial statements.

**Critical Accounting Policies.** In reviewing and understanding financial information for the Company, you are encouraged to read and understand the significant accounting policies used in preparing our financial statements. These policies are described in Note 1 of the notes to our unaudited consolidated financial statements included in Item 1 hereof as well as in Note 2 to our audited consolidated financial statements included in the Form 10-K. The accounting and financial reporting policies of the Company conform to accounting principles generally accepted in the United States of America (“U.S. GAAP”) and to general practices within the banking industry. Accordingly, the financial statements require certain estimates, judgments and assumptions, which are believed to be reasonable, based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities as well as contingent assets and contingent liabilities at the date of the financial statements and the reported amounts of income and expenses during the periods presented. The following accounting policies comprise those that management believes are the most critical to aid in fully understanding and evaluating our reported financial results. These policies require numerous estimates or economic assumptions that may prove inaccurate or may be subject to variations which may significantly affect our reported results and financial condition for the period or in future periods.

*Allowance for Loan Losses.* The allowance for loan losses is established through a provision for loan losses charged to expense. Losses are charged against the allowance for loan losses when management believes that the collectability in full of the principal of a loan is unlikely. Subsequent recoveries are added to the allowance. The allowance for loan losses is maintained at a level that management considers adequate to provide for estimated losses and impairments based upon an evaluation of known and inherent losses in the loan portfolio that are both probable and reasonable to estimate. Loan impairment is evaluated based on the fair value of collateral or estimated net realizable value. It is the policy of management to provide for losses on unidentified loans in its portfolio in addition to criticized and classified loans.

Management monitors its allowance for loan losses at least quarterly and makes adjustments to the allowance through the provision for loan losses as economic conditions and other pertinent factors indicate. The quarterly review and adjustment of the qualitative factors employed in the allowance methodology and the updating of historic loss experience allow for timely reaction to emerging conditions and trends. In this context, a series of qualitative factors are used in a methodology as a measurement of how current circumstances are affecting the loan portfolio. Included in these qualitative factors are:

- Levels of past due, classified, criticized and non-accrual loans, troubled debt restructurings and loan modifications;
  - Nature and volume of loans;
- Changes in lending policies and procedures, underwriting standards, collections, charge-offs and recoveries and for commercial loans, the level of loans being approved with exceptions to the Bank's lending policy;
  - Experience, ability and depth of management and staff;
  - National and local economic and business conditions, including various market segments;
  - Quality of the Bank's loan review system and the degree of Board oversight;
  - Concentrations of credit and changes in levels of such concentrations; and
  - Effect of external factors on the level of estimated credit losses in the current portfolio.

In determining the allowance for loan losses, management has established a general pooled allowance. Values assigned to the qualitative factors and those developed from historic loss experience provide a dynamic basis for the calculation of reserve factors for both pass-rated loans (the general pooled allowance) and those for criticized and classified loans. The amount of the specific allowance is determined through a loan-by-loan analysis of certain large dollar commercial real estate loans, construction and land development loans and multi-family loans. Loans not individually reviewed are evaluated as a group using reserve factor percentages based on historical loss experience and the qualitative factors described above. In determining the appropriate level of the general pooled allowance, management makes estimates based on internal risk ratings, which take into account such factors as debt service coverage, loan-to-value ratios and external factors. Estimates are periodically measured against actual loss experience.

This evaluation is inherently subjective as it requires material estimates including, among others, exposure at default, the amount and timing of expected future cash flows on impaired loans, value of collateral, estimated losses on our commercial, construction and residential loan portfolios and historical loss experience. All of these estimates may be susceptible to significant change.

While management uses the best information available to make loan loss allowance evaluations, adjustments to the allowance may be necessary based on changes in economic and other conditions or changes in accounting guidance. In addition, the Department and the FDIC, as an integral part of their examination processes, periodically review our allowance for loan losses. The Department and the FDIC may require the recognition of adjustments to the allowance for loan losses based on their judgment of information available to them at the time of their examination. To the extent that actual outcomes differ from management's estimates, additional provisions to the allowance for loan losses may be required that would adversely affect earnings in future periods.

*Investment and mortgage-backed securities available for sale.* Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated using quoted prices of securities with similar characteristics or discounted cash flows and are classified within Level 2 of the fair value hierarchy. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. There were no securities with a Level 3 classification as of December 31, 2018 or September 30, 2018.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. The Company determines whether the unrealized losses are temporary or are considered other than temporary. The evaluation is based upon factors such as the creditworthiness of the issuers/guarantors, the underlying collateral, if applicable, and the continuing performance of the securities. In addition, the Company also considers the likelihood that the security will be required to be sold because of regulatory concerns, our internal intent not to dispose of the security prior to maturity and whether the entire cost basis of the security is expected to be recovered. In determining whether the cost basis will be recovered, management evaluates other facts and circumstances that may be indicative of an “other-than-temporary” impairment condition. This includes, but is not limited to, an evaluation of the type of security, length of time and extent to which the fair value has been less than cost, and near-term prospects of the issuer.

In addition, certain assets are measured at fair value on a non-recurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The Company measures impaired loans and other real estate owned at fair value on a non-recurring basis.

Valuation techniques and models utilized for measuring financial assets and liabilities are reviewed and validated by the Company at least quarterly.

*Income Taxes.* The Company accounts for income taxes in accordance with U.S. GAAP. The Company records deferred income taxes that reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Management exercises significant judgment in the evaluation of the amount and timing of the recognition of the resulting tax assets and liabilities. The judgments and estimates required for the evaluation are updated based upon changes in business factors and the tax laws. If actual results differ from the assumptions and other considerations used in estimating the amount and timing of tax recognized, there can be no assurance that additional expenses will not be required in future periods.

In evaluating our ability to recover deferred tax assets, we consider all available positive and negative evidence, including our past operating results and our forecast of future taxable income. In determining future taxable income,

we make assumptions for the amount of taxable income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require us to make judgments about our future taxable income and are consistent with the plans and estimates we use to manage our business. Any reduction in estimated future taxable income may require us to record an additional valuation allowance against our deferred tax assets. An increase in the valuation allowance would result in additional income tax expense in the period and could have a significant impact on our future earnings.

U.S. GAAP prescribes a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the consolidated income statement. Assessment of uncertain tax positions requires careful consideration of the technical merits of a position based on management's analysis of tax regulations and interpretations. Significant judgment may be involved in the assessment of the tax position.



**Forward-looking Statements.** This Quarterly Report on Form 10-Q contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include, but are not limited to, expectations or predictions of future financial or business performance, conditions relating to the Company. These forward-looking statements include statements with respect to the Company’s beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions, that are subject to significant risks and uncertainties, and are subject to change based on various factors (some of which are beyond the Company’s control). The words “may,” “could,” “should,” “would,” “will,” “believe,” “anticipate,” “estimate,” “expect,” “intend,” “plan” and similar expressions are intended to identify forward-looking statements.

In addition to factors previously disclosed in the reports filed by the Company with the Securities and Exchange commission (“SEC”) and those identified elsewhere in this Form 10-Q, the following factors, among others, could cause actual results to differ materially from forward looking statements or historical performance: the strength of the United States economy in general and the strength of the local economies in which the Company conducts its operations; general economic conditions; legislative and regulatory changes; monetary and fiscal policies of the federal government; changes in tax policies, rates and regulations of federal, state and local tax authorities, including the affects of the Tax Cuts and Jobs Act (“Tax Reform Act”); changes in interest rates, deposit flows, the cost of funds, demand for loan products, demand for financial services, competition, changes in the quality or composition of the Company's loan, investment and mortgage-backed securities portfolios; geographic concentration of the Company’s business; fluctuations in real estate values; the adequacy of loan loss reserves; the risk that goodwill and intangibles recorded in the Company’s financial statements will become impaired; changes in accounting principles, policies or guidelines and other economic, competitive, governmental and technological factors affecting the Company’s operations, markets, products, services and fees; and the success of the Company at managing the risks involved in the foregoing.

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 to reflect events or circumstances occurring after the date of this Form 10-Q.

For a complete discussion of the assumptions, risks and uncertainties related to our business, readers are encouraged to review the Company’s filings with the SEC, including the “Risk Factors” section in the Company’s most recent Form 10-K, as supplemented by its quarterly or other reports subsequently filed with the SEC.

**Market Overview.** The economy continued to improve during 2018 and 2017.

The Company continues to focus on the credit quality of its customers, closely monitoring the financial status of borrowers throughout the Company’s markets, gathering information, working on early detection of potential problems, taking pre-emptive steps where necessary and performing the analysis required to maintain adequate

reserves for loan losses.

The Company continues to maintain capital well in excess of regulatory requirements.

The following discussion provides further details on the financial condition of the Company at December 31, 2018 and September 30, 2018, and the results of operations for the three months ended December 31, 2018 and 2017.

### **COMPARISON OF FINANCIAL CONDITION AT DECEMBER 31, 2018 AND SEPTEMBER 30, 2018**

The Company had total assets of approximately \$1.1 billion at December 31, 2018 and September 30, 2018. However, the investment portfolio increased by \$84.7 million primarily as a result of purchases of U.S. government agency mortgage-backed securities and investment grade corporate bonds. The increase in investment securities was partially funded by a \$38.3 million reduction in cash equivalents during the quarter ended December 31, 2018. Net loans receivable decreased \$14.4 million to \$588.5 million at December 31, 2018 from \$602.9 million at September 30, 2018.

Total liabilities increased by \$31.7 million to \$984.5 million at December 31, 2018 from \$952.8 million at September 30, 2018. Total deposits decreased \$31.9 million. The reduction in deposits was primarily due to the maturity of wholesale deposits that were replaced by lower costing FHLB advances. At December 31, 2018, the Company had FHLB advances outstanding of \$217.4 million, as compared to \$154.7 million at September 30, 2018. All of the borrowings had maturities of less than six years.

Total stockholders' equity increased by \$2.3 million to \$130.7 million at December 31, 2018 from \$128.4 million at September 30, 2018. The increase was primarily due to a \$2.1 million increase in the fair value of investment securities held for sale combined with \$2.0 million of net income. These increases were partially offset by \$1.7 million of purchases of treasury stock and a dividend payment totaling \$447,000.

## **COMPARISON OF RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED DECEMBER 31, 2018 AND 2017**

**Net income.** The Company recognized net income of \$2.0 million, or \$0.22 per diluted share, for the quarter ended December 31, 2018 as compared to \$34,000 or \$0.004 per diluted share, for the comparable period in 2017. The increase in net income for the three-month period ended December 31, 2018 as compared to the same quarter in the prior year reflected primarily the effect of the \$1.8 million one-time non-cash charge in December 2017 related to the re-measurement of the Company's deferred tax assets arising from the lower U.S. corporate tax rate provided for by the Tax Reform Act.

**Net interest income.** For the three months ended December 31, 2018, net interest income amounted to \$6.0 million as compared to \$6.1 million for the same period in 2017. The results reflected a \$2.0 million increase in interest income which was offset by an increase of \$2.1 million in interest paid on deposits and borrowings. The yield on interest-earning assets increased to 3.79% for the quarter ended December 31, 2018 from 3.66% for the same period in 2017 due primarily to the increased yields on investments purchased during a rising rate environment combined with the results of the shift in emphasis to originating commercial and construction loans, which generally bear higher yields than those obtained on residential loans. However, the weighted average cost of borrowings and deposits increased more rapidly, increasing to 1.76% for the quarter ended December 31, 2018 from 0.98% for the comparable period in 2017 due to increases in market rates of interest which affected both deposit and borrowing costs. The net interest margin decreased to 2.28% during the quarter ended December 31, 2018 from 2.80% during the comparable period in 2017 as the flattening of the yield curve has resulted in a more rapid increase in the rates paid on interest-bearing liabilities than the yields earned on interest-earning assets.

**Average balances, net interest income, and yields earned and rates paid.** The following table shows for the periods indicated the total dollar amount of interest earned from average interest-earning assets and the resulting yields, as well as the interest expense on average interest-bearing liabilities and the resulting costs, expressed both in dollars and rates, the interest rate spread and the net interest margin. Average yields and rates have been annualized. Tax-exempt income and yields have been adjusted to a tax-equivalent basis. All average balances are based on monthly balances. Management does not believe that the monthly averages differ significantly from what the daily averages would be.

|  | <b>Three Months<br/>Ended December 31,<br/>2018</b> |                 |                                       | <b>2017</b>                |                 |                                       |   |
|--|---|-----------------|---------------------------------------|----------------------------|-----------------|---------------------------------------|---|
|  | <b>Average<br/>Balance</b>                          | <b>Interest</b> | <b>Average<br/>Yield/Rate<br/>(1)</b> | <b>Average<br/>Balance</b> | <b>Interest</b> | <b>Average<br/>Yield/Rate<br/>(1)</b> |   |
| <b>(Dollars in Thousands)</b>  |   |                 |                                       |                            |                 |                                       |   |
| Interest-earning assets:   |   |                 |                                       |                            |                 |                                       |   |
| Investment securities (4)  | \$ 184,332  | \$ 1,532        | 3.30                                  | % \$ 132,530               | \$ 996          | 2.98                                  | % |
| Mortgage-backed securities   | 225,748   | 1,755           | 3.08                                  | 132,623                    | 842             | 2.52                                  |   |
| Loans receivable(2)  | 585,290   | 6,462           | 4.38                                  | 576,336                    | 6,107           | 4.20                                  |   |
| Other interest-earning assets  | 50,901  | 252             | 1.96                                  | 29,488                     | 91              | 1.22                                  |   |
| Total interest-earning assets  | 1,046,271   | 10,001          | 3.79                                  | 870,977                    | 8,036           | 3.66                                  |   |
| Cash and non interest-bearing balances                                     | 2,155   |                 |                                       | 2,262                      |                 |                                       |   |
| Other non interest-earning assets  | 28,171  |                 |                                       | 48,811                     |                 |                                       |   |
| Total assets   | \$ 1,076,597  |                 |                                       | \$ 922,050                 |                 |                                       |   |
| Interest-bearing liabilities:  |   |                 |                                       |                            |                 |                                       |   |
| Savings accounts   | \$ 63,035   | 99              | 0.62                                  | \$ 103,204                 | 19              | 0.07                                  |   |
| Money market deposit and NOW<br>accounts                                   | 111,793   | 125             | 0.44                                  | 127,149                    | 49              | 0.15                                  |   |
| Certificates of deposit  | 566,472   | 2,816           | 1.97                                  | 409,294                    | 1,343           | 1.30                                  |   |
| Total deposits   | 741,300   | 3,040           | 1.63                                  | 639,647                    | 1,411           | 0.88                                  |   |
| Advances from Federal Home Loan<br>Bank                                    | 155,626   | 945             | 2.41                                  | 127,799                    | 488             | 1.51                                  |   |
| Advances from borrowers for taxes and<br>insurance                         | 2,580   | 1               | 0.15                                  | 2,750                      | 1               | 0.14                                  |   |
| Total interest-bearing liabilities   | 899,506   | 3,986           | 1.76                                  | 770,196                    | 1,900           | 0.98                                  |   |
| Non interest-bearing liabilities:  |   |                 |                                       |                            |                 |                                       |   |
| Non interest-bearing demand accounts                                       | 16,312  |                 |                                       | 10,529                     |                 |                                       |   |
| Other liabilities  | 32,305  |                 |                                       | 5,439                      |                 |                                       |   |
| Total liabilities  | 948,123   |                 |                                       | 786,164                    |                 |                                       |   |
| Stockholders' equity   | 128,474   |                 |                                       | 135,886                    |                 |                                       |   |
| Total liabilities and stockholders' equity                                 | \$ 1,076,597  |                 |                                       | \$ 922,050                 |                 |                                       |   |
| Net interest-earning assets  | \$ 146,765  |                 |                                       | \$ 100,781                 |                 |                                       |   |
| Net interest income; interest rate spread                                  |   | \$ 6,015        | 2.03                                  | %                          | \$ 6,136        | 2.68                                  | % |
| Net interest margin(3)   |   |                 | 2.28                                  | %                          |                 | 2.80                                  | % |
| Average interest-earning assets to<br>average interest-bearing liabilities |   | 116.32%         |                                       |                            | 113.09%         |                                       |   |

(1) Yields and rates for the three month periods are annualized.

(2) Includes non-accrual loans. Calculated net of unamortized deferred fees, undisbursed portion of loans-in-process and the allowance for loan losses.

(3) Equals net interest income divided by average interest-earning assets.

(4) Tax exempt yields have been adjusted to a tax equivalent basis.

**Provision for loan losses.** The Company recorded no provision for loan losses for the three months ended December 31, 2018, primarily due to the decrease in the size of the loan portfolio, compared to a provision for loan losses of \$210,000 for the same period in 2017. During the three months ended December 31, 2018 and 2017, the Company did not record any recoveries or charge offs. As of December 31, 2018, the Company had reviewed \$16.5 million of loans for possible impairment compared to \$16.0 million reviewed for possible impairment as of September 30, 2018.

The allowance for loan losses totaled \$5.2 million, or 0.9% of total loans and 37.8% of total non-performing loans at December 31, 2018 (which included loans acquired at their fair value as a result of the acquisition of Polonia Bancorp, Inc. (“Polonia”) as of January 1, 2017) as compared to \$5.2 million, or 0.9% of total loans and 32.1% of total non-performing loans at September 30, 2018. The Company believes that the allowance for loan losses at December 31, 2018 was sufficient to cover all inherent and known losses associated with the loan portfolio at such date.

The Company’s methodology for assessing the adequacy of the allowance establishes both specific and general pooled allocations of the allowance. Loans are assigned ratings, either individually for larger credits or in homogeneous pools, based on an internally developed grading system. The resulting determinations are reviewed and approved by senior management.

At December 31, 2018, the Company’s non-performing assets totaled \$14.7 million or 1.3% of total assets as compared to \$14.4 million or 1.3% of total assets at September 30, 2018. Non-performing assets at December 31, 2018 included five construction loans aggregating \$8.8 million, 26 one-to-four family residential loans aggregating \$3.5 million, and four commercial real estate loans aggregating \$1.4 million. Non-performing assets at December 31, 2018 also included real estate owned consisting of two single-family residential properties with an aggregate carrying value of \$1.0 million. At December 31, 2018, the Company had nine loans aggregating \$6.0 million that were classified as troubled debt restructurings (“TDRs”). Five of such loans aggregating \$644,000 were performing in accordance with the restructured terms as of December 31, 2018 and were accruing interest. One TDR is on non-accrual and consists of a \$445,000 loan secured by a single-family property. The three remaining TDRs totaling \$4.9 million are also classified as non-accrual and are a part of a lending relationship totaling \$10.6 million (after taking into account the previously disclosed \$1.9 million write-down recognized during the quarter ending March 31, 2017 related to this borrowing relationship). The primary project of the borrower (the development of a 169-unit townhouse project in Bristol Borough, Pennsylvania) is the subject of litigation between the Bank and the borrower. As previously disclosed, subsequent to the commencement of the litigation, the borrower filed for bankruptcy under Chapter 11 (Reorganization) of the federal bankruptcy code in June 2017. The Bank has moved the underlying litigation noted above with the borrower and the Bank from state court to the federal bankruptcy court in which the bankruptcy proceeding is being heard. The state litigation is stayed pending the resolution of the bankruptcy proceedings.

At December 31, 2018, the Company had \$2.8 million of loans delinquent 30-89 days as to interest and/or principal. Such amount consisted of sixteen one-to-four family residential loans totaling \$2.5 million, one commercial real estate loan in the amount of \$88,000, one multi-family loan in the amount of \$161,000 and one consumer loan in the amount of \$57,000. At September 30, 2018, the Company had \$1.9 million of loans delinquent 30-89 days as to interest and/or principal. Such amount consisted of ten one-to-four family residential loans totaling \$1.0 million, one commercial real estate loan totaling \$722,000 and four consumer loans totaling \$116,000.

At December 31, 2018, the Company also had a total of 21 loans aggregating \$6.7 million that had been designated “special mention”. These loans consist of fourteen one-to-four family residential loans totaling \$2.3 million, one multi-family residential loan in the amount of \$328,000 and six commercial real estate loans totaling \$4.1 million. At

September 30, 2018, we had a total of 26 loans aggregating \$4.7 million designated as “special mention”.

The following table shows the amounts of non-performing assets (defined as non-accruing loans, accruing loans 90 days or more past as to principal and/or interest and real estate owned) as of December 31, 2018 and September 30, 2018. At neither date did the Company have any accruing loans 90 days or more past due that were accruing.

|   | December<br>31,<br>2018 |                               | September 30,<br>2018 |   |
|---|-------------------------|-------------------------------|-----------------------|---|
|   |                         | <b>(Dollars in Thousands)</b> |                       |   |
| Non-accruing loans:   |                         |                               |                       |   |
| One-to-four family residential                              | \$ 3,437                |                               | \$ 3,012              |   |
| Commercial real estate                                      | 1,478                   |                               | 1,627                 |   |
| Construction and land development                           | 8,753                   |                               | 8,750                 |   |
| Total non-accruing loans                                    | 13,668                  |                               | 13,389                |   |
| Real estate owned, net: (1)                                 | 1,027                   |                               | 1,026                 |   |
| Total non-performing assets                                 | \$ 14,695               |                               | \$ 14,415             |   |
| <br>  |                         |                               |                       |   |
| Total non-performing loans as a percentage of loans, net    | 2.32                    | %                             | 2.65                  | % |
| Total non-performing loans as a percentage of total assets  | 1.23                    | %                             | 1.24                  | % |
| Total non-performing assets as a percentage of total assets | 1.32                    | %                             | 1.33                  | % |

(1) Real estate owned balances are shown net of related loss allowances and consist solely of real property.

**Non-interest income.** With respect to the quarter ended December 31, 2018, non-interest income amounted to \$380,000 as compared to \$415,000 for the same quarter in fiscal 2018. Non-interest income was higher in the first quarter of fiscal 2018 as compared to the first quarter of fiscal 2019 primarily due to earnings from fees associated with interest rate swaps.

**Non-interest expense.** For the three months ended December 31, 2018, non-interest expense decreased \$51,000, compared to the same period in the prior year. The primary reason for the decrease was a reduction in professional services, partially offset by an increase in salaries and employee benefit expense.

**Income tax expense.** For the three-month period ended December 31, 2018, the Company recorded income tax expense of \$429,000, compared to income tax expense of \$2.3 million for the prior year quarter. The 2017 period included a \$1.8 million one-time charge related to a re-evaluation of the Company's deferred tax assets as a result of the enactment of the Tax Reform Act. Effective October 1, 2018, the Company's statutory tax rate is 21%. During the period January 1, 2018 until September 30, 2018, its statutory tax rate was 24.25% while during the three months ended December 31, 2017, the statutory tax rate was 35%.



## LIQUIDITY AND CAPITAL RESOURCES

The Company's liquidity, represented by cash and cash equivalents, is a product of its operating, investing and financing activities. Our primary sources of funds are deposits, scheduled principal and interest payments on loans, loan prepayments and the maturity of loans, mortgage-backed securities and other investments, and other funds provided from operations. While scheduled payments from the amortization of loans and mortgage-backed securities and maturing investment securities are relatively predictable sources of funds, deposit flows and loan and securities prepayments can be greatly influenced by market rates of interest, economic conditions and competition. The Company also maintains excess funds in short-term, interest-earning assets that provide additional liquidity. At December 31, 2018, the Company's cash and cash equivalents amounted to \$9.9 million. In addition, its available-for-sale investment securities amounted to an aggregate of \$393.2 million at such date.

We use our liquidity to fund existing and future loan commitments, to fund maturing certificates of deposit and demand deposit withdrawals, to invest in other interest-earning assets, and to meet operating expenses. At December 31, 2018, the Company had \$39.7 million in outstanding commitments to originate loans, not including loans in process. The Company also had commitments under unused lines of credit of \$112.6 million and letters of credit outstanding of \$1.6 million at December 31, 2018. Certificates of deposit as of December 31, 2018 that are maturing in one year or less totaled \$384.8 million. Based upon our historical experience, we anticipate that a significant portion of the maturing certificates of deposit will be redeposited with us.

In addition to cash flows from loan and securities payments and prepayments as well as from sales of available for sale securities, we have significant borrowing capacity available to fund liquidity needs should the need arise. Our borrowings consist solely of advances from the FHLB, of which we are a member. Under terms of the collateral agreement with the FHLB, we pledge residential mortgage loans as well as our stock in the FHLB as collateral for such advances. At December 31, 2018, we had \$217.4 million in outstanding FHLB advances and had the ability to obtain an additional \$207.6 million in FHLB advances. Additional borrowing capacity with the FHLB could be obtained with the pledging of certain investment securities. The Bank has a line of credit amounting to \$12.5 million with ACBB, which has yet to be drawn upon. The Bank has also obtained approval to borrow from the Federal Reserve Bank discount window.

We anticipate that we will continue to have sufficient funds and alternative funding sources to meet our current commitments.

The following table summarizes the Company's and Bank's regulatory capital ratios as of December 31, 2018 and September 30, 2018 and compares them to current regulatory guidelines. The Company is not subject to capital ratios imposed by Basel III on bank holding companies because the Company is deemed to be a small bank holding company. The capital ratios provided for the company are presented for informational purposes only.

|  | Actual Ratio |   | Required for<br>Capital Adequacy<br>Purposes |  | To Be<br>Well Capitalized<br>Under Prompt<br>Corrective Action<br>Provisions |   |
|--|--------------|---|--|--|--|---|
| December 31, 2018:                       |              |   |  |  |  |   |
| Tier 1 capital (to average assets)       |              |   |  |  |  |   |
| The Company                              | 11.96        | % | N/A  |  | N/A  |   |
| The Bank                                 | 11.55        | % | 4.0  |  | 5.0  | % |
| Tier 1 common (to risk-weighted assets)  |              |   |  |  |  |   |
| The Company                              | 19.96        | % | N/A  |  | N/A  |   |
| The Bank                                 | 19.28        | % | 4.5  |  | 6.5  | % |
| Tier 1 capital (to risk-weighted assets) |              |   |  |  |  |   |
| The Company                              | 19.96        | % | N/A  |  | N/A  |   |
| The Bank                                 | 19.28        | % | 6.0  |  | 8.0  | % |
| Total capital (to risk-weighted assets)  |              |   |  |  |  |   |
| The Company                              | 20.81        | % | N/A  |  | N/A  |   |
| The Bank                                 | 20.12        | % | 8.0  |  | 10.0   | % |
| September 30, 2018:                      |              |   |  |  |  |   |
| Tier 1 capital (to average assets)       |              |   |  |  |  |   |
| Company                                  | 12.51        | % | N/A  |  | N/A  |   |
| Bank                                     | 11.86        | % | 4.0  |  | 5.0  | % |
| Tier 1 common (to risk-weighted assets)  |              |   |  |  |  |   |
| The Company                              | 19.74        | % | N/A  |  | N/A  |   |
| The Bank                                 | 18.73        | % | 4.5  |  | 6.5  | % |
| Tier 1 capital (to risk-weighted assets) |              |   |  |  |  |   |
| Company                                  | 19.74        | % | N/A  |  | N/A  |   |
| Bank                                     | 18.73        | % | 6.0  |  | 8.0  | % |
| Total capital (to risk-weighted assets)  |              |   |  |  |  |   |
| Company                                  | 20.58        | % | N/A  |  | N/A  |   |
| Bank                                     | 19.56        | % | 8.0  |  | 10.0   | % |

## **IMPACT OF INFLATION AND CHANGING PRICES**

The financial statements, accompanying notes, and related financial data of the Company presented herein have been prepared in accordance with generally accepted accounting principles which 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.

Unlike most industrial companies, substantially all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the price of goods and services, since such prices are affected by inflation to a larger extent than interest rates. In the current interest rate environment, liquidity and the maturity structure of the Company's assets and liabilities are critical to the maintenance of acceptable performance levels.

**How We Manage Market Risk.** Market risk is the risk of loss from adverse changes in market prices and rates. Our market risk arises primarily from interest rate risk which is inherent in our lending, investment and deposit gathering activities. To that end, management actively monitors and manages interest rate risk exposure. In addition to market risk, our primary risk is credit risk on our loan portfolio. We attempt to manage credit risk through our loan underwriting and oversight policies.

The principal objective of our interest rate risk management function is to evaluate the interest rate risk embedded in certain balance sheet accounts, determine the level of risk appropriate given our business strategy, operating environment, capital and liquidity requirements and performance objectives, and manage the risk consistent with approved guidelines. We seek to manage our exposure to risks from changes in interest rates while at the same time trying to improve our net interest spread. We monitor interest rate risk as such risk relates to our operating strategies. We have established an Asset/Liability Committee which is comprised of our President and Chief Executive Officer, Chief Financial Officer, Chief Lending Officer, Treasurer and Controller. The Asset/Liability Committee meets on a regular basis and is responsible for reviewing our asset/liability policies and interest rate risk position. Both the extent and direction of shifts in interest rates are uncertainties that could have a negative impact on future earnings.

In recent years, as a part of our asset/liability management strategy we primarily have reduced our investment in longer term fixed-rate callable agency bonds, increased our origination or purchase of hybrid adjustable-rate single-family residential mortgage loans, commercial real estate and construction loans and increased our portfolio of step-up callable agency bonds and agency issued collateralized mortgage-backed securities (“CMOs”) with short effective lives. In addition, we recently implemented interest rate swaps to reduce funding cost for a five year period. However, notwithstanding the foregoing steps, we remain subject to a significant level of interest rate risk in a low interest rate environment due to the high proportion of our loan portfolio that consists of fixed-rate loans as well as our decision in prior periods to invest a significant amount of our assets in long-term, fixed-rate investment and mortgage-backed securities.

**Gap Analysis.** The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are “interest rate sensitive” and by monitoring a Company’s interest rate sensitivity “gap.” An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within that same time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. During a period of rising interest rates, a negative gap would tend to affect adversely net interest income while a positive gap would tend to result in an increase in net interest income. Conversely, during a period of falling interest rates, a negative gap would tend to result in an increase in net interest income while a positive gap would tend to affect adversely net interest income.

The following table sets forth the amounts of our interest-earning assets and interest-bearing liabilities outstanding at December 31, 2018, which we expect, based upon certain assumptions, to reprice or mature in each of the future time periods shown (the "GAP Table"). Except as stated below, the amounts of assets and liabilities shown which reprice or mature during a particular period were determined in accordance with the earlier of term to repricing or the contractual maturity of the asset or liability. The table sets forth an approximation of the projected repricing of assets and liabilities at December 31, 2018, on the basis of contractual maturities, anticipated prepayments, and scheduled rate adjustments within a three-month period and subsequent selected time intervals. The loan amounts in the table reflect principal balances expected to be redeployed and/or repriced as a result of contractual amortization and anticipated prepayments of adjustable-rate loans and fixed-rate loans, and as a result of contractual rate adjustments on adjustable-rate loans. Annual prepayment rates for variable-rate and fixed-rate single-family and multi-family residential and commercial mortgage loans are assumed to range from 6.2% to 30.6%. The annual prepayment rate for mortgage-backed securities is assumed to range from 0.7% to 23.4%. For savings accounts, checking accounts and money markets, the decay rates vary on an annual basis over a ten year period.

|  | <b>3 Months<br/>or Less<br/>(Dollars in Thousands)</b> | <b>More than<br/>3 Months<br/>to 1 Year</b> | <b>More than<br/>1 Year<br/>to 3 Years</b> | <b>More than<br/>3 Years<br/>to 5 Years</b> | <b>More than<br/>5 Years</b> | <b>Total<br/>Amount</b> |
|--|--|---|--|---|------------------------------|-------------------------|
| Interest-earning assets(1):  |  |   |  |   |                              |                         |
| Investment and mortgage-backed securities(2)   | \$ 20,530  | \$ 45,123                                   | \$ 100,549                                 | \$ 88,666                                   | \$ 202,373                   | \$457,241               |
| Loans receivable(3)  | 142,984  | 72,010                                      | 134,990                                    | 105,622                                     | 132,905                      | 588,511                 |
| Other interest-earning assets(4)   | 17,759   | -   | 1,355                                      | 249   | -                            | 19,363                  |
| Total interest-earning assets  | \$ 181,273   | \$ 117,133                                  | \$ 236,894                                 | \$ 194,537                                  | \$ 335,278                   | \$1,065,115             |
| Interest-bearing liabilities:  |  |   |  |   |                              |                         |
| Savings accounts   | \$ 2,343   | \$ 7,236                                    | \$ 12,012                                  | \$ 11,582                                   | \$ 54,802                    | \$87,975                |
| Money market deposit and NOW accounts  | 4,089  | 12,265                                      | 20,352                                     | 16,503                                      | 61,816                       | 115,025                 |
| Certificates of deposit  | 181,005  | 207,831                                     | 89,315                                     | 56,906                                      | -                            | 535,057                 |
| Advances from FHLB   | 3,764  | 19,637                                      | 40,287                                     | 80,213                                      | 73,500                       | 217,401                 |
| Advances from borrowers for taxes and insurance  | 3,410  | -   | -  | -   | -                            | 3,410                   |
| Total interest-bearing liabilities   | \$ 194,611   | \$ 246,969                                  | \$ 161,966                                 | \$ 165,204                                  | \$ 190,118                   | \$958,868               |
| Interest-earning assets less interest-bearing liabilities  | (\$13,338 )  | (\$129,836 )                                | \$ 74,928                                  | \$ 29,333                                   | \$ 145,160                   | \$106,247               |
| Cumulative interest-rate sensitivity gap (5)   | (\$13,338 )  | (\$143,174 )                                | (\$68,246 )                                | (\$38,913 )                                 | \$106,247                    |                         |
| Cumulative interest-rate gap as a percentage of total assets at December 31, 2018                                  | -1.42 %  | -12.78 %                                    | -11.07 %                                   | -6.82 %                                     | 9.81 %                       |                         |
| Cumulative interest-earning assets as a percentage of cumulative interest-bearing liabilities at December 31, 2018 | 93.15 %  | 67.58 %                                     | 88.69 %                                    | 94.94 %                                     | 111.08 %                     |                         |

(1) Interest-earning assets are included in the period in which the balances are expected to be redeployed and/or repriced as a result of anticipated prepayments, scheduled rate adjustments and contractual maturities.

(2) For purposes of the gap analysis, investment securities are reflected at amortized cost.

(3) For purposes of the gap analysis, loans receivable includes non-performing loans and is gross of the allowance for loan losses and unamortized deferred loan fees, but net of the undisbursed portion of loans-in-process.

(4) Includes FHLB stock.

(5) Cumulative interest-rate sensitivity gap represents the difference between interest-earning assets and interest-bearing liabilities.

Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as variable-rate loans, have features which restrict changes in interest rates applicable to the assets both on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, prepayment and early withdrawal levels would likely deviate significantly from those assumed in calculating the table. Finally, the ability of many borrowers to service their variable-rate loans may be adversely affected in the event of an interest rate increase.

**Net Portfolio Value Analysis.** Our interest rate sensitivity also is monitored by management through the use of a model which generates estimates of the changes in our net portfolio value (“NPV”) over a range of interest rate scenarios. NPV is the present value of expected cash flows from assets, liabilities and off-balance sheet contracts. The NPV ratio, under any interest rate scenario, is defined as the NPV in that scenario divided by the market value of assets in the same scenario. The “Sensitivity Measure” is the decline in the NPV ratio, in basis points, caused by a 2% increase or decrease in rates, whichever produces a larger decline. The following table sets forth our NPV as of December 31, 2018 and reflects the changes to NPV as a result of immediate and sustained changes in interest rates as indicated.

| Change in<br>Interest Rates<br>In Basis Points<br>(Rate Shock) | Net Portfolio Value    |             |           | NPV as % of Portfolio<br>Value of Assets |        |          |  |  |
|--|------------------------|-------------|-----------|--|--------|----------|--|--|
|  | Amount                 | \$ Change   | % Change  | NPV<br>Ratio                             | Change |          |  |  |
|  | (Dollars in Thousands) |             |           |  |        |          |  |  |
| 300  | \$95,075               | \$(64,030 ) | (40.24 )% | 9.30                                     | %      | (5.12 )% |  |  |
| 200  | 114,559                | (44,546 )   | (28.00 )% | 10.98                                    | %      | (3.44 )% |  |  |
| 100  | 133,537                | (25,568 )   | (16.07 )% | 12.50                                    | %      | (1.92 )% |  |  |
| Static   | 159,105                | -           | -         | 14.42                                    | %      | -        |  |  |
| (100 )   | 169,140                | 10,035      | 6.31 %    | 14.87                                    | %      | 0.45 %   |  |  |
| (200 )   | 169,955                | 10,850      | 6.82 %    | 14.66                                    | %      | 0.24 %   |  |  |
| (300 )   | 191,530                | 32,425      | 20.38 %   | 16.14                                    | %      | 1.72 %   |  |  |

At September 30, 2018, the Company’s NPV was \$163.6 million or 15.18% of the market value of assets. Following a 200 basis point increase in interest rates, the Company’s “post shock” NPV would be \$123.0 million or 12.3% of the market value of assets.

As is the case with the GAP Table, certain shortcomings are inherent in the methodology used in the above interest rate risk measurements. Modeling changes in NPV requires the making of certain assumptions which may or may not



reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the models presented assume that the composition of our interest sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and also assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or repricing of specific assets and liabilities. Accordingly, although the NPV model provides an indication of interest rate risk exposure at a particular point in time, such model is not intended to and does not provide a precise forecast of the effect of changes in market interest rates on net interest income and will differ from actual results.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As of December 31, 2018, there had not been any material change to the market risk disclosure contained in the Company's Annual Report on Form 10-K for the year ended September 30, 2018, set forth in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation –Exposure to Changes in Interest Rates."

### **ITEM 4. CONTROLS AND PROCEDURES**

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of the end of period covered by this report, our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and are operating in an effective manner.

No change in our internal control over financial reporting (as defined in Rule 13a-15(f) or 15d-15(f) under the Securities Exchange Act of 1934) occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II**

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

As previously disclosed in the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2016, on March 31, 2016, Island View Properties, Inc., trading as Island View Crossing II, LP ("Island View Crossing"), and Renato J. Gualtieri (collectively, the "Gualtieri Parties") filed suit (the "Philadelphia Litigation") in the Court of Common Pleas, Philadelphia, Pennsylvania (the "Court"), against the Bank seeking damages in an amount in excess of \$27.0 million. The lawsuit asserts allegations related to a loan granted by the Bank to the Gualtieri Parties to develop a 169-unit townhouse and condominium project located in Bristol Borough in Bucks County, Pennsylvania (the "Project").

In May 2016, the Bank filed a motion with the court seeking to dismiss the majority of claims asserted in the Philadelphia Litigation. In August 2016, the Court dismissed a majority of the Gualtieri Parties' claims. The Bank has also counterclaimed against the Gualtieri Parties for failure to satisfy the nine loans extended thereto and for failure to complete the Project.

After commencement of the Philadelphia Litigation, the Bank filed Complaints for Confession against the Gualtieri Parties and certain other entities affiliated with Renato J. Gualtieri ("Gualtieri Parties and Affiliated Entities") based on the claimed defaults under the nine loans issued by the Bank.. The Bank has also filed foreclosure actions with regard to the commercial properties collateralizing the loans issued to the Gualtieri Parties and Affiliated Entities. These actions are currently stayed pending the resolution of the litigation pending in the bankruptcy court as described below.

Shortly after the Court lifted the stay in the Philadelphia Litigation, the Gualtieri Parties and Affiliated Entities filed for bankruptcy under Chapter 11. The Bank has removed the underlying Philadelphia Litigation from state court to the federal bankruptcy court.

As the Chapter 11 bankruptcy litigation is in its early stages, no prediction can be made as to the outcome thereof. However, the Bank believes that it has meritorious defenses to the Chapter 11 bankruptcy litigation and intends to vigorously defend the claims.

Within the bankruptcy, Island View Crossing, as the debtor and the Chapter 11 Trustee, filed a separate adversary proceeding against the Bank seeking to avoid certain collateral mortgages made by Island View Crossing as well as seeking to avoid certain loans made to Island View Crossing including, but not limited to, a \$1.4 million loan and a \$5.5 million loan. The complaint was filed on or about December 3, 2018. The Bank is evaluating the matter. Given the relatively early stages of the case and the complaint just being filed, we are unable to determine the likelihood of an unfavorable outcome at this time. The Bank, however, believes it meritorious defenses to the claims and intends to vigorously defend against the claims.

Prudential Bancorp is involved in various legal proceedings occurring in the ordinary course of business. Management of the Company, based on discussions with litigation counsel, does not believe that such proceedings will have a material adverse effect on the financial condition or operations of Prudential Bancorp. There can be no assurance that any of the outstanding legal proceedings to which the Company is a party will not be decided adversely to the Company's interests and have a material adverse effect on the financial condition and operations of the Company.

**Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended September 30, 2018, as such factors could materially affect the Company’s business, financial condition, or future results of operations. As of December 31, 2018, no material changes have occurred to the risk factors of the Company as reported in the Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2018. The risks described in the 2018 Annual Report on Form 10-K are not the only risks that the Company faces. Additional risks and uncertainties not currently known to the Company, or that the Company currently deems to be immaterial, also may have a material adverse impact on the Company’s business, financial conditions, or results of operations.

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

(a) and (b) Not applicable

(b) The Company’s repurchases of equity shares for the quarter ended December 31, 2018 were as follows:

| <b>Period</b>         | <b>Total Number of Shares Purchased</b> | <b>Average Price Paid Per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)(2)</b> | <b>Maximum Number of Shares that May Yet Purchased Under Plans or Programs (1) (2)</b> |
|-----------------------|---|-------------------------------------|--|--|
| October 1 - 31, 2018  | 35,200                                  | \$ 17.43                            | 35,200   | 57,465   |
| November 1 - 30, 2018 | 24,800                                  | \$ 17.45                            | 24,800   | 932,665  |
| December 1 - 31, 2018 | 36,165                                  | \$ 17.51                            | 36,165   | 896,500  |
|                       | 96,165                                  | \$ 17.47                            | 96,165   |  |

(1) On July 15, 2015, the Company announced that the Board of Directors had approved a second stock repurchase program authorizing the Company to repurchase up 850,000 shares of common stock, approximately 10% of the Company's then outstanding shares.

(2) On November 19, 2018, the Company announced that the Board of Directors had approved a third stock repurchase program authorizing the Company to repurchase up 900,000 shares of common stock, approximately 10% of the Company's then outstanding shares.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

Not applicable

**Item 6. Exhibits**

**Exhibit No. Description**

|             |  |
|-------------|--|
| <u>31.1</u> | <u>Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer</u> |
| <u>31.2</u> | <u>Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer</u> |
| <u>32.0</u> | <u>Section 1350 Certifications</u>                                       |
| 101.INS     | XBRL Instance Document.  |
| 101.SCH     | XBRL Taxonomy Extension Schema Document.                                 |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document.                   |
| 101.LAB     | XBRL Taxonomy Extension Label Linkbase Document.                         |
| 101.PRE     | XBRL Taxonomy Extension Presentation Linkbase Document.                  |
| 101.DEF     | XBRL Taxonomy Extension Definitions Linkbase Document.                   |

**SIGNATURES**

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

**PRUDENTIAL BANCORP, INC.**

*Date: February 11, 2019 By: /s/ Dennis Pollack  
Dennis Pollack  
President and Chief Executive Officer*

*Date: February 11 2019 By: /s/ Jack E. Rothkopf  
Jack E. Rothkopf  
Senior Vice President, Chief Financial Officer and Treasurer*