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

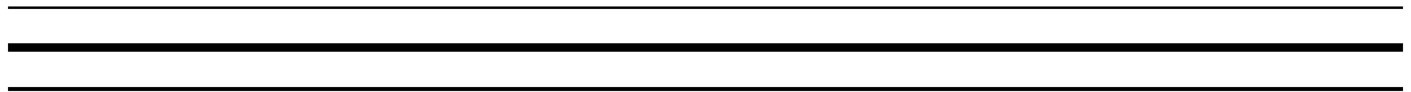
---

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		Page
Item 1.	Business	1
Item 1A.	Risk Factors	35
Item 1B.	Unresolved Staff Comments	37
Item 2.	Properties	37
Item 3.	Legal Proceedings	38
Item 4.	Submission of Matters to a Vote of Security Holders	39
PART II		
Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	40
Item 6.	Selected Financial Data	42
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	44
Item 7A.	Quantitative and Qualitative Disclosures about Market Risk	55
Item 8.	Financial Statements and Supplementary Data	59
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	92
Item 9A.	Controls and Procedures	92
Item 9B.	Other Information	92
PART III		
Item 10.	Directors, Executive Officers and Corporate Governance	92
Item 11.	Executive Compensation	92
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	93
Item 13.	Certain Relationships and Related Transactions and Director Independence	93

Item 14.	Principal Accounting Fees and Services	93
PART IV		
Item 15.	Exhibits and Financial Statement Schedules	93
	Signatures	

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%	226	15.87%
Commercial business	12	0.07%	2	0.09%	2	0.09%	29	1.70%	21	1.83%
Consumer	2	0.35%	-	0.49%	1	0.67%	1	0.33%	10	0.44%
Unallocated	-	-	-	-	54	-	89	-	72	-
Total allowance for loan losses	$ 1,011	100.00%	$ 618	100.00%	$ 558	100.00%	$ 558	100.00%	$ 553	100.00%

Our overall allowance for loan losses increased by $393,000 from September 30, 2006 to September 30, 2007 due primarily to a specific reserve of $370,000 applied to one construction loan for which the borrower was not able to satisfy the terms of the loan and there was a corresponding deterioration in the real estate collateral for the loan.

Investment Activities

General. We invest in securities in accordance with policies approved by our board of directors. The investment policy designates our President, our Chief Financial Officer and our Treasurer as the Investment Committee, which committee is authorized by the board to make the Bank's investments consistent with the investment policy. The board of directors of Prudential Savings Bank reviews all investment activity on a monthly basis.

Our investment policy is designed primarily to manage the interest rate sensitivity of our assets and liabilities, to generate a favorable return without incurring undue interest rate and credit risk, to complement our lending activities and to provide and maintain liquidity. In recent periods, we maintained our investment and mortgage-backed securities portfolio at a relatively consistent level due to concerns over the interest rate risk inherent in investing in long-term, fixed-rate residential mortgage loans in the low interest environment that has existed in recent years.

At September 30, 2007, our investment and mortgage-backed securities amounted to $227.2 million or 47.9% of total assets at such date. The largest component of our securities portfolio in recent periods has been U.S. Government and agency obligations, which amounted to $135.3 million or 59.5% of the securities portfolio at September 30, 2007. In

addition, we invest in mortgage-backed securities and to a significantly lesser degree, municipal securities and other securities. Included in our investment securities available for sale is a $33.8 million investment in a mutual fund that invests primarily in adjustable-rate mortgages and floating-rate securities. At September 30, 2007, we had an unrecognized loss on this investment of approximately $1.2 million which reduced our total equity accordingly.

Approximately $33.5 million of U.S. Government and agency securities at September 30, 2007 were “step-up” securities. These securities require the issuer to pay increased interest rates in the future according to pre-determined schedules and formulas. Our portfolio currently contains securities that call for various interest rate increases at various repricing intervals. The repricing periods range from annually to every three years with interest rate adjustments ranging from 0.25% to 3.0%. In addition, these securities are callable at the option of the issuers. Although designed to protect the investor in a rising rate environment, the rate increases on these securities may not keep pace with rising interest rates in a rapidly rising interest rate environment. Also, because of the call feature, the securities may be called by the issuer at a time when we are not able to reinvest the proceeds of the called security at a rate comparable to that which we were earning on the security at the time it was called.

Pursuant to Statement of Financial Accounting Standards (“SFAS”) No. 115, our securities are classified as available for sale, held to maturity, or trading, at the time of acquisition. Securities classified as held to maturity must be purchased with the intent and ability to hold that security until its final maturity, and can be sold prior to maturity only under rare circumstances. Held to maturity securities are accounted for based upon the amortized cost of the security. Available for sale securities can be sold at any time based upon needs or market conditions. Available for sale securities are accounted for at fair value, with unrealized gains and losses on these securities, net of income tax provisions, reflected in retained earnings as accumulated other comprehensive income. At September 30, 2007, we had $134.8 million of investment securities classified as held to maturity, $38.3 million of investment securities classified as available for sale, $45.5 million of mortgage-backed securities classified as held to maturity, $8.5 million of mortgage-backed securities classified as available for sale, and no securities classified as trading account.

We do not purchase mortgage-backed derivative instruments nor do we purchase corporate obligations which are not rated investment grade or better.

Our mortgage-backed securities consist primarily of mortgage pass-through certificates issued by the Government National Mortgage Association (“GNMA” or “Ginnie Mae”), Fannie Mae (“FNMA”) or Freddie Mac (“FHLMC”). We have not invested in collateralized mortgage obligations (“CMOs”) issued by such agencies. At September 30, 2007, all of our mortgage-backed securities were issued by the GNMA, FNMA or FHLMC.

Investments in mortgage-backed securities involve a risk that actual prepayments will be greater than estimated prepayments over the life of the security, which may require adjustments to the amortization of any premium or accretion of any discount relating to such instruments thereby changing the net yield on such securities. There is also reinvestment risk associated with the cash flows from such securities or in the event such securities are redeemed by the issuer. In addition, the market value of such securities may be adversely affected by changes in interest rates.

Ginnie Mae is a government agency within the Department of Housing and Urban Development which is intended to help finance government-assisted housing programs. Ginnie Mae securities are backed by loans insured by the Federal Housing Administration, or guaranteed by the Veterans Administration. The timely payment of principal and interest on Ginnie Mae securities is guaranteed by Ginnie Mae and backed by the full faith and credit of the U.S. Government. Freddie Mac is a private corporation chartered by the U.S. Government. Freddie Mac issues participation certificates backed principally by conventional mortgage loans. Freddie Mac guarantees the timely payment of interest and the ultimate return of principal on participation certificates. Fannie Mae is a private corporation chartered by the U.S. Congress with a mandate to establish a secondary market for mortgage loans. Fannie Mae guarantees the timely payment of principal and interest on Fannie Mae securities. Freddie Mac and Fannie Mae securities are not backed by the full faith and credit of the U.S. Government, but because Freddie Mac and Fannie Mae are U.S. Government-sponsored enterprises, these securities are considered to be among the highest quality investments with minimal credit risks.

The following table sets forth certain information relating to our investment and mortgage-backed securities portfolios at the dates indicated.

	September 30,					
	2007		2006		2005	
	Amortized Cost	Market Value	Amortized Cost	Market Value	Amortized Cost	Market Value
	(In Thousands)					
Mortgage-backed securities	$ 54,026	$ 52,762	$ 54,894	$ 54,142	$ 66,828	$ 67,124
U.S. Governnment and agency obligations	135,331	134,251	132,198	129,675	129,954	128,163
Municipal obligations	2,450	2,411	2,884	2,853	2,884	2,847
Mutual funds	34,982	33,807	34,982	34,052	34,982	34,123
Total	226,789	223,231	224,958	220,722	234,648	232,257
FHLB stock	2,397	2,397	2,217	2,217	1,811	1,811
FHLMC stock	26	1,560	26	1,754	26	1,493
FNMA stock	1	7	1	7	1	5
Total investment and mortgage-backed securities	$ 229,213	$ 227,195	$ 227,202	$ 224,700	$ 236,486	$ 235,566

The following tables set forth the amount of investment and mortgage-backed securities which mature during each of the periods indicated and the weighted average yields for each range of maturities at September 30, 2007. Tax-exempt yields have not been adjusted to a tax-equivalent basis.

	Amounts at September 30, 2007 Which Mature In							
	One Year or Less	Weighted Average Yield	Over One Year Through Five Years	Weighted Average Yield	Over Five Through Ten Years	Weighted Average Yield	Over Ten Years	Weighted Average Yield
	(Dollars in Thousands)							
Bonds and other debt securities:								
U.S. gov and agency oblig	$ 6,000	4.30%	$ 25,002	4.56%	$ 38,142	5.18%	$ 66,187	5.54%
Municipal obligations	-	-		-	2,450	3.52%	-	-
Mortgage-backed securities	-	-	1,693	4.50%	22	6.75%	52,311	5.18%
Total	$ 6,000	4.30%	$ 26,695	4.56%	$ 40,614	5.08%	$ 118,498	5.38%

The following table sets forth the composition of our mortgage-backed securities portfolio at each of the dates indicated all of which were classified as held to maturity in fiscal 2005 while a portion was classified as available-for-sale in fiscal 2006 and 2007. The securities all bore fixed rates of interest in 2005 and 2006. During 2007, certain securities had variable rates of interest.

	September 30,		
	2007	2006	2005
	(In Thousands)		
GNMA	$ 42,471	$ 46,991	$ 62,449
FHLMC	1,693	1,920	2,541
FNMA	9,862	5,983	1,838
Total mortgage-backed securities	$ 54,026	$ 54,894	$ 66,828

Information regarding the contractual maturities and weighted average yield of our mortgage-backed securities portfolio at September 30, 2007 is presented below. Due to repayments of the underlying loans, the actual maturities of mortgage-backed securities generally are substantially less than the scheduled maturities.

	Amounts at September 30, 2007 Which Mature In					
	One Year or Less	Weighted Average Yield	Over One through Five Years	Weighted Average Yield	Over Five Years	Weighted Average Yield
	(Dollars in Thousands)					
GNMA	$ -	-	$ -	-	$ 42,471	5.05%
FHLMC	-	-	1,693	4.50%	-	-
FNMA	-	-	-	-	9,862	5.74%
Total	$ -	-	$ 1,693	4.50%	$ 52,333	5.18%

The following table sets forth the purchases, and principal repayments of our mortgage-backed securities at amortized cost during the periods indicated.

	At or For the Year Ended September 30,		
	2007	2006	2005
	(Dollars in Thousands)		
Mortgage-backed securities at beginning of period	$ 54,894	$ 66,828	$ 80,932
Purchases	6,762	4,610	4,481
Maturities and repayments	(8,009)	(12,011)	(18,615)
Sales	-	(4,564)	-
Amortizations of premiums and discounts, net	379	31	30

Mortgage-backed securities at end of period	$ 54,026	$ 54,894	$ 66,828
Weighted average yield at end of period	5.16%	5.09%	5.16%

20

Sources of Funds

General. Deposits, loan repayments and prepayments, proceeds from sales of loans, cash flows generated from operations and FHLB advances are the primary sources of our funds for use in lending, investing and for other general purposes.

Deposits. We offer a variety of deposit accounts with a range of interest rates and terms. Our deposits consist of checking, both interest-bearing and non-interest-bearing, money market, savings and certificate of deposit accounts. At September 30, 2007, 46.2% of the funds deposited with Prudential Savings Bank were in core deposits, which are deposits other than certificates of deposit.

The flow of deposits is influenced significantly by general economic conditions, changes in money market rates, prevailing interest rates and competition. Our deposits are obtained predominantly from the areas where our branch offices are located. We have historically relied primarily on customer service and long-standing relationships with customers to attract and retain these deposits; however, market interest rates and rates offered by competing financial institutions significantly affect our ability to attract and retain deposits. The interest rates offered on our deposits are competitive in the market place and have increased over the past year as market rates have increased.

Prudential Savings Bank uses traditional means of advertising its deposit products, including broadcast and print media and generally does not solicit deposits from outside its market area.

We do not actively solicit certificate accounts of $100,000 and above, known as “jumbo CDs,” or use brokers to obtain deposits. At September 30, 2007, our jumbo CDs amounted to $56.4 million, of which $41.3 million are scheduled to mature within twelve months. At September 30, 2007, the weighted average remaining maturity of our certificate of deposit accounts was 11.3 months.

The following table shows the distribution of, and certain other information relating to, our deposits by type of deposit, as of the dates indicated.

	September 30,					
	2007		2006		2005	
	Amount	%	Amount	%	Amount	%
	(Dollars in thousands)					
Certificate accounts:						
1.00% - 1.99%	$ -	-	$ -	-	$ 618	0.18%
2.00% - 2.99%	-	-	617	0.18%	45,973	13.66%
3.00% - 3.99%	14,745	4.16%	30,933	8.91%	52,903	15.72%
4.00% - 4.99%	36,827	10.40%	70,410	20.27%	30,212	8.98%
5.00% - 5.99%	138,993	39.26%	69,642	20.05%	14,611	4.35%
Total certificate accounts	190,565	53.82%	171,602	49.41%	144,317	42.89%
Transaction accounts:						
Savings	70,903	20.03%	76,989	22.17%	87,709	26.07%
Checking:						
Interest bearing	26,806	7.57%	29,675	8.55%	41,094	12.21%
Non-interest bearing	2,089	0.59%	4,528	1.30%	3,441	1.02%
Money market	63,675	17.99%	64,498	18.57%	59,907	17.81%
Total transaction accounts	163,473	46.18%	175,690	50.59%	192,151	57.11%

Total deposits	$	354,038	100.00%	$	347,292	100.00%	$	336,468	100.00%

The following table shows the average balance of each type of deposit and the average rate paid on each type of deposit for the periods indicated.

	Year Ended September 30,								
	2007			2006			2005		
	Average Balance	Interest Expense	Average Rate Paid	Average Balance	Interest Expense	Average Rate Paid	Average Balance	Interest Expense	Average Rate Paid
	(Dollars in Thousands)								
Savings	$ 71,815	$ 1,986	2.77%	$ 81,472	$ 2,458	3.02%	$ 91,821	$ 1,728	1.88%
Interest-bearing checking and money market accounts	93,701	3,321	3.54%	98,112	3,081	3.14%	101,146	2,273	2.25%
Certificate accounts	181,604	7,944	4.37%	156,869	5,304	3.38%	144,445	4,521	3.13%
Total interest-bearing deposits	347,120	$ 13,251	3.82%	336,453	$ 10,843	3.22%	337,412	$ 8,522	2.53%
Non-interest bearing deposits	5,009			3,789			10,066		
Total deposits	$ 352,129		3.76%	$ 340,242		3.19%	$ 347,478		2.45%

The following table shows our savings flows during the periods indicated.

	Year Ended September 30,		
	2007	2006	2005
	(In Thousands)		
Total deposits	$ 516,548	$ 488,409	$ 504,735
Total withdrawals	(518,719)	(485,532)	(524,140)
Interest credited	8,916	7,948	6,714
Total increase (decrease) in deposits	$ 6,745	$ 10,825	$ (12,691)

The following table presents, by various interest rate categories and maturities, the amount of certificates of deposit at September 30, 2007.

	Balance at September 30, 2007 Maturing in the 12 Months Ending September 30,				
Certificates of Deposit	2008	2009	2010	Thereafter	Total
	(In Thousands)				
3.00% - 3.99%	$ 11,674	$ 3,071	$ -	$ -	$ 14,745
4.00% - 4.99%	26,750	4,898	4,641	537	36,826
5.00% - 5.99%	98,458	21,063	401	19,072	138,994
Total certificate accounts	$ 136,882	$ 29,032	$ 5,042	$ 19,609	$ 190,565

The following tables show the maturities of our certificates of deposit of $100,000 or more at September 30, 2007, by time remaining to maturity.

Quarter Ending:	Amount	Weighted Avg Rate
	(Dollars in Thousands)	
December 31, 2007	$ 13,390	5.04%
March 31, 2008	19,081	5.08%
June 30, 2008	4,580	4.79%
September 30, 2008	4,266	5.10%
After September 30, 2008	15,096	4.98%
Total certificates of deposit with balances of $100,000 or more	$ 56,413	5.02%

Borrowings. We utilize advances from the Federal Home Loan Bank of Pittsburgh as an alternative to retail deposits to fund our operations as part of our operating strategy. These FHLB advances are collateralized primarily by certain of our mortgage loans and mortgage-backed securities and secondarily by our investment in capital stock of the Federal Home Loan Bank of Pittsburgh. FHLB advances are made pursuant to several different credit programs, each of which has its own interest rate and range of maturities. The maximum amount that the Federal Home Loan Bank of Pittsburgh will advance to member institutions, including Prudential Savings Bank, fluctuates from time to time in accordance with the policies of the Federal Home Loan Bank. At September 30, 2007, we had $33.7 million in outstanding FHLB advances and $256.4 million of additional FHLB advances available. At such date, maturities range from one month to four years. We have not utilized any other types of borrowings such as securities sold under agreements to repurchase. The increases in borrowings during fiscal 2006 and 2007 were to meet increased loan demand.

The following table shows certain information regarding our borrowings at or for the dates indicated:

	At or For the Year Ended September 30,		
	2007	2006	2005
	(Dollars in Thousands)		
FHLB advances:			
Average balance outstanding	27,686	19,628	13,841
Maximum amount outstanding at any month-end during the period	33,743	31,784	13,859
Balance outstanding at end of period	33,743	31,784	13,823
Average interest rate during the period	5.54%	5.57%	3.57%
Weighted average interest rate at end of period	5.26%	5.49%	5.53%

We have six FHLB advances made under a low-income housing program in which we participate. Four of the FHLB advances amortize over the period to maturity. Three of these advances are at an interest rate of 3.0% and one is at 2.0%. The other two FHLB advances bear a zero percent interest rate. The total of these six FHLB advances is $743,000. At September 30, 2007, repayments of $42,000 are due within one year as part of the program. Advances from the FHLB which are not part of the low-income housing program total $33.0 million, with interest rates ranging from 5.05% to 5.98% and maturities ranging from October 2007 to September 2010.

Subsidiaries

The Company has only one direct subsidiary: Prudential Savings Bank. The Bank's sole subsidiary as of September 30, 2007 was PSB Delaware, Inc. ("PSB"), a Delaware-chartered company established to hold certain investments of the Bank. As of September 30, 2007, PSB has assets of $66.0 million primarily consisting of mortgage backed securities. We may consider the establishment of one or more additional subsidiaries in the future.

Employees

At September 30, 2007, we had 70 full-time employees, and five part-time employees. None of such employees are represented by a collective bargaining group, and we believe that our relationship with our employees is good.

REGULATION

Set forth below is a brief description of certain laws relating to the regulation of Prudential Bancorp, Prudential Mutual Holding Company and Prudential Savings Bank. This description does not purport to be complete and is qualified in its entirety by reference to applicable laws and regulations.

General

Prudential Savings Bank as a Pennsylvania chartered savings bank with deposits insured by the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation, is subject to extensive regulation and examination by the Pennsylvania Department of Banking and by the Federal Deposit Insurance Corporation. The federal and state laws and regulations applicable to banks regulate, among other things, the scope of their business, their investments, the reserves required to be kept against deposits, the timing of the availability of deposited funds and the nature and amount of and collateral for certain loans. This regulatory structure also gives the federal and state banking agencies extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. The laws and regulations governing Prudential Savings Bank generally have been promulgated to protect depositors and not for the purpose of protecting shareholders.

Federal law provides the federal banking regulators, including the Federal Deposit Insurance Corporation and the Federal Reserve Board, with substantial enforcement powers. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders, and to initiate injunctive actions against banking organizations and institution-affiliated parties, as defined. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities. Any change in such regulation, whether by the Pennsylvania Department of Banking, the Federal Deposit Insurance Corporation, the Federal Reserve Board or the United States Congress, could have a material impact on us and our operations.

Prudential Bancorp and Prudential Mutual Holding Company are registered as bank holding companies under the Bank Holding Company Act and are subject to regulation and supervision by the Federal Reserve Board and by the Pennsylvania Department of Banking. Prudential Bancorp and Prudential Mutual Holding Company file annually a report of their operations with, and are subject to examination by, the Federal Reserve Board and the Pennsylvania Department of Banking. This regulation and oversight is generally intended to ensure that Prudential Bancorp and Prudential Mutual Holding Company limit their activities to those allowed by law and that they operate in a safe and sound manner without endangering the financial health of Prudential Savings Bank.

In connection with the reorganization completed in March 2005, Prudential Bancorp registered its common stock with the SEC under the Securities Exchange Act of 1934. Prudential Bancorp is subject to the proxy and tender offer rules, insider trading reporting requirements and restrictions, and certain other requirements under the Securities Exchange Act of 1934. Prudential Bancorp's common stock is listed on the Nasdaq Global Market under the symbol "PBIP." The Nasdaq Stock Market listing requirements impose additional requirements on us, including, among other things, rules relating to corporate governance and the composition and independence of our board of directors and various committees of the board, such as the audit committee.

Regulation of Prudential Bancorp and Prudential Mutual Holding Company

Bank Holding Company Act Activities and Other Limitations. Under the Bank Holding Company Act, Prudential Bancorp and Prudential Mutual Holding Company must obtain the prior approval of the Federal Reserve Board before they may acquire control of another bank or bank holding company, merge or consolidate with another bank holding company, acquire all or substantially all of the assets of another bank or bank holding company, or acquire direct or indirect ownership or control of any voting shares of any bank or bank holding company if, after such acquisition, Prudential Bancorp and Prudential Mutual Holding Company would directly or indirectly own or control more than 5% of such shares.

Federal statutes impose restrictions on the ability of a bank holding company and its nonbank subsidiaries to obtain extensions of credit from its subsidiary bank, on the subsidiary bank’s investments in the stock or securities of the holding company, and on the subsidiary bank’s taking of the holding company’s stock or securities as collateral for loans to any borrower. A bank holding company and its subsidiaries are also prevented from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property, or furnishing of services by the subsidiary bank.

A bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the policy of the Federal Reserve Board that a bank holding company should stand ready to use available resources to provide adequate capital to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company’s failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve Board to be an unsafe and unsound banking practice or a violation of the Federal Reserve Board regulations, or both.

Non-Banking Activities. The business activities of Prudential Bancorp and Prudential Mutual Holding Company, as bank holding companies, are restricted by the Bank Holding Company Act. Under the Bank Holding Company Act and the Federal Reserve Board’s bank holding company regulations, bank holding companies may only engage in, or acquire or control voting securities or assets of a company engaged in,

- banking or managing or controlling banks and other subsidiaries authorized under the Bank Holding Company Act; and
- any Bank Holding Company Act activity the Federal Reserve Board has determined to be so closely related that it is incidental to banking or managing or controlling banks.

The Federal Reserve Board has determined by regulation that certain activities are closely related to banking including operating a mortgage company, finance company, credit card company, factoring company, trust company or savings association; performing certain data processing operations; providing limited securities brokerage services; acting as an investment or financial advisor; acting as an insurance agent for certain types of credit-related insurance; leasing personal property on a full-payout, non-operating basis; providing tax planning and preparation services; operating a collection agency; and providing certain courier services. However, as discussed below, certain other activities are permissible for a bank holding company that becomes a financial holding company.

Financial Modernization. The Gramm-Leach-Bliley Act permits greater affiliation among banks, securities firms, insurance companies, and other companies under a new type of financial services company known as a "financial holding company." A financial holding company essentially is a bank holding company with significantly expanded powers. Financial holding companies are authorized by statute to engage in a number of financial activities previously impermissible for bank holding companies, including securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; and merchant banking activities. The Gramm-Leach-Bliley Act also permits the Federal Reserve Board and the Treasury Department to authorize additional activities for financial holding companies if they are "financial in nature" or "incidental" to financial activities. A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized, well managed, and has at least a "satisfactory" Community Reinvestment Act rating. A financial holding company must provide notice to the Federal Reserve Board within 30 days after commencing activities previously determined by statute or by the Federal Reserve Board and Department of the Treasury to be permissible. Prudential Bancorp and Prudential Mutual Holding Company have not submitted notices to the Federal Reserve Board of their intent to be deemed financial holding companies. However, they are not precluded from submitting a notice in the future should they wish to engage in activities only permitted to financial holding companies.

Regulatory Capital Requirements. The Federal Reserve Board has adopted capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the Bank Holding Company Act. The Federal Reserve Board's capital adequacy guidelines for Prudential Bancorp, on a consolidated basis, are similar to those imposed on Prudential Savings Bank by the Federal Deposit Insurance Corporation. See "-Regulation of Prudential Savings Bank - Regulatory Capital Requirements."

Restrictions on Dividends. Prudential Bancorp's ability to declare and pay dividends may depend in part on dividends received from Prudential Savings Bank. The Pennsylvania Banking Code regulates the distribution of dividends by savings banks and states, in part, that dividends may be declared and paid out of accumulated net earnings, provided that the bank continues to meet its surplus requirements. In addition, dividends may not be declared or paid if Prudential Savings Bank is in default in payment of any assessment due the Federal Deposit Insurance Corporation.

A Federal Reserve Board policy statement on the payment of cash dividends states that a bank holding company should pay cash dividends only to the extent that the holding company's net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company's capital needs, asset quality and overall financial condition. The Federal Reserve Board also indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Furthermore, under the federal prompt corrective action regulations, the Federal Reserve Board may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as "undercapitalized." See "-Regulation of Prudential Savings Bank - Prompt Corrective Action," below.

Sarbanes-Oxley Act of 2002. On July 30, 2002, President George W. Bush signed into law the Sarbanes-Oxley Act of 2002, which generally establishes a comprehensive framework to modernize and reform the oversight of public company auditing, improve the quality and transparency of financial reporting by those companies and strengthen the independence of auditors. Among other things, the new legislation (i) created a public company accounting oversight board which is empowered to set auditing, quality control and ethics standards, to inspect registered public accounting firms, to conduct investigations and to take disciplinary actions, subject to SEC oversight and review; (ii) strengthened auditor independence from corporate management by, among other things, limiting the scope of consulting services that auditors can offer their public company audit clients; (iii) heightened the responsibility of public company directors and senior managers for the quality of the financial reporting and disclosure made by their companies; (iv) adopted a number of provisions to deter wrongdoing by corporate management; (v) imposed a number of new corporate disclosure requirements; (vi) adopted provisions which generally seek to limit and expose to public view possible conflicts of interest affecting securities analysts; and (vii) imposed a range of new criminal penalties for fraud and other wrongful acts, as well as extended the period during which certain types of lawsuits can be brought against a company or its insiders.

As a non-accelerated filer, the Company is not required to provide management's report on internal control over financial reporting until it files an annual report for a fiscal year ending on or after December 15, 2007.

Restrictions Applicable to Mutual Holding Companies. While regulations governing Pennsylvania-chartered mutual holding companies have not been adopted, under authority of Section 115.1 of the Pennsylvania Banking Code of 1965, as amended, and a policy statement issued by the Pennsylvania Department of Banking, the Department approved the reorganization of Prudential Saving Bank to the mutual holding company form of organization.

Pursuant to Pennsylvania law, a mutual holding company may engage only in the following activities:

- investing in the stock of one or more financial institution subsidiaries;
- acquiring one or more additional financial institution subsidiaries into a subsidiary of the holding company;
- merging with or acquiring another holding company, one of whose subsidiaries is a financial institution subsidiary;
- investing in a corporation the capital stock of which is available for purchase by a savings bank under federal law or under the Pennsylvania Banking Code;
- engaging in such activities as are permitted, by statute or regulation, to a holding company of a federally chartered insured mutual institution under federal law; and
- engaging in such other activities as may be permitted by the Pennsylvania Department of Banking.

If a mutual holding company acquires or merges with another holding company, the holding company acquired or the holding company resulting from such merger or acquisition may only invest in assets and engage in activities listed above, and has a period of two years to cease any non-conforming activities and divest of any non-conforming investments.

The mutual holding company will be subject to such regulations as the Pennsylvania Department of Banking may prescribe. No mutual holding company regulations have been issued to date by the Department.

Regulation of Prudential Savings Bank

Pennsylvania Savings Bank Law. The Pennsylvania Banking Code contains detailed provisions governing the organization, location of offices, rights and responsibilities of directors, officers, and employees, as well as corporate powers, savings and investment operations and other aspects of Prudential Savings Bank and its affairs. The code delegates extensive rule-making power and administrative discretion to the Pennsylvania Department of Banking so that the supervision and regulation of state-chartered savings banks may be flexible and readily responsive to changes in economic conditions and in savings and lending practices.

The Pennsylvania Banking Code also provides that state-chartered savings banks may engage in any activity permissible for a federal savings association, subject to regulation by the Pennsylvania Department of Banking. The Federal Deposit Insurance Act, however, prohibits Prudential Savings Bank from making new investments, loans, or becoming involved in activities as principal and equity investments which are not permitted for national banks unless:

- the Federal Deposit Insurance Corporation determines the activity or investment does not pose a significant risk of loss to the Deposit Insurance Fund; and
- Prudential Savings Bank meets all applicable capital requirements.

Accordingly, the additional operating authority provided to Prudential Savings Bank by the Pennsylvania Banking Code is significantly restricted by the Federal Deposit Insurance Act.

Insurance of Accounts. The deposits of Prudential Savings Bank are insured to the maximum extent permitted by the Deposit Insurance Fund, which is administered by the Federal Deposit Insurance Corporation, and are backed by the full faith and credit of the U.S. Government. As insurer, the Federal Deposit Insurance Corporation is authorized to conduct examinations of, and to require reporting by, insured institutions. It also may prohibit any insured institution from engaging in any activity the Federal Deposit Insurance Corporation determines by regulation or order to pose a serious threat to the Federal Deposit Insurance Corporation. The Federal Deposit Insurance Corporation also has the authority to initiate enforcement actions against savings institutions.

Each Federal Deposit Insurance Corporation insured institutions is assigned to one of three capital groups which are based solely on the level of an institution’s capital - “well capitalized,” “adequately capitalized” and “undercapitalized” - which are defined in the same manner as the regulations establishing the prompt corrective action system discussed below. These three groups are then divided into three subgroups which reflect varying levels of supervisory concern, from those which are considered to be healthy to those which are considered to be of substantial supervisory concern. The matrix so created results in various assessment risk classifications, with rates effective January 1, 2007 ranging from five basis points for well capitalized, healthy institutions, such as Prudential Savings Bank, to 43 basis points for undercapitalized institutions with substantial supervisory concerns. Prudential Savings Bank currently is considered well capitalized and has a five basis point assessment rate.

In addition, all institutions with deposits insured by the Federal Deposit Insurance Corporation are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation, a mixed-ownership government corporation established to recapitalize the predecessor to the Savings Association Insurance Fund. The assessment rate for the fourth quarter of 2007 was .0114% of insured deposits and is adjusted quarterly. These assessments will continue until the Financing Corporation bonds mature in 2019.

The Federal Deposit Insurance Corporation may terminate the deposit insurance of any insured depository institution, including Prudential Savings Bank, if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the Federal Deposit Insurance Corporation. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance, if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the Federal Deposit Insurance Corporation. Management is aware of no existing circumstances which would result in termination of Prudential Savings Bank’s deposit insurance.

Deposit Insurance Reform. On February 8, 2006, President George W. Bush signed into law (“FDI Reform Act of 2005”) legislation that merged the Bank Insurance Fund and the Savings Association Insurance Fund to form the Deposit Insurance Fund, eliminated any disparities in bank and thrift risk-based premium assessments, reduced the administrative burden of maintaining and operating two separate funds and established certain new insurance coverage limits and a mechanism for possible periodic increases. The legislation also gave the Federal Deposit Insurance Corporation greater discretion to identify the relative risks all institutions present to the Deposit Insurance Fund and set risk-based premiums.

Major provisions in the legislation include:

- merging the Savings Association Insurance Fund and Bank Insurance Fund, which became effective March 31, 2006;

- maintaining basic deposit and municipal account insurance coverage at $100,000 but providing for a new basic insurance coverage for retirement accounts of $250,000. Insurance coverage for basic deposit and retirement accounts could be increased for inflation every five years in $10,000 increments beginning in 2011;

- providing the Federal Deposit Insurance Corporation with the ability to set the designated reserve ratio within a range of between 1.15% and 1.50%, rather than maintaining 1.25% at all times regardless of prevailing economic conditions;

- providing a one-time assessment credit of $4.7 billion to banks and savings associations in existence on December 31, 1996, which may be used to offset future premiums with certain limitations; and

- requiring the payment of dividends of 100% of the amount that the insurance fund exceeds 1.5% of the estimated insured deposits and the payment of 50% of the amount that the insurance fund exceeds 1.35% of the estimated insured deposits (when the reserve is greater than 1.35% but no more than 1.5%).

Pursuant to the Reform Act, the Federal Deposit Insurance Corporation has determined to maintain the designated reserve ratio at its current 1.25%, which will be reviewed annually. The Federal Deposit Insurance Corporation has also adopted a new risk-based premium system that provides for quarterly assessments based on an insured institution's ranking in one of four risk categories based upon supervisory and capital evaluations. Beginning in 2007, well-capitalized institutions (generally those with CAMELS composite ratings of 1 or 2) were grouped in Risk Category I and were assessed for deposit insurance at an annual rate of between five and seven basis points. The assessment rate for an individual institution is determined according to a formula based on a weighted average of the institution's individual CAMEL component ratings plus either five financial ratios or, in the case of an institution with assets of $10.0 billion or more, the average ratings of its long-term debt. Institutions in Risk Categories II, III and IV will be assessed at annual rates of 10, 28 and 43 basis points, respectively. Prudential Savings Bank has been able to offset its deposit insurance premium for fiscal 2007 with the special assessment credit. It is anticipated that the special assessment credit will offset a portion of the deposit insurance premium in fiscal 2008. Although the Bank remains in the lowest risk tier for the assessment, we will most likely experience additional deposit insurance expense in future periods due to the FDI Reform Act of 2005.

Regulatory Capital Requirements. The Federal Deposit Insurance Corporation has promulgated capital adequacy requirements for state-chartered banks that, like Prudential Savings Bank, are not members of the Federal Reserve Board System. The capital regulations establish a minimum 3% Tier 1 leverage capital requirement for the most highly rated state-chartered, non-member banks, with an additional cushion of at least 100 to 200 basis points for all other state-chartered, non-member banks, which effectively increases the minimum Tier 1 leverage ratio for such other banks to 4% to 5% or more. Under the Federal Deposit Insurance Corporation’s regulations, the highest-rated banks are those that the Federal Deposit Insurance Corporation determines are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, which are considered a strong banking organization, rated composite 1 under the Uniform Financial Institutions Rating System. Tier 1, or leverage capital, is defined as the sum of common shareholders’ equity, including retained earnings, noncumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries, minus all intangible assets other than certain purchased mortgage servicing rights and purchased credit card relationships.

The Federal Deposit Insurance Corporation’s regulations also require that state-chartered, non-member banks meet a risk-based capital standard. The risk-based capital standard requires the maintenance of total capital, defined as Tier 1 capital and supplementary (Tier 2) capital, to risk weighted assets of 8%. In determining the amount of risk-weighted assets, all assets, plus certain off balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on the risks the Federal Deposit Insurance Corporation believes are inherent in the type of asset or item. The components of Tier 1 capital for the risk-based standards are the same as those for the leverage capital requirement. The components of supplementary (Tier 2) capital include cumulative perpetual preferred stock, mandatory subordinated debt, perpetual subordinated debt, intermediate-term preferred stock, up to 45% of unrealized gains on equity securities and a portion of a bank’s allowance for loan losses. Allowance for loan losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of supplementary capital that may be included in total capital is limited to 100% of Tier 1 capital.

A bank that has less than the minimum leverage capital requirement is subject to various capital plan and activities restriction requirements. The Federal Deposit Insurance Corporation’s regulations also provide that any insured depository institution with a ratio of Tier 1 capital to total assets that is less than 2.0% is deemed to be operating in an unsafe or unsound condition pursuant to Section 8(a) of the Federal Deposit Insurance Act and could be subject to potential termination of deposit insurance.

Prudential Savings Bank is also subject to minimum capital requirements imposed by the Pennsylvania Department of Banking on Pennsylvania chartered depository institutions. Under the Pennsylvania Department of Banking's capital regulations, a Pennsylvania bank or savings association must maintain a minimum leverage ratio of Tier 1 capital, as defined under the Federal Deposit Insurance Corporation's capital regulations, to total assets of 4%. In addition, the Pennsylvania Department of Banking has the supervisory discretion to require a higher leverage ratio for any institution or association based on inadequate or substandard performance in any of a number of areas. The Pennsylvania Department of Banking incorporates the same Federal Deposit Insurance Corporation risk-based capital requirements in its regulations.

At September 30, 2007, Prudential Savings Bank exceeded all of its regulatory capital requirements, with leverage and total risk-based capital ratios of 15.52% and 34.77%, respectively.

Prompt Correction Action. The following table shows the amount of capital associated with the different capital categories set forth in the prompt correction action regulations.

Capital Category	Total Risk-Based Capital	Tier 1 Risk-Based Capital	Tier 1 Leverage Capital
Well capitalized	10% or more	6% or more	5% or more
Adequately capitalized	8% or more	4% or more	4% or more
Undercapitalized	Less than 8%	Less than 4%	Less than 4%
Significantly undercapitalized	Less than 6%	Less than 3%	Less than 3%

In addition, an institution is "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. Under specified circumstances, a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized institution or an undercapitalized institution to comply with supervisory actions as if it were in the next lower category, except that the Federal Deposit Insurance Corporation may not reclassify a significantly undercapitalized institution as critically undercapitalized.

An institution generally must file a written capital restoration plan which meets specified requirements within 45 days of the date that the institution receives notice or is deemed to have notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. A federal banking agency must provide the institution with written notice of approval or disapproval within 60 days after receiving a capital restoration plan, subject to extensions by the agency. An institution which is required to submit a capital restoration plan must concurrently submit a performance guaranty by each company that controls the institution. In addition, undercapitalized institutions are subject to various regulatory restrictions, and the appropriate federal banking agency also may take any number of discretionary supervisory actions.

At September 30, 2007, Prudential Savings Bank was deemed a well capitalized institution for purposes of the above regulations and as such is not subject to the above mentioned restrictions.

The table below sets forth the Company and the Bank's capital position relative to its regulatory capital requirements at September 30, 2007.

	Actual		Required for Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions		Excess Over Well Capitalized Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in Thousands)							
Total risk-based capital								
Company	$ 81,877	38.43%	$ 17,044	8.00%	N/A	N/A	N/A	N/A
Bank	74,081	34.77	17,044	8.00	$ 21,305	10.00%	$ 52,776	24.77%
Tier 1 risk-based capital								
Company	80,702	37.88	8,522	4.00	N/A	N/A	N/A	N/A
Bank	72,906	34.22	8,522	4.00	12,783	6.00	60,123	28.22
Tier 1 leverage capital								
Company	80,702	17.08	18,900	4.00	N/A	N/A	N/A	N/A
Bank	72,906	15.52	18,785	4.00	23,482	5.00	49,424	10.52

Affiliate Transaction Restrictions. Federal laws strictly limit the ability of banks to engage in transactions with their affiliates, including their bank holding companies. Such transactions between a subsidiary bank and its parent company or the nonbank subsidiaries of the bank holding company are limited to 10% of a bank subsidiary's capital and surplus and, with respect to such parent company and all such nonbank subsidiaries, to an aggregate of 20% of the bank subsidiary's capital and surplus. Further, loans and extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also requires that all transactions between a bank and its affiliates be on terms as favorable to the bank as transactions with non-affiliates.

Federal Home Loan Bank System. Prudential Savings Bank is a member of the Federal Home Loan Bank of Pittsburgh, which is one of 12 regional Federal Home Loan Banks. Each Federal Home Loan Bank serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by member institutions and proceeds from the sale of consolidated obligations of the Federal Home Loan Bank System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the board of directors of the Federal Home Loan Bank. At September 30, 2007, Prudential Savings Bank had $33.7 million in FHLB advances.

As a member, Prudential Savings Bank is required to purchase and maintain stock in the Federal Home Loan Bank of Pittsburgh in an amount equal to the greater of 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year or 5% of its outstanding advances from the Federal Home Loan Bank. At September 30, 2007, Prudential Savings Bank had $2.4 million in stock of the Federal Home Loan Bank of Pittsburgh which was in compliance with this requirement.

Federal Reserve Board System. The Federal Reserve Board requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts, which are primarily checking and NOW accounts, and non-personal time deposits. The balances maintained to meet the reserve requirements imposed by the Federal Reserve Board may be used to satisfy the liquidity requirements that are imposed by the Pennsylvania Department of Banking. At September 30, 2007, Prudential Savings Bank was in compliance with these reserve

requirements.

Dividend Waivers By Prudential Mutual Holding Company

It has been the policy of a number of mutual holding companies to waive the receipt of dividends declared by their subsidiary companies. In connection with its approval of the reorganization, however, the Federal Reserve Board imposed certain conditions on the waiver by Prudential Mutual Holding Company of dividends paid on the common stock by Prudential Bancorp. In particular, the Federal Reserve Board requires that Prudential Mutual Holding Company obtain the prior approval of the Federal Reserve Board before Prudential Mutual Holding Company may waive any dividends from Prudential Bancorp. As of the date hereof, we are not aware that the Federal Reserve Board has given its approval to any waiver of dividends by any mutual holding company that has requested such approval.

The Federal Reserve Board approval of the reorganization also required that the amount of any dividends waived by Prudential Mutual Holding Company will not be available for payment to the public stockholders of Prudential Bancorp (i.e., shareholders except for Prudential Mutual Holding Company) and that such amounts will be excluded from Prudential Bancorp's capital for purposes of calculating dividends payable to the public shareholders. Moreover, Prudential Savings Bank would be required to maintain the cumulative amount of dividends waived by Prudential Mutual Holding Company in a restricted capital account that would be added to the liquidation account established in the reorganization. This amount would not be available for distribution to public stockholders. The restricted capital account and liquidation account amounts would not be reflected in Prudential Savings Bank's financial statements, but would be considered as a notational or memorandum account of Prudential Savings Bank. These accounts would be maintained in accordance with the laws, rules, regulations and policies of the Pennsylvania Banking Department and the plan of reorganization. The plan of reorganization also provides that if Prudential Mutual Holding Company converts to stock form in the future (commonly referred to as a second step reorganization), any waived dividends would reduce the percentage of the converted company's shares of common stock issued to public shareholders in connection with any such transaction.

Prudential Mutual Holding Company does not expect to seek the prior approval of the Federal Reserve Board to waive dividends declared by Prudential Bancorp. If Prudential Mutual Holding Company decides that it is in its best interest to waive a particular dividend to be paid by Prudential Bancorp and the Federal Reserve Board approves such waiver, then Prudential Bancorp would pay such dividend only to its public shareholders. The amount of the dividend waived by Prudential Mutual Holding Company would be treated in the manner described above. Prudential Mutual Holding Company's decision as to whether or not to waive a particular dividend will depend on a number of factors, including Prudential Mutual Holding Company's capital needs, the investment alternatives available to Prudential Mutual Holding Company as compared to those available to Prudential Bancorp, and the possibility of regulatory approvals.

TAXATION

Federal Taxation

General. Prudential Bancorp, Prudential Mutual Holding Company and Prudential Savings Bank are subject to federal income taxation in the same general manner as other corporations with some exceptions listed below. The following discussion of federal, state and local income taxation is only intended to summarize certain pertinent income tax matters and is not a comprehensive description of the applicable tax rules. Prudential Savings Bank's federal and state income tax returns for taxable years through September 30, 2003 have been closed for purposes of examination by the Internal Revenue Service or the Pennsylvania Department of Revenue.

Prudential Bancorp files a consolidated federal income tax return with Prudential Savings Bank and its subsidiary, PSB Delaware, Inc. Accordingly, any cash distributions made by Prudential Bancorp to its shareholders will be treated as cash dividends and not as a non-taxable return of capital to shareholders for federal and state tax purposes.

Method of Accounting. For federal income tax purposes, Prudential Bancorp and Prudential Savings Bank report income and expenses on the accrual method of accounting and file their federal income tax return on a fiscal year basis.

Bad Debt Reserves. The Small Business Job Protection Act of 1996 eliminated the use of the reserve method of accounting for bad debt reserves by savings associations, effective for taxable years beginning after 1995. Prior to that time, Prudential Savings Bank was permitted to establish a reserve for bad debts and to make additions to the reserve. These additions could, within specified formula limits, be deducted in arriving at taxable income. As a result of the Small Business Job Protection Act of 1996, savings associations must use the specific charge-off method in computing their bad debt deduction beginning with their 1996 federal tax return. In addition, federal legislation required the recapture over a six year period of the excess of tax bad debt reserves at December 31, 1995 over those established as of December 31, 1987.

Taxable Distributions and Recapture. Prior to the Small Business Job Protection Act of 1996, bad debt reserves created prior to January 1, 1988 were subject to recapture into taxable income if Prudential Savings Bank failed to meet certain thrift asset and definitional tests. New federal legislation eliminated these savings association related recapture rules. However, under current law, pre-1988 reserves remain subject to recapture should Prudential Savings Bank make certain non-dividend distributions or cease to maintain a bank charter.

At September 30, 2007, the total federal pre-1988 reserve was approximately $6.6 million. The reserve reflects the cumulative effects of federal tax deductions by Prudential Savings Bank for which no federal income tax provisions have been made.

Alternative Minimum Tax. The Internal Revenue Code imposes an alternative minimum tax at a rate of 20% on a base of regular taxable income plus certain tax preferences. The alternative minimum tax is payable to the extent such alternative minimum tax income is in excess of the regular income tax. Net operating losses, of which Prudential Savings Bank has none, can offset no more than 90% of alternative minimum taxable income. Certain payments of alternative minimum tax may be used as credits against regular tax liabilities in future years. Prudential Savings Bank has not been subject to the alternative minimum tax.

Net Operating Loss Carryovers. For net operating losses in tax years beginning before August 6, 1997, Prudential Savings Bank may carry back net operating losses to the three years preceding the loss year and then forward to fifteen years following the loss years. For net operating losses in years beginning after August 5, 1997, net operating losses can be carried back to the two years preceding the loss year and forward to the 20 years following the loss year. At September 30, 2007, Prudential Savings Bank had no net operating loss carry forwards for federal income tax purposes.

Corporate Dividends Received Deduction. Prudential Bancorp may exclude from its income 100% of dividends received from Prudential Savings Bank as a member of the same affiliated group of corporations. The corporate dividends received deduction is 80% in the case of dividends received from corporations which a corporate recipient owns less than 80%, but at least 20% of the distribution corporation. Corporations which own less than 20% of the stock of a corporation distributing a dividend may deduct only 70% of dividends received.

State and Local Taxation

Pennsylvania Taxation. Prudential Bancorp is subject to the Pennsylvania Corporate Net Income Tax, Capital Stock and Franchise Tax. The Corporation Net Income Tax rate for 2006 is 9.99% and is imposed on unconsolidated taxable income for federal purposes with certain adjustments. In general, the Capital Stock and Franchise Tax is a property tax imposed on a corporation's capital stock value at a statutorily defined rate, such value being determined in accordance with a fixed formula based upon average net income and net worth.

Prudential Savings Bank is subject to tax under the Pennsylvania Mutual Thrift Institutions Tax Act, as amended to include thrift institutions having capital stock. Pursuant to the Mutual Thrift Institutions Tax, the tax rate is 11.50%. The Mutual Thrift Institutions Tax exempts Prudential Savings Bank from other taxes imposed by the Commonwealth of Pennsylvania for state income tax purposes and from all local taxation imposed by political subdivisions, except taxes on real estate and real estate transfers. The Mutual Thrift Institutions Tax is a tax upon net earnings, determined in accordance with generally accepted accounting principles with certain adjustments. The Mutual Thrift Institutions Tax, in computing income according to generally accepted accounting principles, allows for the deduction of interest earned on state and federal obligations, while disallowing a percentage of a thrift's interest expense deduction in the proportion of interest income on those securities to the overall interest income of Prudential Savings Bank. Net operating losses, if any, thereafter can be carried forward three years for Mutual Thrift Institutions Tax purposes.

Item 1A. Risk Factors.

In analyzing whether to make or to continue an investment in our securities, investors should consider, among other factors, the following risk factors.

Our Portfolio of Loans With a Higher Risk of Loss Is Increasing

In recent years, we have increased our originations or purchases of construction and land development loans. These loans have a higher risk of default and loss than single-family residential mortgage loans. Construction and land development loans have increased from $24.2 million or 15.9% of our total loan portfolio at September 30, 2003 to $52.4 million or 22.2% of the total loan portfolio at September 30, 2007. At the same time, the percentage of the loan portfolio comprised of single-family residential mortgage loans has decreased. Single-family residential mortgage loans held by Prudential Savings Bank have decreased from 76.0% of our total loan portfolio at September 30, 2003 to 67.9% at September 30, 2007, although the balance of such loans increased. Construction and land development loans generally have a higher risk of loss than single-family residential mortgage loans. The risk of loss on construction and land development loans depends largely upon the accuracy of the initial estimate of the property's value at completion of construction compared to the estimated cost, including interest, of construction and other assumptions. Furthermore, if the estimates of value prove to be inaccurate, we can be confronted with projects, when completed, having values less than the loan amounts. In addition, such loans have significantly higher average loan balances compared to single-family residential mortgage loans. Consequently, an adverse development with respect to one loan or credit relationship could expose us to a significantly greater risk of loss compared to an adverse development with respect to a single-family residential mortgage loan. We may also be required to increase our allowance for loan losses both due to actual losses or the increase in the estimated loss inherent in our portfolio which would reduce our net income. We have also originated or committed to originate substantially larger construction loans in recent periods and our portfolio of such loans is not seasoned.

Our loans are concentrated to borrowers in our market area

At September 30, 2007, the preponderance of our total loans were to individuals and/or secured by properties located in our primary market area of the Philadelphia metropolitan area. We have relatively few loans outside of our market. As a result, we may have a greater risk of loan defaults and losses in the event of an economic downturn in our market area.

Our results of operations are significantly dependent on economic conditions and related uncertainties.

Commercial banking is affected, directly and indirectly, by domestic and international economic and political conditions and by governmental monetary and fiscal policies. Conditions such as inflation, recession, unemployment, volatile interest rates, real estate values, government monetary policy, international conflicts, the actions of terrorists and other factors beyond our control may adversely affect our results of operations. Changes in interest rates, in particular, could adversely affect our net interest income and have a number of other adverse effects on our operations, as discussed in the immediately succeeding risk factor. Adverse economic conditions also could result in an increase in loan delinquencies, foreclosures and nonperforming assets and a decrease in the value of the property or other collateral which secures our loans, all of which could adversely affect our results of operations. We are particularly sensitive to changes in economic conditions and related uncertainties in Eastern Pennsylvania because we derive substantially all of our loans, deposits and other business from this area. Accordingly, we remain subject to the risks associated with prolonged declines in national or local economies.

Changes in interest rates could have a material adverse effect on our operations.

The operations of financial institutions such as ours are dependent to a large extent on net interest income, which is the difference between the interest income earned on interest-earning assets such as loans and investment securities and the interest expense paid on interest-bearing liabilities such as deposits and borrowings. Changes in the general level of interest rates can affect our net interest income by affecting the difference between the weighted average yield earned on our interest-earning assets and the weighted average rate paid on our interest-bearing liabilities, or interest rate spread, and the average life of our interest-earning assets and interest-bearing liabilities. Changes in interest rates also can affect our ability to originate loans; the value of our interest-earning assets and our ability to realize gains from the sale of such assets; our ability to obtain and retain deposits in competition with other available investment alternatives; the ability of our borrowers to repay adjustable or variable rate loans; and the fair value of the derivatives carried on our balance sheet, derivative hedge effectiveness testing and the amount of ineffectiveness recognized in our earnings. Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions and other factors beyond our control. Although we believe that the estimated maturities of our interest-earning assets currently are well balanced in relation to the estimated maturities of our interest-bearing liabilities (which involves various estimates as to how changes in the general level of interest rates will impact these assets and liabilities), there can be no assurance that our profitability would not be adversely affected during any period of changes in interest rates.

We are subject to extensive regulation which could adversely affect our business and operations.

We and our subsidiaries are subject to extensive federal and state governmental supervision and regulation, which are intended primarily for the protection of depositors. In addition, we and our subsidiaries are subject to changes in federal and state laws, as well as changes in regulations, governmental policies and accounting principles. The effects of any such potential changes cannot be predicted but could adversely affect the business and operations of us and our subsidiaries in the future.

We face strong competition which may adversely affect our profitability.

We are subject to vigorous competition in all aspects and areas of our business from banks and other financial institutions, including savings and loan associations, savings banks, finance companies, credit unions and other providers of financial services, such as money market mutual funds, brokerage firms, consumer finance companies and insurance companies. We also compete with non-financial institutions, including retail stores that maintain their own credit programs and governmental agencies that make available low cost or guaranteed loans to certain borrowers. Certain of our competitors are larger financial institutions with substantially greater resources, lending limits, larger branch systems and a wider array of commercial banking services. Competition from both bank and non-bank organizations will continue.

Our ability to successfully compete may be reduced if we are unable to make technological advances.

The banking industry is experiencing rapid changes in technology. In addition to improving customer services, effective use of technology increases efficiency and enables financial institutions to reduce costs. As a result, our future success will depend in part on our ability to address our customers' needs by using technology. We cannot assure you that we will be able to effectively develop new technology-driven products and services or be successful in marketing these products to our customers. Many of our competitors have far greater resources than we have to invest in technology.

We and our banking subsidiary are subject to capital and other requirements which restrict our ability to pay dividends.

Our ability to pay dividends to our shareholders may depend upon the dividends we receive from Prudential Savings Bank. Dividends paid by the Bank are subject to restrictions under Pennsylvania and federal laws and regulations. In addition, Prudential Savings Bank must maintain certain capital levels, which may restrict the ability of the Bank to pay dividends to us and our ability to pay dividends to our shareholders.

Holders of our common stock have no preemptive rights and are subject to potential dilution.

Our articles of incorporation do not provide any shareholder with a preemptive right to subscribe for additional shares of common stock upon any increase thereof. Thus, upon the issuance of any additional shares of common stock or other voting securities of Prudential Bancorp or securities convertible into common stock or other voting securities, shareholders may be unable to maintain their pro rata voting or ownership interest in us.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties

We currently conduct business from our main office and six banking offices. The following table sets forth the net book value of the land, building and leasehold improvements and certain other information with respect to the our offices at September 30, 2007. All the offices are owned by us with the exception of the Old City Branch.

Description/Address	Leased/Owned	Date of Lease Expiration	Net Book Value of Property		Amount of Deposits	
			(In Thousands)			
Main Office 1834 Oregon Avenue Philadelphia, PA 19145-4725	Owned	N/A	$	540	$	188,526
Snyder Branch 2101 South 19th Street Philadelphia, PA 19145-3709	Owned	N/A		6		24,745
Center City Branch 112 South 19th Street Philadelphia, PA 19103-4667	Owned	N/A		18		27,059
Broad Street Branch 1722 South Broad Street Philadelphia, PA 19145-2388	Owned	N/A		239		48,368
Pennsport Branch 238A Moore Street Philadelphia, PA 19148-1925	Owned	N/A		62		37,038
Drexel Hill Branch 601 Morgan Avenue Drexel Hill, PA 19026-3105	Owned	N/A		94		27,809
Old City Branch 28 North 3rd Street Philadelphia, PA 19106-2108	Leased	September 2010		503		493

Item 3. Legal Proceedings

On October 4, 2006, Stilwell Value Partners I, L.P. (“Stilwell”) filed suit in the United States District Court for the Eastern District of Pennsylvania against Prudential Mutual Holding Company (the “MHC”), Prudential Bancorp, Inc. of Pennsylvania (the “Company”) and each of the directors of the MHC and the Company individually seeking equitable relief including (i) enjoining the Company and the directors from allowing the MHC to participate in any shareholder vote to consider the adoption of proposed stock option and stock recognition and retention plans (collectively, the “Stock Plans”) and (ii) enjoining MHC from participating in any shareholder vote to approve the Stock Plans. In the event that the MHC and the Company are not enjoined, Stilwell is seeking damages, the amount to be determined at trial.

Stilwell alleges that the Company’s prospectus used to solicit offers to purchase shares of the Company’s common stock in connection with the mutual holding reorganization of Prudential Savings Bank “promised” that the Stock Plans would be submitted for consideration only by the Company’s public shareholders and not by the MHC which controls a majority of the Company’s issued and outstanding shares of common stock and that Stilwell relied on such promise in determining to invest in the common stock of the Company. Stilwell also alleges the individual directors have

violated their fiduciary duties to Stilwell by delaying the consideration of the Stock Plans until such time that MHC can vote its shares on the Stock Plans assuring their approval by shareholders. The Company believes Stilwell's allegations are without merit and intends to vigorously defend the case. On November 20, 2006, the Company, the MHC and the director defendants filed a motion to dismiss the complaint, asserting, among other things, that the prospectus contained no "promise," implied or otherwise, that the MHC would never vote on the adoption of the Stock Plans and that the breach of fiduciary duty claim, with respect to the timing of any such vote, is legally insufficient. Stilwell filed an opposition brief to the Company's motion on December 20, 2006 and the Company filed its reply brief on January 8, 2007. On July 20, 2007, oral argument was heard on the motion to dismiss. On August 15, 2007, the Court ruled that there was no express promise of the sort that would support a promissory estoppel claim, no "unconscionability" of the sort that would support an unjust enrichment claim, and no "fundamental unfairness" of the sort that would support a claim for "disenfranchisement." The Court also ruled that Stilwell does not have standing to assert claims for breach of fiduciary duty against the directors individually. Accordingly, the Court granted the motion to dismiss all of the claims against the Company and the individual directors and all but one of the claims against the MHC. The only claim remaining is a breach of fiduciary duty asserted against the MHC as majority shareholder. The Court dismissed the claims with prejudice which prevents Stilwell from reasserting such claims in amended form.

The Court has scheduled a pre-trial conference to establish the timing of the remaining discovery and trial. A substantial amount of document discovery has been completed; no other discovery has been taken.

The Company believes Stilwell's remaining allegation is without merit and the remaining defendant, the MHC, intends to vigorously defend the case. However, no prediction can be made as to the outcome of the one remaining claim.

Other than the above referenced litigation, 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 or operations of the Company. 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 4. Submission of Matters to a Vote of Security Holders

Not applicable.

PART II

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

(a) Our common stock is traded on the NASDAQ Global Market (NASDAQ) under the symbol “PBIP”. At December 11, 2007, there were approximately 303 registered shareholders of record, not including the number of persons or entities whose stock is held in nominee or "street" name through various brokerage firms and banks.

The following graph demonstrates comparison of the cumulative total returns for the common stock of Prudential Bancorp, the NASDAQ Composite Index, the SNL Securities MHC Thrift Index and the SNL Securities Thrift Index for the periods indicated. The graph below represents $100 invested in our common stock at its closing price on March 30, 2005, the date the common stock commenced trading on the Nasdaq National Market. The cumulative total returns include the payment of dividends by Prudential Bancorp.

	Period Ending					
Index	03/30/05	09/30/05	03/31/06	09/30/06	03/31/07	09/30/07
Prudential Bancorp, Inc. of PA	$ 100.00	$ 121.75	$ 138.51	$ 135.95	$ 142.06	$ 129.51
NASDAQ Composite	100.00	152.46	161.84	183.58	192.69	230.49
SNL MHC Thrift Index	100.00	104.06	116.09	132.18	143.07	137.88
SNL Thrift Index	100.00	102.32	112.93	119.11	119.41	108.70

* Source: SNL Financial LC

The following table shows the quarterly high and low trading prices of our stock and the amount of cash dividends declared per share for fiscal 2007 and 2006.

Quarter ended:	Stock Price High	Stock Price Low	Cash dividends per share
September 30, 2007	$ 13.75	$ 12.38	$ 0.05
June 30, 2007	13.85	13.36	0.05
March 31, 2007	13.89	13.38	0.05
December 31, 2006	13.88	13.15	0.04

Quarter ended:	Stock Price High	Stock Price Low	Cash dividends per share
September 30, 2006	$ 13.45	$ 13.10	$ 0.04
June 30, 2006	14.02	12.82	0.04
March 31, 2006	13.96	11.70	0.04
December 31, 2005	11.98	10.70	0.04

(b) Not applicable

(c) The following table presents the repurchasing activity of the stock repurchase program during the fourth quarter of fiscal 2007:

Period	Total Number of shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
Month #1 July 1, 2007 – July 31, 2007	42,300	$ 13.50	42,300	282,000
Month #2 August 1, 2007 – August 31, 2007	93,500	13.16	93,500	188,500
Month #3 September 1, 2007 – September 30, 2007	-	-	-	188,500
Total	135,800	$ 13.27	135,800	188,500

Notes to the table.

(1) On August 15, 2007, the Company announced its fifth stock repurchase program to repurchase 230,500 shares or approximately 5% of the Company's outstanding common stock held by shareholders other than Prudential Mutual Holding Company, such program commenced upon completion of the fourth program (which was completed in August 2007).

Item 6. Selected Financial Data

Set forth below is selected financial and other data of Prudential Bancorp. Prior to March 29, 2005, the date we completed the reorganization, such data only reflects information with respect to Prudential Savings Bank.

	At September 30,				
	2007	2006	2005	2004	2003
	(Dollars in Thousands)				
Selected Financial and Other Data:					
Total assets	$ 474,192	$ 472,381	$ 446,592	$ 406,638	$ 395,825
Cash and cash equivalents	12,269	13,428	26,815	10,061	24,108
Investment securities:					
Held-to-maturity	134,782	132,084	129,840	114,806	98,991
Available-for-sale	38,343	38,747	38,584	40,287	43,175
Mortgage-backed securities:					
Held-to-maturity	45,534	50,360	66,828	80,932	82,556
Available-for-sale	8,549	4,615	--	--	--
Loans receivable, net	219,149	219,418	175,091	151,565	137,926
Deposits	354,038	347,292	336,468	349,159	340,777
FHLB advances	33,743	31,784	13,823	13,862	13,900
Total equity, substantially restricted	80,961	87,448	90,825	39,099	36,548
Banking offices	7	6	6	6	6

	Year Ended September 30,				
	2007	2006	2005	2004	2003
	(Dollars in Thousands)				
Selected Operating Data:					
Total interest income	$ 26,907	$ 24,542	$ 21,077	$ 19,513	$ 18,813
Total interest expense	14,784	11,935	9,297	9,002	9,707
Net interest income	12,123	12,607	11,780	10,511	9,106
Provision for loan losses	395	60	--	50	180
Net interest income after provision for loan losses	11,728	12,547	11,780	10,461	8,926
Total non-interest income	1,046	938	567	581	742
Total non-interest expense	7,990	7,875	7,069	7,323	6,047
Income before income taxes	4,784	5,610	5,278	3,719	3,621
Income taxes	1,387	1,773	1,886	1,246	1,253
Net income	$ 3,397	$ 3,837	$ 3,392	$ 2,473	$ 2,368
Basic earnings per share (1)	0.30	0.32	0.15	--	--
Diluted earnings per share (1)	0.30	0.32	0.15	--	--
Selected Operating Ratios(2):					
Average yield on interest-earning assets	5.92%	5.58%	5.03%	4.97%	5.18%
Average rate on interest-bearing liabilities	3.93	3.34	2.64	2.48	2.91
Average interest rate spread(3)	1.99	2.24	2.39	2.49	2.27
Net interest margin(3)	2.67	2.87	2.81	2.68	2.51
Average interest-earning assets to average interest-bearing liabilities	120.64	122.94	118.81	108.13	108.67
Net interest income after provision	146.78	159.33	166.64	142.85	147.61

for loan losses to non-interest expense					
Total non-interest expense to average assets	1.70	1.73	1.64	1.80	1.61
Efficiency ratio(4)	60.67	58.14	57.25	66.02	61.40
Return on average assets	0.72	0.84	0.79	0.61	0.63
Return on average equity	3.98	4.26	5.14	6.50	6.64
Average equity to average assets	18.15	19.82	15.30	9.36	9.52

(Footnotes on next page)

	At or For the Year Ended September 30,				
	2007	2006	2005	2004	2003
Asset Quality Ratios(5):					
Non-performing loans as a percent of total loans receivable(6)	1.18%	0.07%	0.14%	0.32%	0.65%
Non-performing assets as a percent of total assets(6)	0.55	0.03	0.13	0.25	0.38
Allowance for loan losses as a percent of non-performing loans	38.97	409.66	233.47	116.49	62.13
Net charge-offs to average loans receivable	--	--	--	0.03	0.16
Capital Ratios(5):					
Tier 1 leverage ratio					
Company	17.08%	18.64%	20.98%	N/A	N/A
Bank	15.52	14.74	14.55	9.39%	9.03%
Tier 1 risk-based capital ratio					
Company	37.88%	39.23%	48.54%	N/A	N/A
Bank	34.22	31.12	34.71	24.50	21.95
Total risk-based capital ratio					
Company	38.43%	39.68%	48.98%	N/A	N/A
Bank	34.77	31.56	35.16	25.22	22.29

(1) Due to the timing of the Bank's reorganization into the mutual holding company form and the completion of the Company's initial public offering on March 29, 2005, earnings per share for the year ended September 30, 2005 is for the six month period ended September 30, 2005. There were no shares of common stock of the Company outstanding prior to the reorganization on March 29, 2005.

(2) With the exception of end of period ratios, all ratios are based on average monthly balances during the indicated periods.

(3) Average interest rate spread represents the difference between the average yield on interest-earning assets and the average rate paid on interest-bearing liabilities, and net interest margin represents net interest income as a percentage of average interest-earning assets.

(4) The efficiency ratio represents the ratio of non-interest expense divided by the sum of net interest income and non-interest income.

(5) Asset quality ratios and capital ratios are end of period ratios, except for net charge-offs to average loans receivable. The Bank converted to a Pennsylvania-chartered savings bank in August 2004 and thus became subject to the Federal Deposit Insurance Corporation regulatory capital regulations. Prior thereto, the Bank was a Pennsylvania-chartered savings association subject to regulations by the Office of Thrift Supervision. Under Federal Deposit Insurance Corporation regulations, capital ratios for the Bank are based on average assets rather than assets, as adjusted, at the relevant date as required by the regulations of the Office of Thrift Supervision. Since the Company did not have any capital stock outstanding prior to March 29, 2005, no capital ratios are presented for the pre-2005 periods.

(6) Non-performing assets consist of non-performing loans and real estate owned. Non-performing loans consist of all loans 90 days or more past due and loans in excess of 90 days delinquent and still accruing interest. It is our policy to cease accruing interest on all loans, other than single-family residential mortgage loans, 90 days or

more past due. Real estate owned consists of real estate acquired through foreclosure and real estate acquired by acceptance of a deed-in-lieu of foreclosure.

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

Overview

We are a community oriented savings bank headquartered in Philadelphia, Pennsylvania. We operate seven banking offices in Philadelphia and Delaware Counties. Our primary business consists of attracting deposits from the general public and using those funds together with funds we borrow to originate loans to our customers and invest primarily in U.S. Government and agency securities and mortgage-backed securities. At September 30, 2007, we had total assets of $474.2 million, including $219.5 million in net loans and $227.2 million of investment and mortgage-backed securities, total deposits of $354.0 million and total stockholders' equity of $81.0 million.

This Management's Discussion and Analysis section is intended to assist in understanding the financial condition and results of operations of Prudential Bancorp. The results of operations of Prudential Bancorp are primarily dependent on the results of the Bank. The information contained in this section should be read in conjunction with our consolidated financial statements and the accompanying notes to the consolidated financial statements contained in Item 8 of this Annual Report on Form 10-K.

Forward-looking Statements.

In addition to historical information, this Annual Report on Form 10-K includes certain "forward-looking statements" based on management's current expectations. The Company's actual results could differ materially, as such term is defined in the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, from management's expectations. Such forward-looking statements include statements regarding management's current intentions, beliefs or expectations as well as the assumptions on which such statements are based. These forward-looking statements are subject to significant business, economic and competitive uncertainties and contingencies, many of which are not subject to Prudential Bancorp's control. You are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those contemplated by such forward-looking statements. Factors that could cause future results to vary from current management expectations include, but are not limited to, general economic conditions, legislative and regulatory changes, monetary and fiscal policies of the federal government, changes in tax policies, rates and regulations of federal, state and local tax authorities, 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, 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.

The Company undertakes no obligation to update or revise any forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results that occur subsequent to the date such forward-looking statements are made.

Critical Accounting Policies

In reviewing and understanding financial information for Prudential Bancorp, you are encouraged to read and understand the significant accounting policies used in preparing our financial statements. These policies are described in Note 2 of the notes to our consolidated financial statements included in Item 8 hereof. The accounting and financial reporting policies of Prudential Bancorp conform to accounting principles generally accepted in the United States of America 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 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. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. Subsequent recoveries are added to the allowance. The allowance is an amount that management believes will cover known and inherent losses in the loan portfolio, based on evaluations of the collectibility of loans. The evaluations take into consideration such factors as changes in the types and amount of loans in the loan portfolio, historical loss experience, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral, estimated losses relating to specifically identified loans, and current economic conditions. 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 impacted loans, value of collateral, estimated losses on our commercial, construction and residential loan portfolios and general amounts for 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. Historically, our estimates of the allowance for loan loss have not required significant adjustments from management’s initial estimates. In addition, the Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation, as an integral part of their examination processes, periodically review our allowance for loan losses. The Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation 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 examinations. 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 impact earnings in future periods.

Income Taxes. We make estimates and judgments to calculate some of our tax liabilities and determine the recoverability of some of our deferred tax assets, which arise from temporary differences between the tax and financial statement recognition of revenues and expenses. We also estimate a reserve for deferred tax assets if, based on the available evidence, it is more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods. These estimates and judgments are inherently subjective. In the past, our estimates and judgments to calculate our deferred tax accounts have not required significant revision to our initial estimates.

In evaluating our ability to recover deferred tax assets, we consider all available positive and negative evidence, including our past operating results, recent cumulative losses 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.

Recent Accounting Pronouncements

On July 13, 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), which is effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." This Interpretation prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. The Company adopted FIN 48 on October 1, 2007, and the adoption did not have a significant impact of on the Company's financial statements.

In September 2006, the Emerging Issues Task Force (EITF) of FASB issued EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements" (EITF 06-04). EITF 06-4 requires the recognition of a liability related to the postretirement benefits covered by an endorsement split-dollar life insurance arrangement. EITF 06-4 is effective for fiscal years beginning after December 15, 2007, with earlier application permitted. The Company is currently assessing the impact of the adoption of EITF 06-04 on its financial statements.

On September 2006, the Task Force reached a conclusion on EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance-Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance" ("EITF 06-5"). The EITF clarifies certain factors that should be considered in the determination of the realizable asset to be reported in the statement of financial condition. EITF 06-5 is effective for fiscal years beginning after December 15, 2006. The guidance did not have a material impact on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurement." Statement of Financial Accounting Standards ("SFAS") No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently assessing the impact of SFAS No. 157 on its financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued SAB No. 108 expressing the SEC staff's views regarding the process of quantifying financial statement misstatements and the build up of improper amounts on the balance sheet. SAB No. 108 requires that registrants quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in a misstated amount that, when all relevant quantitative and qualitative factors are considered, is material. The built up misstatements, while not considered material in the individual years in which the misstatements were built up, may be considered material in a subsequent year if a company were to correct those misstatements through current period earnings. Initial application of SAB No. 108 allows registrants to elect not to restate prior periods but to reflect the initial application in their annual financial statements covering the first fiscal year ending after November 15, 2006. The cumulative effect of the initial application should be reported in the carrying amounts of assets and liabilities as of the beginning of that fiscal year and the offsetting adjustment, net of tax, should be made to the opening balance of retained earnings for that year.

The Company implemented SAB No. 108 on October 1, 2006 which resulted in an increase in mortgage-backed securities held to maturity of approximately $321,000, an increase in income tax liabilities of approximately $149,000 and a cumulative adjustment to increase retained earnings as of that date by approximately $172,000. The adjustment relates to two separate accounting entries. The first entry pertains to the method of accounting that was utilized in past years for the recognition of interest income on mortgage-backed securities. Prior to fiscal 2006, the Company used the straight line method over the contractual life of the securities rather than using the effective yield method prescribed by SFAS No. 91, "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring

Loans and Initial Direct Costs of Leases". The impact of this entry was the correction of an understatement of mortgage-backed securities by approximately $321,000 and a corresponding understatement of income tax payable of $109,000. The second entry relates to a write off of a deferred tax asset of approximately $40,000 that was incorrectly accounted for in prior periods.

In prior periods, management performed a quantitative and qualitative analysis of the differences between these two methods of accounting and concluded that there was not a material impact on any past individual quarter or annual reporting periods.

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities”. The Statement provides companies with an option to report selected financial assets and liabilities at fair value. This Statement is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2007. Early adoption is permitted under certain circumstances. The Company is currently assessing the impact of SFAS No. 159 on its financial statements.

In March 2007, the FASB ratified Emerging Issues Task Force Issue No. 06-10 “Accounting for Collateral Assignment Split-Dollar Life Insurance Agreements: (EITF 06-10). EITF 06-10 provides guidance for determining a liability for the postretirement benefit obligation as well as recognition and measurement of the associated asset on the basis of the terms of the collateral assignment agreement. EITF 06-10 is effective for fiscal years beginning after December 15, 2007. The Company is currently assessing the impact of the adoption of EITF 06-10 on its financial statements.

Derivative Financial Instruments, Contractual Obligations and Other Commitments. Derivative financial instruments includes futures, forwards, interest rate swaps, option contracts, and other financial instruments with similar characteristics. We have not used derivative financial instruments in the past and do not currently have any intent to do so in the future.

While we have not used derivative financial instruments, we are a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and the unused portions of lines of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition. Commitments to extend credit generally have fixed expiration dates and may require additional collateral from the borrower if deemed necessary. Commitments to extend credit are not recorded as an asset or liability by us until the instrument is exercised.

The following tables summarize our outstanding commitments to originate loans and to advance additional amounts pursuant to outstanding letters of credit, lines of credit and under our construction loans at the dates indicated.

Commitments

The following tables summarize our outstanding commitments to originate loans and to advance additional amounts pursuant to outstanding letters of credit, lines of credit and undisbursed construction loans at September 30, 2007.

	Total Amounts Committed	Amount of Commitment Expiration - Per Period			
		To 1 Year	1-3 Years	4-5 Years	After 5 Years
	(In Thousands)				
Letters of credit	$ 95	$ -	$ 95	$ -	$ -
Lines of credit (2)	7,194	-	-	-	7,194
Undisbursed portions of loans in process (1)	15,897	12,214	3,683	-	-
Commitments to originate loans	10,361	10,361	-	-	-
Total commitments	$ 33,547	$ 22,575	$ 3,778	$ -	$ 7,194

(1) Includes participation interests sold to other financial institutions totaling $2.1 million; Prudential Savings