PRUDENTIAL BANCORP INC OF PENNSYLVANIA
Form 10-K
December 21, 2007

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

FORM 10-K
FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTIONS 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended SEPTEMBER 30, 2007

-or-

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ________________ to ________________

Commission File Number: 0-51214

PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA
(Exact Name of Registrant as Specified in its Charter)

PENNSYLVANIA	68-0593604
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

1834 OREGON AVENUE
PHILADELPHIA, PENNSYLVANIA
(Address of Principal Executive Offices)

Registrant's telephone number: (including area code) (215) 755-1500

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock (par value $0.01 per share)	The Nasdaq Stock Market, LLC

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

YES o NO x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer x

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant based on the closing price of $13.68 on March 31, 2007, the last business day of the Registrant's second quarter was $59,488,574 (11,813,950 shares outstanding less 7,465,370 shares held by affiliates at $13.68 per share). Although directors and executive officers of the Registrant and certain employee benefit plans were assumed to be "affiliates" of the Registrant for purposes of the calculation, the classification is not to be interpreted as an admission of such status.

As of the close of business on December 10, 2007 there were 11,429,976 shares of the Registrant's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Definitive Proxy Statement for the 2008 Annual Meeting of Stockholders are incorporated by reference in Part III.

Prudential Bancorp, Inc. of Pennsylvania and Subsidiaries
FORM 10-K INDEX
For the Fiscal Year Ended September 30, 2007

PART I

Item 1. Business

General

Our Company, Prudential Bancorp, Inc. of Pennsylvania (the “Company” or “Prudential Bancorp”), is a Pennsylvania corporation which was organized as a mid-tier holding company for our bank, Prudential Savings Bank, a Pennsylvania-chartered, FDIC-insured savings bank (the “Bank” or “Prudential Savings Bank”). Our Bank is a wholly owned subsidiary of the Company. The Company’s results of operations are primarily dependent on the results of the Bank. As of September 30, 2007, the Company, on a consolidated basis, had total assets of approximately $474.2 million, total deposits of approximately $354.0 million, and total stockholders’ equity of approximately $81.0 million.

The Company was formed when the Bank reorganized from a mutual savings bank to a mutual holding company structure in March 2005. Prudential Mutual Holding Company, a Pennsylvania corporation, is the mutual holding company parent of the Company. As of September 30, 2007, Prudential Mutual Holding Company owns 60.2% (6,910,062 shares) of the Company’s outstanding common stock and must continue to own at least a majority of the outstanding voting stock of the Company.

Our Bank is a community-oriented savings bank headquartered in south Philadelphia which was originally organized in 1886 as a Pennsylvania-chartered building and loan association known as “The South Philadelphia Building and Loan Association No. 2.” We grew through a number of mergers with other mutual institutions with our last merger being with Continental Savings and Loan Association in 1983. We converted to a Pennsylvania-chartered savings bank in August 2004. Our banking office network currently consists of our headquarters and main office and six full-service branch offices. Six of our banking offices are located in Philadelphia (Philadelphia County) and one is in Drexel Hill in neighboring Delaware County, Pennsylvania. We maintain ATMs at six of our banking offices. We also provide on-line banking services.

We are primarily engaged in attracting deposits from the general public and using those funds to invest in loans and securities. Our principal sources of funds are deposits, repayments of loans and mortgage-backed securities, maturities of investment securities and interest-bearing deposits, funds provided from operations and funds borrowed from the Federal Home Loan Bank of Pittsburgh. These funds are primarily used for the origination of various loan types including single-family residential mortgage loans, construction and land development loans, non-residential or commercial real estate mortgage loans, home equity loans and lines of credit, commercial business loans and consumer loans. We are an active originator of residential home mortgage loans and construction and land development loans in our market area. Traditionally, our Bank focused on originating or purchasing fixed-rate, long-term single-family residential mortgage loans for portfolio. In recent years, we have substantially increased our involvement in construction and land development lending. Such loans typically have higher yields as compared to single-family residential mortgage loans and have adjustable rates of interest and/or shorter terms to maturity. As a result of such emphasis, our construction and land development loans have grown from $24.2 million or 15.9% of the total loan portfolio at September 30, 2003 to $52.4 million or 22.2% of our total loan portfolio at September 30, 2007. Although 2007 saw a decline in our construction loans from 2006 which had a balance of $82.8 million, or 32.3% of total loans at September 30, 2006, as long as market conditions are favorable for this activity, we would expect such lending to continue in the future.

The investment and mortgage-backed securities portfolio has decreased over the last several years from $235.3 million at September 30, 2005 to $227.2 million at September 30, 2007 as maturing and called securities have been reinvested into the loan portfolio, in particular adjustable rate construction loans. A significant portion of our investment securities consist of securities with "step-up" interest rate adjustment features and an investment in a mutual fund which invests primarily in high quality adjustable-rate mortgage-backed and floating-rate securities. We have designated the substantial majority of our investment and mortgage-backed securities as held to maturity since we have both the intent and ability to hold them until their maturity. Although we chose to invest in such securities rather than originate long-term, fixed-rate loans at historically low rates, such course of action was not free of interest rate risk. At September 30, 2007, our $180.3 million of investment and mortgage-backed securities held to maturity had an aggregate gross unrealized loss of $2.5 million due to the recent increases in market rates of interest. However, with the recent rises in market rates of interest, we have increased our single-family residential mortgage loan origination activities. During fiscal 2006 and 2007 we classified mortgage-backed securities purchased of $4.6 million, and $4.8 million, respectively as available for sale and may also consider designating more of our securities purchased in the future as available for sale rather than as held to maturity in order to increase our ability to adjust our asset mix as market and competitive conditions change.

In addition to offering loans and deposits we also offer, on an agency basis, securities and insurance products to our customers through an affiliation with a third-party broker-dealer.

Even though we have increased and expanded our involvement in construction and land development lending in recent years, at the same time we have been able to maintain our high asset and credit quality. At September 30, 2007, our total non-performing assets amounted to $2.6 million, or 0.55% of total assets. Although non-performing assets had been steadily declining during the past several years from $1.5 million or 0.38% of total assets at September 30, 2003 to a low point of $151,000 or 0.03% of total assets at September 30, 2006, one construction loan, with a principal balance of $2.0 million was placed in non-accrual status during the fourth fiscal quarter of 2007 as the borrower was not able to satisfy the terms of the loan and there was a corresponding deterioration in the value of the related real estate collateral. Loan charge-offs, net of recoveries, were $2,000 for fiscal 2007. There were no charge-offs during fiscal years 2006 and 2005. At September 30, 2007, the ratio of our allowance for loan losses to non-performing loans was 39.0%. We believe our credit quality is attributed to careful underwriting and the knowledge and experience of our management team.

Our executive offices are located at 1834 Oregon Avenue, Philadelphia, Pennsylvania and our telephone number is (215) 755-1500.

Market Area and Competition

Our primary market area is Philadelphia, in particular South Philadelphia and Center City, as well as Delaware County. We also are involved in Bucks, Chester and Montgomery Counties which, along with Delaware County, comprise the suburbs of Philadelphia. We also make loans in contiguous counties in southern New Jersey. This area is referred to as the Delaware Valley region. The Philadelphia metropolitan area is one of the leading regions for biotech and pharmaceutical research with many of the largest pharmaceutical companies maintaining a presence in the region. It is also a major health care area with a number of teaching and research hospitals being operated.

We face significant competition in originating loans and attracting deposits. This competition stems primarily from commercial banks, other savings banks and savings associations and mortgage-banking companies. Many of the financial service providers operating in our market area are significantly larger, and have greater financial resources, than us. We face additional competition for deposits from short-term money market funds and other corporate and government securities funds, mutual funds and from other non-depository financial institutions such as brokerage firms and insurance companies.

2

Lending Activities

General. At September 30, 2007, our net loan portfolio totaled $219.1 million or 46.2% of total assets. Historically, our principal lending activity has been the origination of loans collateralized by one- to four-family, also known as "single-family," residential real estate loans secured by properties located in our market area. In addition, while we have been making construction loans to developers and homebuilders for more than 25 years, we substantially increased our construction and land development lending activities beginning in fiscal 2000. We also originate, to a substantially lesser degree, multi-family and commercial real estate loans, home equity loans and lines of credit, commercial business loans and consumer loans.

The types of loans that we may originate are subject to federal and state laws and regulations. Interest rates charged by us on loans are affected principally by the demand for such loans and the supply of money available for lending purposes and the rates offered by our competitors. These factors are, in turn, affected by general and economic conditions, the monetary policy of the federal government, including the Federal Reserve Board, legislative tax policies and governmental budgetary matters.

Loan Portfolio Composition. The following table shows the composition of our loan portfolio by type of loan at the dates indicated.

	September 30,									
	2007		2006		2005		2004		2003	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
	(Dollars in thousands)									
Real estate loans:										
One- to four-family residential(1)	$ 159,945	67.85%	$ 155,454	60.69%	$ 135,394	67.22%	$ 124,085	71.54%	$ 115,880	75.98%
Multi-family residential	4,362	1.85%	5,074	1.98%	2,541	1.26%	3,181	1.84%	3,539	2.32%
Commercial real estate	18,019	7.64%	11,339	4.42%	9,875	4.90%	5,608	3.23%	7,457	4.89%
Construction and land development	52,429	22.24%	82,800	32.33%	52,093	25.86%	39,217	22.61%	24,199	15.87%
Total real estate loans	234,755	99.58%	254,667	99.42%	199,903	99.24%	172,091	99.22%	151,075	99.06%
Commercial business loans	155	0.07%	234	0.09%	188	0.09%	145	0.08%	145	0.10%
Consumer loans	832	0.35%	1,239	0.49%	1,347	0.67%	1,206	0.70%	1,283	0.84%
Total loans	235,742	100.00%	256,140	100.00%	201,438	100.00%	173,442	100.00%	152,503	100.00%
Less:										
Undisbursed portion of construction loans in process	15,897		36,257		25,824		21,338		13,737	
	(315)		(153)		(35)		(19)		287	

Deferred loan fees					
Allowance for loan losses	1,011	618	558	558	553
Net loans	$ 219,149	$ 219,418	$ 175,091	$ 151,565	$ 137,926

(1) Includes home equity loans and lines of credit.

Contractual Terms to Final Maturities. The following table shows the scheduled contractual maturities of our loans as of September 30, 2007, before giving effect to net items. Demand loans, loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported as due in one year or less. The amounts shown below do not take into account loan prepayments.

3

	One-to-Four Family Residential	Multi-family Residential	Commercial Real Estate	Construction	Commercial Business Loans	Consumer	Total
			(In Thousands)				
Amounts due after September 30, 2007 in:							
One year or less	$ 1,319	$ 1,180	$ 871	$ 46,328	$ 145	$ 59	$ 49,902
After one year through two years	1,427	147	738	6,101	-	39	8,452
After two years through three years	3,144	166	335	-	-	69	3,714
After three years through five years	4,930	36	1,635	-	-	330	6,931
After five years through ten years	19,724	1,592	11,480	-	10	170	32,976
After ten years through fifteen years	84,015	1,203	2,960	-	-	165	88,343
After fifteen years	45,386	38	-	-	-	-	45,424
Total	$ 159,945	$ 4,362	$ 18,019	$ 52,429	$ 155	$ 832	$ 235,742

The following table shows the dollar amount of all loans due after one year from September 30, 2007, as shown in the table above, which have fixed interest rates or which have floating or adjustable interest rates.

	Fixed-Rate	Floating or Adjustable-Rate	Total
		(In Thousands)	
One- to four-family residential	$ 140,108	$ 18,518	$ 158,626
Multi-family residential	2,990	192	3,182
Commercial real estate	15,054	2,094	17,148
Construction and land development	143	5,958	6,101
Commercial business	10	-	10
Consumer	730	43	773
Total	$ 159,035	$ 26,805	$ 185,840

Loan Originations. Our lending activities are subject to underwriting standards and loan origination procedures established by our board of directors and management. Loan originations are obtained through a variety of sources, primarily existing customers as well as new customers obtained from referrals and local advertising and promotional efforts. We also use loan correspondents and brokers as a source for a substantial part of our residential mortgage loans, either having them originate such loans using our documentation or purchasing such loans from them immediately upon closing. Consumer loan applications are taken at any of our offices while loan applications for all other types of loans are taken only at our main office. All loan applications are processed and underwritten centrally at our main office.

Our single-family residential mortgage loans are written on standardized documents used by the Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac") and Federal National Mortgage Association ("FNMA" or "Fannie Mae"). Property valuations of loans secured by real estate are undertaken by independent third-party appraisers approved by our board of directors.

In addition to originating loans, we purchase single-family residential loans from correspondents due to limited demand in our primary market area. However, all of such loans are underwritten by us using our underwriting criteria and approved by the executive committee or the full board of directors prior to purchase. We also occasionally purchase participation interests in larger balance loans, typically commercial real estate loans, from other financial institutions in our market area. Such participations are reviewed for compliance with our underwriting criteria and are approved by the executive committee or the full board before they are purchased. Generally, loan purchases have been without any recourse to the seller. However, we actively monitor the performance of such loans through the receipt of regular reports from the lead lender regarding the loan's performance, physically inspecting the loan security property on a periodic basis, discussing the loan with the lead lender on a regular basis and receiving copies of updated financial statements from the borrower.

In addition, we have sold participation interests in construction and land development loans originated by us to other institutions in our market area. In addition, beginning in fiscal 2002, we have sold to the Federal Home Loan Bank of Pittsburgh pursuant to the Mortgage Partnership Finance program long-term, fixed-rate single-family loans originated which had interest rates below certain levels established by the board of directors. Such sales provide for a limited amount of recourse. At September 30, 2007, our recourse exposure was approximately $64,000. When we have sold participation interests, it has been done without recourse. We generally have sold participation interests in loans only when a loan would exceed our loan-to-one borrower limits. With respect to the sale of participation interests in such loans, we have received commitments to purchase such participation interests prior to the time the loan is closed. Under applicable Pennsylvania law, we are permitted to make loans to one borrower in an aggregate amount of up to 15% of the capital accounts of the Bank which consist of the aggregate of its capital, surplus, undivided profits, capital securities and reserve for loan losses. At September 30, 2007, the Bank's loans to one borrower limit was approximately $11.1 million. At September 30, 2007, our three largest loans to one borrowers and related entities amounted to $8.4 million, $7.9 million, and $6.8 million. All of such loans were performing in accordance with their terms and primarily consist of loans to fund single-family residential condominium construction projects. For more information on such loans, see "Construction and Land Acquisition Lending".

The following table shows our total loans originated, purchased, sold and repaid during the periods indicated.

	Year Ended September 30,		
	2007	2006	2005
		(In Thousands)	
Loan originations:			
One- to four-family residential	$ 28,538	$ 46,368	$ 24,775
Multi-family residential	2,167	2,631	802
Commercial real estate	6,401	1,365	6,012
Construction and land development	27,464	40,257	26,749
Commercial business	6,393	920	40
Consumer	366	455	562
Total loan originations	71,329	91,996	58,940
Loans purchased	-	-	17,787
Total loans originated & acquired	71,329	91,996	76,727
Loans sold	-	-	-
Loan principal repayments	71,550	47,943	53,455
Total loans sold and principal repayments	71,550	47,943	53,455
(Decrease) or increase due to other items, net (1)	(48)	274	254
Net increase in loan portfolio	$ (269)	$ 44,327	$ 23,526

(1) Other items consist of loans in process, deferred fees and the allowance for loan losses.

One- to Four-Family Residential Mortgage Lending. Our primary lending activity continues to be the origination or purchase of loans secured by first mortgages on one- to four-family residences located in our market area. Our single-family residential mortgage loans are obtained through our lending department and branch personnel and through correspondents. Although the balance of such loans increased from $115.9 million at September 30, 2003 to $159.9 million at September 30, 2007, the percentage of single-family residential mortgage loans in our portfolio has decreased from 76.0% at September 30, 2003 to 67.9% at September 30, 2007 due primarily to increased emphasis on construction and land development loans,. Also contributing to the increase in the balances are increases in our home equity loans and lines of credit products.

Our single-family residential mortgage loans generally are underwritten on terms and documentation conforming with guidelines issued by Freddie Mac and Fannie Mae. Applications for one- to four-family residential mortgage loans are accepted only at our main office. We generally have retained for portfolio a substantial portion of the single-family residential mortgage loans that we originate, only selling certain long-term, fixed-rate loans bearing interest rates below certain levels established by the board. All of such loans have been sold to the Federal Home Loan Bank of Pittsburgh pursuant to the Mortgage Partnership Finance Program. We service all loans that we have originated, including loans that we subsequently sell. We currently originate fixed-rate, fully amortizing mortgage loans with maturities of 15, 20 or 30 years. We also offer adjustable rate mortgage (“ARM”) and Balloon loans. However, due to local market conditions, our originations of such loans have been limited in recent years. At September 30, 2007, $17.4 million, or 12.6%, of our one- to four-family residential loan portfolio (excluding home equity loans and lines of credit) consisted of ARM loans.

We underwrite one- to four-family residential mortgage loans with loan-to-value ratios of up to 95%, provided that the borrower obtains private mortgage insurance on loans that exceed 80% of the appraised value or sales price, whichever is less, of the secured property. We also require that title insurance, hazard insurance and, if appropriate, flood insurance be maintained on all properties securing real estate loans. A licensed appraiser appraises all properties securing one- to four-family first mortgage loans. Our mortgage loans generally include due-on-sale clauses which provide us with the contractual right to deem the loan immediately due and payable in the event the borrower transfers ownership of the property. Due-on-sale clauses are an important means of adjusting the yields of fixed-rate mortgage loans in portfolio and we generally exercise our rights under these clauses.

Our single-family residential mortgage loans also include home equity loans and lines of credit, which amounted to $14.9 million and $7.9 million, respectively, at September 30, 2007. The unused portion of home equity lines was $4.3 million at such date. Our home equity loans are fully amortizing and have terms to maturity of up to 20 years. While home equity loans also are secured by the borrower’s residence, we generally obtain a second mortgage position on these loans. Our lending policy provides that our home equity loans have loan-to-value ratios, when combined with any first mortgage, of 80% or less, although the preponderance of our home equity loans have combined loan-to-value ratios of 75% or less. We also offer home equity revolving lines of credit with interest tied to the Wall Street Journal prime rate. Generally, we have a second mortgage on the borrower’s residence as collateral on our home equity lines. In addition, our home equity lines generally have loan-to-value ratios (combined with any loan secured by a first mortgage) of 75% or less. Our customers may apply for home equity lines as well as home equity loans at any banking office.

Construction and Land Acquisition Lending. We have been an active originator of construction and land development loans for many years but have substantially increased our construction loan efforts in recent years as a growth area for us because they have shorter terms to maturity and they generally have floating or adjustable interest rates. We have focused our construction lending on making loans to developers and homebuilders in our primary market area to acquire, develop and build single-family residences or condominium projects. Our construction loans include, to a lesser extent, loans for the construction of multi-family residential or mixed-use properties. At September 30, 2007, our construction loans amounted to $52.4 million, or 22.2% of our total loan portfolio. This amount includes $15.9 million of undisbursed loans in process (of which $2.1 million relates to participation interests we have sold). Our construction loan portfolio has grown appreciably since September 30, 2003, when construction loans amounted to $24.2 million, or 15.9% of our total loan portfolio, although they have decreased since September 30, 2006 when construction loans amounted to $82.8 million or 32.3% of our total loan portfolio.

A substantial amount of our construction loans are construction and development loans to contractors and builders primarily to finance the construction of condominium projects, single-family homes and small to medium-sized residential subdivisions. Loans to finance the construction of condominium projects or single-family homes and subdivisions are generally offered to experienced builders in our primary market area with whom we have an established relationship. Residential construction and development loans are offered with terms of up to 36 months although typically the terms are 12 to 24 months. One or two six-month extensions may be provided for at our option and upon payment of a fee by the borrower. The maximum loan-to-value limit applicable to these loans is 75% of the appraised post construction value and do not require amortization of the principal during the term of the loan. We often establish interest reserves and obtain personal and/or corporate guarantees as additional security on our construction loans. Construction loan proceeds are disbursed periodically in increments as construction progresses and as inspection by our approved appraisers or loan inspectors warrants. Our construction loans are negotiated on an individual basis but typically have floating rates of interest based upon the Wall Street Journal prime rate. Additional fees may be charged as funds are disbursed. In addition to interest payments during the term of the construction loan, we typically require that payments to principal be made as units are completed and released. Generally such principal payments must be equal to 110% of the amount attributable to acquisition and development of the lot plus 100% of the amount attributable to construction of the individual home. We permit a pre-determined number of model homes to be constructed on an unsold or “speculative” basis. All other units must be pre-sold before we will disburse funds for construction. Our construction loans also include loans to acquire land and loans to develop the basic infrastructure, such as roads and sewers. The majority of our construction loans are secured by properties located in Philadelphia and Chester Counties, Pennsylvania. However, we also make construction loans in Bucks, Delaware and Montgomery Counties, Pennsylvania as well as the New Jersey suburbs of Philadelphia. In addition, we have sold participation interests in a number of our larger construction projects, generally retaining at least a 25% interest. Such sales do not provide for any recourse against the Bank.

Set forth below is a brief description of our five largest construction loans, all of which have performed in accordance with their terms.

Our largest construction and development loan is a $20.0 million loan to a limited partnership sponsored by a Philadelphia-based regional developer. We sold participation interests totaling $17.5 million to five other local financial institutions in connection with the closing of the loan in late 2004 and in subsequent years. We also received additional collateral from the borrower consisting of condominium units in another project with an estimated value of $4.6 million at the time such collateral was pledged. The project involves the conversion of an existing building into a mixed-use building which will contain, when completed, approximately 200 loft condominiums above one floor of retail space. The current loan covers the initial phase of the project, representing 133 units. The project also involves the construction of both indoor and outdoor parking lots. The loan has a 36-month term with payments of interest only during the term of the loan and a floating interest at the Wall Street Journal prime plus 1% with a floor of 5.0% with certain provisions for extensions. As of November 2007, the developer has sold 14 units and received agreements of sale covering 45 units. The Bank's outstanding loan balance (with respect to its interest) at September 30, 2007 was approximately $2.4 million with the total loan balance at such date amounting to approximately $19.3 million. As of May 2006, the first phase of the project was completed which involved the initial 34 pre-sale units and building shell work. The developer elected to complete the remaining units in the existing building before they began conveying and occupying sites in order to limit the liability associated with construction site hazards and risks in occupying a building under construction, and to accelerate the overall project ahead of a potential market slowdown. During July 2006, we extended an additional loan of $9.0 million for the second phase of the project. The new loan terms call for payments of interest only during the term of the loan and a floating interest at the Wall Street Journal prime plus 1% with a floor of 5.0%. The new loan will mature in 36 months from the date of the original loan. During 2006, we sold participation interests related to the additional loan totaling $5.7 million to three other local financial institutions. During 2007, the loan maturity was extended until May 2008. The Bank's outstanding loan balance (with respect to its interest) at September 30, 2007 was approximately $3.0 million with the total loan balance at such date amounting to approximately $8.2 million.

7

In October 2005, we extended a $5.0 million loan, also for the conversion of an existing building located in Philadelphia into condominiums. The limited partnership is operated by a Philadelphia-based construction company. The project involves the conversion of the existing building into 34 loft condominium units with outside parking. The loan has a 24 month term with interest only due during the term and a floating interest rate indexed to the Wall Street Journal prime plus 1%. The loan has a floor of 5.0%. The loan provides for one six month extension upon the payment of a fee equal to .5% of the outstanding balance as of the date of the extension. The loan-to-value ratio at the date of origination was approximately 73%. During 2007, the loan maturity was extended until May 2008. We retained the entire interest in the loan. At the date hereof, the outstanding loan balance was approximately $3.6 million and there were reserve deposits on 12 units.

In September 2005, we extended a $3.0 million construction and development loan to a local developer to build a 17 unit townhouse project located in Philadelphia. The loan has a 24-month term with payments of interest only during the term of the loan and a floating interest rate at the Wall Street Journal prime rate plus 1% and with a floor of 7.25%. The loan to value ratio of the loan was approximately 68% at the date of origination without reference to the additional collateral we received. The additional collateral consists of a condo in Philadelphia and an office building in Sewell, New Jersey with estimated equity of $540,000. In August 2006, we extended an additional $1.5 million in order to facilitate successful completion of the project. At September 30, 2007, the outstanding balance of the loan was approximately $3.8 million. During 2007, the loan maturity was extended until April 2008. As of October 2007, seven units have been sold and an additional two units are under agreement of sale.

In June 2006 we extended a $4.0 million construction and land development loan to a local developer to convert an existing building into 16 condominium units with underground parking located in Philadelphia. The loan has a 24-month term with payments of interest only during the term of the loan and a floating interest rate at the Wall Street Journal prime rate plus 1% and with a floor of 7.75%. The loan to value ratio of the loan was approximately 69% at the date of origination without consideration of additional collateral. The additional collateral was 15 real estate properties with equity of approximately $2.3 million. At September 30, 2007, the outstanding balance of the Bank's loan was approximately $1.6 million.

In May 2005 we purchased a $3.0 million interest in a $12.8 million construction and land development loan to a local limited partnership for the acquisition, development, and construction of an 11 story elevator equipped condominium building containing 40 units with parking for 37 vehicles located in Philadelphia. Another financial institution is acting as the lead lender. The loan has a 24-month term with payments of interest only during the term of the loan and a floating interest rate at the Wall Street Journal prime rate plus 0.50%, with certain provisions for extensions. During 2007, the loan maturity was extended until August 2008. As of October 2007, the outstanding balance of the Bank's portion of the loan remains $3.0 million and 27 units are under agreement of sale.

Construction financing is generally considered to involve a higher degree of credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the property's value at completion of construction compared to the estimated costs, including interest, of construction and other assumptions. Additionally, if the estimate of value proves to be inaccurate, we may be confronted with a project, when completed, having a value less than the loan amount. We have attempted to minimize these risks by generally concentrating on residential construction loans in our market area to contractors with whom we have established relationships and by selling, with respect to larger construction and land development loans, participation interests. In the past, to the extent we have experienced any material difficulties, they have primarily related to smaller loans or loan participations we have purchased.

Multi-Family Residential and Commercial Real Estate Loans. At September 30, 2007, our multi-family residential and commercial real estate loans amounted to $22.4 million or 9.5% of our total loan portfolio. Although we continue to offer such loans and will originate such loans when it is favorable to us, multi-family residential loans have declined as a percentage of the loan portfolio since September 30, 2003. Our commercial real estate loans increased from $7.5 million or 4.9% of our total loan portfolio at September 30, 2003 to $18.0 million or 7.6% of our total loan portfolio at September 30, 2007.

Our commercial real estate and residential multi-family real estate loan portfolio consists primarily of loans secured by small office buildings, strip shopping centers, small apartment buildings and other properties used for commercial and multi-family purposes located in our market area. At September 30, 2007, the average commercial and multi-family real estate loan size was approximately $280,000. The largest multi-family residential or commercial real estate loan at September 30, 2007 was $2.0 million which was performing in accordance with its terms. Substantially all of the properties securing our multi-family residential and commercial real estate loans are located in our primary market area.

Although terms for commercial real estate and multi-family loans vary, our underwriting standards generally allow for terms up to 20 years with loan-to-value ratios of not more than 70%. Most of the loans are structured with balloon payments with amortization periods of up to 25 years. Interest rates are either fixed or adjustable, based upon designated market indices such as the Wall Street Journal prime rate plus a margin or, with respect to our multi-family residential loans, the Average Contract Interest Rate for previously occupied houses as reported by the Federal Housing Finance Board. In addition, fees of up to 2% are charged to the borrower at the origination of the loan. We obtain personal guarantees of the principals as additional collateral for commercial real estate and multi-family real estate loans.

Commercial real estate and multi-family real estate lending involves different risks than single-family residential lending. These risks include larger loans to individual borrowers and loan payments that are dependent upon the successful operation of the project or the borrower's business. These risks can be affected by supply and demand conditions in the project's market area of rental housing units, office and retail space and other commercial space. We attempt to minimize these risks by limiting loans to proven businesses, only considering properties with existing operating performance which can be analyzed, using conservative debt coverage ratios in our underwriting, and periodically monitoring the operation of the business or project and the physical condition of the property.

Various aspects of commercial and multi-family loan transactions are evaluated in an effort to mitigate the additional risk in these types of loans. In our underwriting procedures, consideration is given to the stability of the property's cash flow history, future operating projections, current and projected occupancy levels, location and physical condition. Generally, we impose a debt service ratio (the ratio of net cash flows from operations before the payment of debt service to debt service) of not less than 120%. We also evaluate the credit and financial condition of the borrower, and if applicable, the guarantor. Appraisal reports prepared by independent appraisers are reviewed by us prior to the closing of the loan. With respect to participations, we underwrite the loans as if we were the originating lender.

Consumer Lending Activities. We offer various types of consumer loans such as loans secured by deposit accounts and unsecured personal loans. Consumer loans are originated primarily through existing and walk-in customers and direct advertising. At September 30, 2007, $832,000, or 0.4% of the total loan portfolio consisted of these types of loans.

Consumer loans generally have higher interest rates and shorter terms than residential loans. However, consumer loans have additional credit risk due to the type of collateral securing the loan or in some cases the absence of collateral.

Commercial Business Loans. Our commercial business loans amounted to $155,000 or 0.07% of the total loan portfolio at September 30, 2007.

Our commercial business loans typically are made to small to mid-sized businesses in our market area primarily to provide working capital. Small business loans may have adjustable or fixed rates of interest and generally have terms of three years or less but may go up to 15 years. Our commercial business loans generally are secured by real estate. In addition, we generally obtain personal guarantees from the principals of the borrower with respect to all commercial business loans.

Loan Approval Procedures and Authority. Our board of directors establishes Prudential Savings Bank's lending policies and procedures. Our various lending policies are reviewed at least annually by our management team and the board in order to propose modifications as a result of market conditions, regulatory changes and other factors. All modifications must be approved by our board of directors.

Home equity loans and lines of credit up to $100,000 can be approved by one underwriter and either of two lending officers. Amounts in excess of the individual lending limit with respect to home equity loans and lines of credit must be approved by our two lending officers, and our President or Chief Financial Officer. All mortgage loans must be approved by either the executive committee of the board or the full board of directors of Prudential Savings Bank.

Asset Quality

General. One of our key objectives has been, and continues to be, maintaining a high level of asset quality. In addition to maintaining credit standards for new originations which we believe are sound, we are proactive in our loan monitoring, collection and workout processes in dealing with delinquent or problem loans. We also retain an independent, third party to undertake periodic reviews of the credit quality of a random sample of new loans and all of our major loans on an ongoing basis.

Reports listing all delinquent accounts are generated and reviewed by management on a monthly basis. These reports include information regarding all loans 30 days or more delinquent and all real estate owned and are provided to the board of directors. The procedures we take with respect to delinquencies vary depending on the nature of the loan, period and cause of delinquency and whether the borrower is habitually delinquent. When a borrower fails to make a required payment on a loan, we take a number of steps to have the borrower cure the delinquency and restore the loan to current status. We generally send the borrower a written notice of non-payment after the loan is first past due. Our guidelines provide that telephone, written correspondence and/or face-to-face contact will be attempted to ascertain the reasons for delinquency and the prospects of repayment. When contact is made with the borrower at any time prior to foreclosure, we will attempt to obtain full payment, work out a repayment schedule with the borrower to avoid foreclosure or, in some instances, accept a deed in lieu of foreclosure. In the event payment is not then received or the loan not otherwise satisfied, additional letters and telephone calls generally are made. If the loan is still not brought current or satisfied and it becomes necessary for us to take legal action, which typically occurs after a loan is 90 days or more delinquent, we will commence foreclosure proceedings against any real property that secures the loan. If a foreclosure action is instituted and the loan is not brought current, paid in full, or refinanced before foreclosure sale, the property securing the loan generally is sold at foreclosure and, if purchased by us, becomes real estate owned.

On loans where the collection of principal or interest payments is doubtful, the accrual of interest income ceases (“non-accrual” loans). On loans 90 days or more past due as to principal and interest payments, our policy, with certain limited exceptions with respect to single-family residential mortgage loans, is to discontinue accruing additional interest and reverse any interest currently accrued. On occasion, this action may be taken earlier if the financial condition of the borrower raises significant concern with regard to his/her ability to service the debt in accordance with the terms of the loan agreement. Interest income is not accrued on these loans until the borrower’s financial condition and payment record demonstrate an ability to service the debt.

Real estate which is acquired as a result of foreclosure is classified as real estate owned until sold. Real estate owned is recorded at the lower of cost or fair value less estimated selling costs. Costs associated with acquiring and improving a foreclosed property are usually capitalized to the extent that the carrying value does not exceed fair value less estimated selling costs. Holding costs are charged to expense. Gains and losses on the sale of real estate owned are charged to operations, as incurred.

We account for our impaired loans under generally accepted accounting principles. An impaired loan generally is one for which it is probable, based on current information, that the lender will not collect all the amounts due under the contractual terms of the loan. Large groups of smaller balance, homogeneous loans are collectively evaluated for impairment. Loans collectively evaluated for impairment include smaller balance commercial real estate loans, residential real estate loans and consumer loans. These loans are evaluated as a group because they have similar characteristics and performance experience. Larger commercial real estate, construction and commercial business loans are individually evaluated for impairment. We had one impaired loan as of September 30, 2007. The impaired loan was a construction loan in the amount of $2.0 million to build two residential real estate properties, for which the borrower was not able to satisfy the terms of the loan. There was also a deterioration in the value of the real estate collateral securing the loan. There were no impaired loans as of September 30, 2006.

Federal regulations and our policies require that we utilize an internal asset classification system as a means of reporting problem and potential problem assets. We have incorporated an internal asset classification system, consistent with Federal banking regulations, as a part of our credit monitoring system. We currently classify problem and potential problem assets as “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.”

When an insured institution classifies one or more assets, or portions thereof, as “substandard” or “doubtful,” it is required that a general valuation allowance for loan losses be established for loan losses in an amount deemed prudent by management. General valuation allowances represent loss allowances which have been established to recognize the inherent losses associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies one or more assets, or portions thereof, as “loss,” it is required either to establish a specific allowance for losses equal to 100% of the amount of the asset so classified or to charge off such amount.

A savings institution’s determination as to the classification of its assets and the amount of its valuation allowances is subject to review by Federal and state bank regulators which can order the establishment of additional general or specific loss allowances. The Federal banking agencies, have adopted an interagency policy statement on the allowance for loan and lease losses. The policy statement provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of allowances and guidance for banking agency examiners to use in determining the adequacy of general valuation guidelines. Generally, the policy statement recommends that institutions have effective systems and controls to identify, monitor and address asset quality problems; that management analyze all significant factors that affect the collectibility of the portfolio in a reasonable manner; and that management establish acceptable allowance evaluation processes that meet the objectives set forth in the policy statement. In July 2001, the SEC issued Staff Accounting Bulletin (“SAB”) No. 102, “Selected Loan Loss Allowance Methodology and Documentation Issues.” The guidance contained in the SAB focuses on the documentation the SEC staff normally expects registrants to prepare and maintain in support of the allowance for loan and lease losses. Concurrent with the SEC’s issuance of SAB No. 102, the federal banking agencies, represented by the Federal Financial Institutions Examination Council (“FFIEC”), issued an interagency policy statement entitled “Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions” (Policy Statement). The SAB and Policy Statement were the result of an agreement between the SEC and the federal banking agencies in March 1999 to provide guidance on allowance for loan and lease losses methodologies and supporting documentation. Our allowance for loan losses includes a portion which is allocated by type of loan, based primarily upon our periodic reviews of the risk elements within the various categories of loans, as well as an unallocated portion. The specific components relate to certain impaired loans. The general components covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. The unallocated portion of the allowance is established upon consideration of various qualitative and quantitative factors with respect to the overall loan portfolio. Our management believes that, based on information currently available, its allowance for loan losses is maintained at a level which covers all known and inherent losses that are both probable and reasonably estimable at each reporting date. However, actual losses are dependent upon future events and, as such, further additions to the level of allowances for loan losses may become necessary.

We review and classify assets on a quarterly basis and the board of directors is provided with monthly reports on our classified assets. We classify assets in accordance with the management guidelines described above. At September 30, 2007, 2006 and 2005, we had no assets classified as “doubtful” or “loss”, and $2.0 million, $151,000 and $600,000, respectively, of assets classified as “substandard.” In addition, as of September 30, 2007, 2006 and 2005, we did not have any loans designated “special mention.”

Delinquent Loans. The following table shows the delinquencies in our loan portfolio as of the dates indicated.

	September 30, 2007				September 30, 2006			
	30-89 Days Overdue		90 or More Days Overdue		30-89 Days Overdue		90 or More Days Overdue	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance
	(Dollars in thousands)							
One- to four-family residential	10	$ 433	8	$ 502	15	$ 1,502	4	$ 151
Multi-family residential	-	-	-	-	-	-	-	-
Commercial real estate	-	-	-	-	-	-	-	-
Construction and land development	-	-	-	-	-	-	-	-
Commercial business	-	-	1	69	1	1	-	-
Consumer loans	-	-	-	-	-	-	-	-
Total delinquent loans	10	$ 433	9	$ 571	16	$ 1,503	4	$ 151
Delinquent loans to total net loans	0.20%		0.26%			0.68%		0.07%
Delinquent loans to total loans	0.18%		0.24%			0.59%		0.06%

Non-Performing Loans and Real Estate Owned. The following table sets forth information regarding our non-performing loans and real estate owned. Our general policy is to cease accruing interest on loans, other than single-family residential loans, which are 90 days or more past due and to reverse all accrued interest. During the fourth fiscal quarter of 2007, one construction loan for $2.0 million was placed in non-accrual status. We had no loans on non-accrual status during the year ended September 30, 2006.

The following table shows the amounts of our non-performing assets (defined as non-accruing loans, accruing loans 90 days or more past due and real estate owned) at the dates indicated. We did not have troubled debt restructurings at any of the dates indicated.

	September 30,				
	2007	2006	2005	2004	2003
	(Dollars in thousands)				
Non-accruing loans:					
One- to four-family residential	$ -	$ -	$ -	$ -	$ -
Multi-family residential	-	-	-	-	-
Commercial real estate	-	-	-	-	-
Construction and land development	2,022	-	-	-	500
Commercial business	-	-	-	-	-
Consumer	-	-	-	-	-
Total non-accruing loans	2,022	-	-	-	500
Accruing loans 90 days or more past due:					
One- to four-family residential	502	151	240	478	386
Multi-family residential	-	-	-	-	-
Commercial real estate	-	-	-	-	-
Construction	-	-	-	-	-
Commercial business	69	-	-	-	-
Consumer	-	-	-	1	4
Total accruing loans 90 days or more past due	571	151	240	479	390
Total non-performing loans(1)	2,593	151	240	479	890
Real estate owned, net(2)	-	-	360	548	626
Total non-performing assets	$ 2,593	$ 151	$ 600	$ 1,027	$ 1,516
Total non-performing loans as a percentage of loans, net	1.18%	0.07%	0.14%	0.32%	0.65%
Total non-performing loans as a percentage of total assets	0.55%	0.03%	0.05%	0.12%	0.22%
Total non-performing assets as a percentage of total assets	0.55%	0.03%	0.13%	0.25%	0.38%

(1) Non-performing loans consist of non-accruing loans plus accruing loans 90 days or more past due.
(2) Real estate owned balances are shown net of related loss allowances and consists solely of real property.

Interest income on impaired loans other than non-accrual loans is recognized on an accrual basis. Interest income on non-accrual loans is recognized only as collected. There was no such interest recognized for fiscal 2007 or 2006.

Property acquired by Prudential Savings Bank through foreclosure is initially recorded at the lower of cost, which is the lesser of the carrying value of the loan or fair value at the date of acquisition, or the fair value of the related assets at the date of foreclosure, less estimated costs to sell. Thereafter, if there is a further deterioration in value, we charge earnings for the diminution in value. Our policy is to obtain an appraisal on real estate subject to foreclosure proceedings prior to the time of foreclosure if the property is located outside our market area or consists of other than single-family residential property. We may obtain re-appraisals on a periodic basis on foreclosed properties. We also conduct inspections on foreclosed properties. As of September 30, 2007, we held no real estate owned.

In the second quarter of fiscal 2006, the only real estate owned property at September 30, 2005 was sold at a pre-tax gain of approximately $106,000.

Allowance for Loan Losses. The allowance for loan losses is established through a provision for loan losses. We maintain the allowance at a level believed, to the best of management's knowledge, 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 on no less than a quarterly basis in order to identify those inherent losses and to assess the overall collection probability for the loan portfolio. For each primary type of loan, we establish a loss factor reflecting our estimate of the known and inherent losses in such loan type using both a quantitative analysis as well as consideration of qualitative factors. Our 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 our loans, the value of collateral securing the loan, the borrower's ability to repay and repayment performance, the number of loans requiring heightened management oversight, local economic conditions and industry experience. In addition, each loan type is assigned a rating based on the assumed risk elements of such loan types. Such risk ratings are periodically reviewed by management and revised as deemed appropriate. The establishment of the allowance for loan losses is significantly affected by management judgment and uncertainties and there is a likelihood that different amounts would be reported under different conditions or assumptions. Various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to make additional provisions for estimated loan losses based upon judgments different from those of management. As of September 30, 2007, our allowance for loan losses was 0.43% of total loans receivable and 39.0% of non-performing loans. The amount of the allowance at each of the dates set forth in the tables on the following page consisted of general reserves with the exception of a $370,000 specific reserve as of September 30, 2007.

We have reviewed the Interagency Policy Statement on the Allowance For Loan and Lease Losses (ALLL), issued December 13, 2006. The purpose of this policy statement is to issue guidance on important aspects of loan loss allowance practices. We believe that our methodology for the evaluation of our loan portfolio and the calculation of our ALLL is consistent with this statement.

In the five-year period ended September 30, 2007, our loan charge-offs have been relatively modest and two loans were responsible for the majority of such charge-offs.

We will continue to monitor and modify our allowance for loan losses as conditions dictate. No assurances can be given that our level of allowance for loan losses will cover all of the inherent losses on our loans or that future adjustments to the allowance for loan losses will not be necessary if economic and other conditions differ substantially from the economic and other conditions used by management to determine the current level of the allowance for loan losses.

The following table shows changes in our allowance for loan losses during the periods presented.

	At or For the Year Ended September 30,				
	2007	2006	2005	2004	2003
	(Dollars in thousands)				
Total loans outstanding at end of period	$ 235,742	$ 256,140	$ 201,438	$ 173,442	$ 152,503
Average loans outstanding	221,262	197,913	163,166	142,348	156,894
Allowance for loan losses, beginning of period	618	558	558	553	621
Provision (recovery) for loan losses	395	60	-	50	180
Charge-offs:					
One- to four-family residential	2	-	-	-	-
Multi-family residential and	-	-	-	-	-
Commercial real estate	-	-	-	50	172
Construction	-	-	-	28	50
Commercial business	-	-	-	-	-
Consumer	-	-	-	-	51
Total charge-offs	2	-	-	78	273
Recoveries on loans previously charged off	-	-	-	33	25
Allowance for loan losses, end of period	$ 1,011	$ 618	$ 558	$ 558	$ 553
Allowance for loan losses as a percent of total loans	0.43%	0.24%	0.28%	0.32%	0.36%
Allowance for loan losses as a percent of non-performing loans	38.97%	409.66%	223.47%	116.49%	62.13%
Ratio of net charge-offs during the period to average loans outstanding during the period	*	*	*	0.03%	0.16%

* Not meaningful

The following table shows how our allowance for loan losses is allocated by type of loan at each of the dates indicated.

	September 30,									
	2007		2006		2005		2004		2003	
	Amount of Allowance	Loan Category as a % of Total Loans	Amount of Allowance	Loan Category as a % of Total Loans	Amount of Allowance	Loan Category as a % of Total Loans	Amount of Allowance	Loan Category as a % of Total Loans	Amount of Allowance	Loan Category as a % of Total Loans
	(Dollars in thousands)									
One- to four-family residential	$ 186	67.85%	$ 148	60.69%	$ 163	67.22%	$ 182	70.92%	$ 137	75.32%
Multi-family residential	22	1.85%	23	1.98%	13	1.26%	16	1.83%	18	2.32%
Commercial real estate	179	7.64%	102	4.42%	98	4.90%	44	2.53%	69	4.22%
Construction and land development	610	22.24%	343	32.33%	227	25.86%	197	22.69		