

ESSA Bancorp, Inc.
Form 10-K
December 14, 2012
Table of Contents

SECURITIES AND EXCHANGE COMMISSION

100 F Street NE

Washington, D.C. 20549

FORM 10-K

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Fiscal Year Ended September 30, 2012**

or

.. **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to**

Commission File No. 001-33384

ESSA Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction of

incorporation or organization)

20-8023072
(I.R.S. Employer

Identification Number)

Edgar Filing: ESSA Bancorp, Inc. - Form 10-K

200 Palmer Street, Stroudsburg, Pennsylvania
(Address of Principal Executive Offices)

(570) 421-0531

18360
Zip Code

(Registrant's telephone number)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$0.01 par value	The NASDAQ Stock Market, LLC

Securities Registered Pursuant to Section 12(g) of the Act: None

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

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

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 twelve months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

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

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

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

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

As of December 12, 2012, there were 18,133,095 shares issued and 13,229,908 shares outstanding of the Registrant's Common Stock.

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, computed by reference to the last sale price on March 31, 2012, was \$99,644,322.

DOCUMENTS INCORPORATED BY REFERENCE

Proxy Statement for the 2012 Annual Meeting of Stockholders of the Registrant (Part III).

Table of Contents

TABLE OF CONTENTS

<u>PART I</u>		
Item 1.	<u>Business</u>	1
Item 1A.	<u>Risk Factors</u>	30
Item 1B.	<u>Unresolved Staff Comments</u>	35
Item 2.	<u>Properties</u>	36
Item 3.	<u>Legal Proceedings</u>	38
Item 4.	<u>Mine Safety Disclosures</u>	38
<u>PART II</u>		
Item 5.	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	39
Item 6.	<u>Selected Financial Data</u>	41
Item 7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	42
Item 7A.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	54
Item 8.	<u>Financial Statements and Supplementary Data</u>	54
Item 9.	<u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	54
Item 9A.	<u>Controls and Procedures</u>	54
Item 9B.	<u>Other Information</u>	55
<u>PART III</u>		
Item 10.	<u>Directors, Executive Officers and Corporate Governance</u>	56
Item 11.	<u>Executive Compensation</u>	56
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	56
Item 13.	<u>Certain Relationships and Related Transactions, and Director Independence</u>	56
Item 14.	<u>Principal Accounting Fees and Services</u>	56
<u>PART IV</u>		
Item 15.	<u>Exhibits, Financial Statement Schedules</u>	57

Table of Contents

Forward Looking Statements

This Annual Report contains certain forward-looking statements which may be identified by the use of words such as believe, expect, anticipate, should, planned, estimated and potential. Examples of forward-looking statements include, but are not limited to, estimates with respect to our financial condition, results of operations and business that are subject to various factors which could cause actual results to differ materially from these estimates and most other statements that are not historical in nature. These factors include, but are not limited to, general and local economic conditions, changes in interest rates, deposit flows, demand for mortgage, and other loans, real estate values, competition, changes in accounting principles, policies, or guidelines, changes in legislation or regulation, and other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services and the ability to successfully integrate acquired entities. Because of these and a wide variety of other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. Please also see Item 1A. Risk Factors.

PART I

Item 1. Business
ESSA Bancorp, Inc.

ESSA Bancorp, Inc. is the Pennsylvania-chartered stock holding company of ESSA Bank & Trust. ESSA Bancorp, Inc. owns 100% of the outstanding shares of common stock of ESSA Bank & Trust. Since being formed in 2006, ESSA Bancorp, Inc. has engaged primarily in the business of holding the common stock of ESSA Bank & Trust. Our executive offices are located at 200 Palmer Street, Stroudsburg, Pennsylvania 18360. Our telephone number at this address is (570) 421-0531. ESSA Bancorp, Inc. is subject to comprehensive regulation and examination by the Federal Reserve Board of Governors. On July 31, 2012, ESSA Bancorp, Inc. completed its acquisition of First Star Bancorp, Inc. and its wholly-owned subsidiary, First Star Bank. The total value of the consideration for the acquisition was \$24.6 million, 50% of which was paid in cash and the remainder paid in the form of ESSA Bancorp, Inc. common stock. The information presented herein includes the combined operations of both companies as of July 31, 2012. At September 30, 2012, ESSA Bancorp, Inc. had consolidated assets of \$1.4 billion, consolidated deposits of \$995.6 million and consolidated stockholders' equity of \$175.4 million. Its consolidated net income for the fiscal year ended September 30, 2012 was \$215,000.

ESSA Bank & Trust

General

ESSA Bank & Trust was organized in 1916. ESSA Bank & Trust is a Pennsylvania chartered full-service, community-oriented savings association. We provide financial services to individuals, families and businesses through our 26 full-service banking offices, located in Monroe, Northampton and Lehigh Counties, Pennsylvania. ESSA Bank & Trust is subject to comprehensive regulation and examination by the Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation.

ESSA Bank & Trust's business consists primarily of accepting deposits from the general public and investing those deposits, together with funds generated from operations and borrowings, in residential first mortgage loans (including construction mortgage loans), commercial real estate loans, home equity loans and lines of credit, commercial and consumer loans. We offer a variety of deposit accounts, including checking, savings and certificates of deposits. We also offer asset management and trust services. We offer investment services through our relationship with PRIMEVEST Financial Services, Inc., a third party broker/dealer and investment advisor. We offer insurance benefit consulting services through our wholly owned subsidiary, ESSA Advisory Services, LLC.

ESSA Bank & Trust's executive offices are located at 200 Palmer Street, Stroudsburg, Pennsylvania 18360. Our telephone number at this address is (570) 421-0531. Our website address is www.essabank.com.

Table of Contents

The Company is a public company, and files interim, quarterly and annual reports with the Securities and Exchange Commission (SEC). All filed SEC reports and interim filings can be obtained from the Bank s website, on the Investor Relations page, without charge from the Company.

Market Area

At September 30, 2012, our 26 full-service banking offices consisted of 13 offices in Monroe County, six offices in Lehigh County, and seven offices in Northampton County, Pennsylvania. Our primary market for deposits is currently concentrated around the areas where our full-service banking offices are located. Our primary lending area consists of the counties where our branch offices are located, and to a lesser extent, the contiguous counties in the Commonwealth of Pennsylvania.

Monroe County is located in eastern Pennsylvania, situated 90 miles north of Philadelphia, 75 miles west of New York and 116 miles northeast of Harrisburg. Monroe County is comprised of 611 square miles of mostly rural terrain. Major industries include tourism, construction and educational facilities. Northampton County is located south of Monroe County and directly borders New Jersey. Lehigh County is located southwest of Monroe County. As of September 30, 2012, we had a deposit market share of approximately 29.1% in Monroe County, which represented the largest deposit market share in Monroe County, 3.69% in Northampton County and 2.43% in Lehigh County.

Lending Activities

Historically, our principal lending activity has been the origination of first mortgage loans for the purchase, construction or refinancing of one-to four-family residential real property. In recent years, we have increased our originations of commercial loans and commercial real estate loans in an effort to increase interest income, diversify our loan portfolio, and better serve the community. Commercial real estate loans have increased from 9.7% of our total loan portfolio at September 30, 2008 to \$160.2 million, or 16.7% of our total loan portfolio at September 30, 2012. One-to four-family residential real estate mortgage loans represented \$696.7 million, or 72.8%, of our loan portfolio at September 30, 2012. Home equity loans and lines of credit totaled \$47.9 million, or 5.0% of our loan portfolio at September 30, 2012. Commercial loans totaled \$12.8 million, or 1.3% of our loan portfolio at September 30, 2012 and construction first mortgage loans totaled \$3.8 million or 0.4% of the total loan portfolio at September 30, 2012. Obligations of states and political subdivisions totaled \$33.7 million or 3.5% of our loan portfolio at September 30, 2012. We originate other consumer loans on a limited basis.

Table of Contents

Loan Portfolio Composition. The following table sets forth the composition of our loan portfolio, by type of loan at the dates indicated, excluding loans held for sale.

	2012		2011		At September 30, 2010		2009		2008	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
(Dollars in thousands)										
Residential first mortgage loans:										
One- to four-family	\$ 696,696	72.8%	\$ 583,599	78.1%	\$ 596,455	80.8%	\$ 604,010	81.7%	\$ 571,609	80.3%
Construction	3,805	0.4	691	0.1	1,302	0.2	1,707	0.2	8,254	1.2
Commercial	12,818	1.3	14,766	2.0	16,545	2.2	16,452	2.2	11,987	1.7
Commercial real estate	160,192	16.7	79,362	10.6	77,943	10.6	67,888	9.2	69,368	9.7
Obligations of states and political subdivisions	33,736	3.5	25,869	3.5						
Home equity loans and lines of credit	47,925	5.0	40,484	5.4	43,559	5.9	46,812	6.3	47,528	6.7
Other	2,485	0.3	2,018	0.3	2,486	0.3	2,526	0.4	3,059	0.4
Total loans receivable	\$ 957,657	100.0%	\$ 746,789	100.0%	\$ 738,290	100.0%	\$ 739,395	100.0%	\$ 711,805	100.0%
Allowance for loan losses	(7,302)		(8,170)		(7,448)		(5,815)		(4,915)	
Total loans receivable, net	\$ 950,355		\$ 738,619		\$ 730,842		\$ 733,580		\$ 706,890	

Table of Contents

Loan Portfolio Maturities and Yields. The following table summarizes the scheduled repayments of our loan portfolio at September 30, 2012. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in one year or less.

	One- to Four-Family		Construction		Commercial		Commercial Real Estate	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
(Dollars in thousands)								
Due During the Years Ending September 30,								
2013	\$ 1,475	5.91%	\$	\$	\$ 1,541	5.80%	\$ 23,716	5.07%
2014	1,686	5.29%			624	6.02%	12,636	5.45%
2015	1,198	5.21%			433	6.07%	18,632	5.40%
2016 to 2017	8,872	5.49%			3,803	5.16%	28,291	6.36%
2018 to 2022	111,394	4.16%			4,049	5.79%	33,046	5.60%
2023 to 2027	241,657	3.93%			708	5.40%	17,099	5.47%
2027 and beyond	330,414	5.21%	3,805	3.76%	1,660	3.94%	26,772	5.23%
Total	\$ 696,696	4.60%	\$ 3,805	3.76%	\$ 12,818	5.36%	\$ 160,192	5.54%

	Obligations of States and Political Subdivisions		Home Equity Loans and Lines of Credit		Other		Total	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
(Dollars in thousands)								
Due During the Years Ending September 30,								
2013	\$ 2,993	2.11%	\$ 540	5.54%	\$ 881	5.48%	\$ 31,146	4.79%
2014		0.00%	624	5.28%	235	7.57%	15,805	5.48%
2015	3,040	3.85%	864	5.21%	411	6.55%	24,578	5.23%
2016 to 2017		0.00%	4,622	4.91%	729	6.38%	46,317	6.02%
2018 to 2022	1,490	4.58%	12,200	5.73%	163	8.38%	162,342	4.59%
2023 to 2027	1,990	2.52%	15,166	4.03%	66	5.95%	276,686	4.02%
2027 and beyond	24,223	3.97%	13,909	3.56%		0.00%	400,783	5.06%
Total	\$ 33,736	3.74%	\$ 47,925	4.47%	\$ 2,485	6.32%	\$ 957,657	4.73%

The following table sets forth the scheduled repayments of fixed- and adjustable-rate loans at September 30, 2012 that are contractually due after September 30, 2013.

	Due After September 30, 2013		
	Fixed	Adjustable	Total
(In thousands)			
Residential first mortgage loans:			
One- to four-family	\$ 646,805	\$ 48,416	\$ 695,221
Construction	3,805		3,805
Commercial	4,485	6,792	11,277
Commercial real estate	28,201	108,275	136,476

Edgar Filing: ESSA Bancorp, Inc. - Form 10-K

Obligations of states and political subdivisions	12,754	17,989	30,743
Home equity loans and lines of credit	18,561	28,824	47,385
Other	1,604		1,604
Total	\$ 716,215	\$ 210,296	\$ 926,511

Loan Originations and Repayments. Historically, we have originated residential mortgage loans pursuant to underwriting standards that generally conform to Fannie Mae and Freddie Mac guidelines. Loan origination activities are primarily concentrated in Monroe, Northampton and Lehigh Counties, Pennsylvania and secondarily from other Pennsylvania counties contiguous to Monroe County. New loans are generated primarily from the efforts of employees and advertising, a network of select mortgage brokers, other parties with whom we do business, customer referrals, and from walk-in customers. Loan applications are centrally underwritten and processed at our corporate center.

Table of Contents

One- to Four-Family Residential Loans. Historically, our principal lending activity has consisted of the origination of one- to four-family residential mortgage loans secured primarily by properties located in Monroe and Northampton Counties, Pennsylvania. At September 30, 2012, approximately \$696.7 million, or 72.8% of our loan portfolio, consisted of one- to four-family residential loans. Our origination of one- to four-family loans increased in fiscal year 2012 compared to fiscal years 2011 and 2010. Originations in fiscal year 2012 were positively influenced by a significant amount of refinancing activity due to record low mortgage rates. Generally, one- to four-family residential mortgage loans are originated in amounts up to 80% of the lesser of the appraised value or purchase price of the property, although loans may be made with higher loan-to-value ratios if private mortgage insurance is specified to compensate for the risk. Fixed-rate loans are originated for terms of 10, 15, 20 and 30 years. At September 30, 2012, our largest loan secured by one- to four-family real estate had a principal balance of approximately \$719,000 and was secured by a single family house. This loan was performing in accordance with its repayment terms.

We also offer adjustable-rate mortgage loans which have initial fixed terms of one, three, five or seven-years before converting to an annual adjustment schedule based on changes in a designated United States Treasury index. We originated \$1.3 million of adjustable rate one- to four-family residential loans during the year ended September 30, 2012 and \$831,000 during the year ended September 30, 2011. Our adjustable rate mortgage loans provide for maximum rate adjustments of 200 basis points per adjustment, with a lifetime maximum adjustment of 500 basis points. Our adjustable rate mortgage loans amortize over terms of up to 30 years.

Adjustable rate mortgage loans decrease the risk associated with changes in market interest rates by periodically repricing, but involve other risks. As interest rates increase, the principal and interest payments on the loan increase, thus increasing the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Adjustment of the contractual interest rate is limited by the periodic and lifetime interest rate adjustments specified by our loan documents; and therefore, is potentially limited in effectiveness during periods of rapidly rising interest rates. At September 30, 2012, \$48.4 million, or 6.96%, of our one- to four-family residential loans had adjustable rates of interest.

All one- to four-family residential mortgage loans that we originate include due-on-sale clauses, which give us the right to declare a loan immediately due and payable in the event that, among other things, the borrower sells or otherwise conveys title to the real property subject to the mortgage and the loan is not repaid.

Regulations limit the amount that a savings association may lend relative to the value of the real estate securing the loan, as determined by an appraisal of the property at the time the loan is originated. For all purchase money loans, we utilize outside independent appraisers approved by the Board of Directors. All purchase money borrowers are required to obtain title insurance. Certain modest refinance requests may utilize an automated valuation model with an exterior inspection report and title search. We also require fire and casualty insurance and, where circumstances warrant, flood insurance.

Home Equity Loans and Lines of Credit. Home equity loans and lines of credit are generated almost exclusively by our branch staff. Eligible properties include primary and vacation homes in northeastern Pennsylvania, with the majority of loans being originated in Monroe County. As of September 30, 2012, home equity loans and lines totaled about \$47.9 million, or 5.0% of our loan portfolio.

The maximum combined loan-to-value originated is currently 70-80%, depending on the collateral and the holder of the first mortgage. There is a modest portion of the portfolio originated in years past that contains original combined loan-to-values of up to 90%. Our home equity lines of credit typically feature a 10 year draw period with interest-only payments permitted, followed by another 10 years of fully amortizing payments with no further ability to draw funds. Similar combined loan-to-value characteristics and standards exist for the lines as are outlined above for the loans.

Loan underwriting standards limit the maximum size of a junior lien loan to between \$100,000 and \$200,000, depending on the loan type and collateral. All loans exceeding 70-75% of value require an appraisal by

Table of Contents

bank-approved, licensed appraisers. Loans with lesser loan-to-value ratios may have utilized either automated valuation models or county tax assessments. Title/lien searches are secured on all home equity loans and lines greater than \$25,000.

Commercial Real Estate Loans. At September 30, 2012, \$160.2 million, or 16.7% of our total loan portfolio consisted of commercial real estate loans. Commercial real estate loans are secured by office buildings, mixed-use properties and other commercial properties. We generally originate adjustable rate commercial real estate loans with an initial term of five years and a repricing option, and a maximum term of up to 25 years. The maximum loan-to-value ratio for most commercial real estate loans is 75% to 80% and 85% for select loans with faster amortizations. At September 30, 2012, we had 803 commercial real estate loans with an outstanding balance of \$160.2 million. At September 30, 2012, our largest commercial real estate loan balance was \$5.7 million, which was performing in accordance with its terms. At September 30, 2012, fifty-nine of our loans secured by commercial real estate totaling \$10.9 million were not performing in accordance with their terms and were on nonaccrual status.

We consider a number of factors in originating commercial real estate loans. We evaluate the qualifications and financial condition of the borrower, including credit history, profitability and expertise, as well as the value and condition of the mortgaged property securing the loan. When evaluating the qualifications of the borrower, we consider the financial resources of the borrower, the borrower's experience in owning or managing similar property and the borrower's payment history with us and other financial institutions. In evaluating the property securing the loan, the factors we consider include the net operating income of the mortgaged property before debt service and depreciation, the ratio of the loan amount to the appraised value of the mortgaged property and the debt service coverage ratio (the ratio of net operating income to debt service) to ensure that it is at least 120% of the monthly debt service. All commercial real estate loans in excess of \$250,000 are appraised by outside independent appraisers approved by the Board of Directors. Personal guarantees are obtained from commercial real estate borrowers although we may occasionally waive this requirement given very strong loan to value and debt service coverage ratios. All purchase money and most asset refinance borrowers are required to obtain title insurance. We also require fire and casualty insurance and, where circumstances warrant, flood insurance.

Loans secured by commercial real estate generally are considered to present greater risk than one- to four-family residential loans. Commercial real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general. Accordingly, the nature of these loans makes them more difficult for management to monitor and evaluate.

First Mortgage Construction Loans. At September 30, 2012, \$3.8 million, or 0.4%, of our total loan portfolio consisted of first mortgage construction loans. Most of our first mortgage construction loans are for the construction of residential properties. We currently offer fixed and adjustable-rate residential first mortgage construction loans. First mortgage construction loans are generally structured for permanent mortgage financing once the construction is completed. At September 30, 2012, our largest first mortgage construction loan balance was \$500,000. The loan was performing in accordance with its terms. First mortgage construction loans will generally be made in amounts of up to 80% of the appraised value of the completed property, or the actual cost of the improvements. First mortgage construction loans require only the payment of interest during the construction period. Once converted to permanent financing, they generally repay over a thirty-year period. Funds are disbursed based on our inspections in accordance with a schedule reflecting the completion of portions of the project.

First mortgage construction loans generally involve a greater degree of credit risk than other one- to four-family residential mortgage loans. The risk of loss on a construction loan depends, in part, upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost of construction and the successful completion of construction within budget.

For all such loans, we utilize outside independent appraisers approved by the Board of Directors. All borrowers are required to obtain title insurance. We also require fire and casualty insurance and, where circumstances warrant, flood insurance on properties.

Table of Contents

Other Loans. We offer a variety of loans that are either unsecured or secured by property other than real estate. These loans include loans secured by deposits, personal loans and automobile loans. At September 30, 2012, these other loans totaled \$2.5 million, or 0.3% of the total loan portfolio.

Loan Approval Procedures and Authority. The loan approval process is intended to assess the borrower's ability to repay the loan, the viability of the loan, and the adequacy of the value of the property that will secure the loan. To assess the borrower's ability to repay, we review each borrower's employment and credit history and information on the historical and projected income and expenses of mortgagors. For all loans the Board has granted lending authority to prescribed loan committees. Larger and more complex loan requests require the involvement of senior management or the Board.

Non-Performing Loans and Problem Assets

After a real estate secured loan becomes 15 days late, we deliver a computer generated late charge notice to the borrower and will attempt to contact the borrower by telephone. When a loan becomes 30 days delinquent, we send a delinquency letter to the borrower. We attempt to make satisfactory arrangements to bring the account current, including interviewing the borrower, until the loan is brought current or a determination is made to recommend foreclosure, deed-in-lieu of foreclosure or other appropriate action. After 60 days, if no satisfactory arrangements have been made, we will commence foreclosure proceedings.

Mortgage loans are reviewed on a regular basis and such loans are placed on non-accrual status when they become more than 90 days delinquent. When loans are placed on non-accrual status, unpaid accrued interest is fully reserved. Further income is recognized only if and when the loan is performing and demonstrates the likelihood of full repayment.

Non-performing Loans. At September 30, 2012, \$24.2 million (or 2.5% of our total loans) were non-performing loans. The majority of these loans were commercial real estate loans and residential mortgage loans. Commercial real estate loans totaled \$10.9 million. Additional non-performing commercial real estate loans acquired as part of the merger with First Star Bank totaled \$7.0 million. Residential first mortgage loans that were 90 days or more past due or troubled debt restructured loans that were considered non-performing at September 30, 2012 totaled \$11.1 million. In connection with the First Star Bank acquisition, the Company acquired loans with deteriorated credit quality totaling \$12.9 million. These loans are being carried at \$7.5 million at September 30, 2012 and contributed to the significant increase in non-performing loans at September 30, 2012 compared to non-performing loans at September 30, 2011. These loans were adjusted to fair market value at the time of acquisition. No additional allowance for loan losses for these loans was deemed necessary at September 30, 2012.

Real Estate Owned. At September 30, 2012, the Company had \$3.0 million of real estate owned consisting of 33 properties. All these properties are being actively marketed and additional losses may occur.

Table of Contents

Non-Performing Assets. The table below sets forth the amounts and categories of our non-performing assets at the dates indicated.

	2012	2011	At September 30, 2010	2009	2008
	(Dollars in thousands)				
Non-accrual loans:					
Residential first mortgage loans:					
One- to four-family	\$ 10,536	\$ 6,854	\$ 8,360	\$ 3,524	\$ 1,379
Construction					
Commercial	1,870	306	199	122	
Commercial real estate	10,909	3,502	1,411	580	2,531
Home equity loans and lines of credit	373	248	200	180	28
Other	19	61	346	159	
Total	23,707	10,971	10,516	4,565	3,938
Accruing loans 90 days or more past due:					
Residential first mortgage loans:					
One- to four-family					
Construction					
Commercial					
Commercial real estate					
Home equity loans and lines of credit					
Other					
Total loans 90 days or more past due					
Troubled debt restructurings	533	529	361	589	
Total non-performing loans	24,240	11,500	10,877	5,154	3,938
Real estate owned	2,998	2,356	2,034	2,579	31
Total non-performing assets	\$ 27,238	\$ 13,856	\$ 12,911	\$ 7,733	\$ 3,969
Troubled debt restructurings: *					
Residential first mortgage loans:					
One- to four-family	\$ 7,342	\$ 5,430	\$ 5,054	\$ 2,981	\$ 149
Construction					
Commercial	227	120	3		
Commercial real estate	5,344	4,372	1,865	180	
Home equity loans and lines of credit	167	250	21	7	
Other		58	59		
Total	\$ 13,080	\$ 10,230	\$ 7,002	\$ 3,168	\$ 149
Ratios:					
Total non-performing loans to total loans	2.53%	1.54%	1.47%	0.70%	0.55%
Total non-performing loans to total assets	1.71%	1.05%	1.01%	0.49%	0.40%

Edgar Filing: ESSA Bancorp, Inc. - Form 10-K

Total non-performing assets to total assets	1.92%	1.26%	1.20%	0.74%	0.40%
---	-------	-------	-------	-------	-------

* Non-performing troubled debt restructurings of \$533,000 are included in total troubled debt restructurings for September 30, 2012. For the year ended September 30, 2012, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was \$592,000.

At September 30, 2012 the principal balance of troubled debt restructures was \$13.1 million as compared to \$10.2 million at September 30, 2011. Of the \$13.1 million of troubled debt restructures at September 30, 2012, \$8.0 million are performing loans and \$5.1 million are non-accrual loans. An additional \$533,000 of performing troubled debt restructures are classified as non-performing assets because they were non-performing assets at the time they were restructured.

Of the 73 loans that make up our troubled debt restructures at September 30, 2012, no loans were granted a rate concession at a below market interest rate. Ten loans with balances totaling \$1.9 million were granted market rate and terms concessions and 62 loans with balances totaling \$10.8 million were granted terms concessions. One loan for \$384,000 was granted a market rate concession.

Table of Contents

Residential real estate loans make up the vast majority of our troubled debt restructures. As of September 30, 2012, troubled debt restructures were comprised of 44 residential loans totaling \$7.3 million, 24 commercial and commercial real estate loans totaling \$5.6 million, and five consumer (Home equity loans, home equity lines and credit, and other) totaling \$167,000.

For the year ended September 30, 2012, 22 loans totaling \$2.2 million were removed from TDR status. Four loans totaling \$537,000 were transferred to foreclosed real estate, one loan for \$327,000 had completed timely payments, and 10 loans totaling \$1.1 million were paid off.

We have modified terms of performing loans that do not meet the definition of a TDR. The vast majority of such loans were simply rate modifications of residential first mortgage loans in lieu of refinancing. The non-TDR rate modifications were all performing loans when the rates were reset to current market rates. For the year ended September 30, 2012, we modified 767 loans (\$101.5 million) in this fashion. With regard to commercial loans, including commercial real estate loans, various non-troubled loans were modified, either for the purpose of a rate reduction to reflect current market rates (in lieu of a refinance) or the extension of a loan's maturity date. In total, they numbered 32 in the year ended September 30, 2012 with an aggregate balance of approximately \$18.6 million.

Table of Contents

Delinquencies. The following table sets forth certain information with respect to our loan portfolio delinquencies at the dates indicated. Loans delinquent for 90 days or more are generally classified as nonaccrual loans.

	Loans Delinquent For		Loans Delinquent For		Total	
	60-89 Days	90 Days and Over	60-89 Days	90 Days and Over	Number	Amount
	Number	Amount	Number	Amount	Number	Amount
	(Dollars in thousands)					

At September 30, 2012

Residential first mortgage loans:						
One- to four-family	11	\$ 1,274	78	\$ 10,536	89	\$ 11,810
Construction						
Commercial			27	1,870	27	1,870
Commercial real estate	3	3,348	59	10,909	62	14,257
Obligations of states and political subdivisions						
Home equity loans and lines of credit	4	138	15	373	19	511
Other			1	19	1	19
Total	18	\$ 4,760	180	\$ 23,707	198	\$ 28,467

At September 30, 2011

Residential first mortgage loans:						
One- to four-family	7	\$ 928	40	\$ 6,854	47	\$ 7,782
Construction						
Commercial	1	1	7	306	8	307
Commercial real estate			17	3,502	17	3,502
Obligations of states and political subdivisions						
Home equity loans and lines of credit	5	187	8	248	13	435
Other	1	2	2	61	3	63
Total	14	\$ 1,118	74	\$ 10,971	88	\$ 12,089

At September 30, 2010

Residential first mortgage loans:						
One- to four-family	6	\$ 558	50	\$ 8,360	56	\$ 8,918
Construction						
Commercial	1	151	2	199	3	350
Commercial real estate	1	107	8	1,411	9	1,518
Home equity loans and lines of credit	5	146	6	200	11	346
Other			3	346	3	346
Total	13	\$ 962	69	\$ 10,516	82	\$ 11,478

At September 30, 2009

Residential first mortgage loans:						
One- to four-family	11	\$ 1,795	19	\$ 3,524	30	\$ 5,319
Construction						
Commercial			2	122	2	122
Commercial real estate	4	537	4	580	8	1,117
Obligations of states and political subdivisions						
Home equity loans and lines of credit			5	180	5	180
Other	1	6	3	159	4	165

Edgar Filing: ESSA Bancorp, Inc. - Form 10-K

Total	16	\$ 2,338	33	\$ 4,565	49	\$ 6,903
<u>At September 30, 2008</u>						
Residential first mortgage loans:						
One- to four-family	1	\$ 118	9	\$ 1,379	10	\$ 1,497
Construction						
Commercial						
Commercial real estate			4	2,531	4	2,531
Obligations of states and political subdivisions						
Home equity loans and lines of credit	1	37	1	28	2	65
Other						
Total	2	\$ 155	14	\$ 3,938	16	\$ 4,093

Table of Contents

Classified Assets. Banking regulations and our Asset Classification Policy provide that loans and other assets considered to be of lesser quality should be classified 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 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. We classify an asset as Special Mention if the asset has a potential weakness that warrants management's close attention. While such assets are not impaired, management has concluded that if the potential weakness in the asset is not addressed, the value of the asset may deteriorate, thereby adversely affecting the repayment of the asset.

At September 30, 2012, the Company classified approximately \$13.8 million of our assets as special mention of which \$5.9 million were commercial and commercial real estate loans, \$40.4 million as substandard of which \$22.3 million were commercial and commercial real estate loans, none as doubtful and none as loss. On the basis of management's review of its assets, at September 30, 2011, we classified approximately \$11.7 million of our assets as special mention, \$27.6 million as substandard, \$1.2 million as doubtful, and none as loss.

The loan portfolio is reviewed on a regular basis to determine whether any loans require classification in accordance with applicable regulations. Not all classified assets constitute non-performing assets.

Allowance for Loan Losses

Our allowance for loan losses is maintained at a level necessary to absorb loan losses that are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses inherent in its loan portfolio and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. Our allowance for loan losses consists of two elements: (1) an allocated allowance, which comprises allowances established on specific loans and class allowances based on historical loss experience and current trends, and (2) an unallocated allowance based on general economic conditions and other risk factors in our markets and portfolios. We maintain a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified losses based on a review of such information. A loan evaluated for impairment is considered to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Loan impairment is measured based on the fair value of collateral method, taking into account the appraised value, any valuation assumptions used, estimated costs to sell and trends in the market since the appraisal date. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions, management's judgment and losses which are probable and reasonably estimable. The allowance is increased through provisions charged against current earnings and recoveries of previously charged-off loans. Loans that are determined to be uncollectible are charged against the allowance. While management uses available information to recognize probable and reasonably estimable loan losses, future loss provisions may be necessary based on changing economic conditions. Payments received on impaired loans generally are either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. The allowance for loan losses as of September 30, 2012 is maintained at a level that represents management's best estimate of losses inherent in the loan portfolio, and such losses were both probable and reasonably estimable.

In addition, the Federal Reserve Board of Governors (the Federal Reserve Board) (as successor to the Office of Thrift Supervision), the FDIC and the Pennsylvania Department of Banking, as an integral part of their examination process, periodically review our allowance for loan losses. The banking regulators may require that we recognize additions to the allowance based on its analysis and review of information available to it at the time of its examination.

Table of Contents

The following table sets forth activity in our allowance for loan losses for the periods indicated.

	At or For the Years Ended September 30, 2010 2009 2008 (Dollars in thousands)				
	2012	2011	2010	2009	2008
Balance at beginning of year	\$ 8,170	\$ 7,448	\$ 5,815	\$ 4,915	\$ 4,206
Charge-offs:					
Residential first mortgage loans:					
One- to four-family	(2,366)	(1,175)	(190)	(117)	(60)
Construction					
Commercial	(31)	(131)	(53)	(9)	(87)
Commercial real estate	(987)		(186)	(457)	
Obligations of states and political subdivisions					
Home equity loans and lines of credit	(380)	(188)	(107)	(20)	(19)
Other	(13)	(4)	(36)		(27)
Total charge-offs	\$ (3,777)	\$ (1,498)	\$ (572)	\$ (603)	\$ (193)
Recoveries:					
Residential first mortgage loans:					
One- to four-family	\$ 291	\$ 146	\$	\$	\$
Construction					
Commercial	26	2			
Commercial real estate	7		4		
Obligations of states and political subdivisions					
Home equity loans and lines of credit	33	14			
Other	2	3	26	3	2
Total recoveries	\$ 359	\$ 165	\$ 30	\$ 3	\$ 2
Net charge-offs	\$ (3,418)	\$ (1,333)	\$ (542)	\$ (600)	\$ (191)
Provision for loan losses	2,550	2,055	2,175	1,500	900
Balance at end of year	\$ 7,302	\$ 8,170	\$ 7,448	\$ 5,815	\$ 4,915
Ratios:					
Net charge-offs to average loans outstanding	0.44%	0.18%	0.07%	0.08%	0.03%
Allowance for loan losses to non-performing loans at end of year	30.12%	71.04%	68.48%	112.82%	124.81%
Allowance for loan losses to total loans at end of year	0.76%	1.09%	1.01%	0.79%	0.69%

As previously disclosed, the Bank's primary federal regulator was changed from the Office of Thrift Supervision (OTS) to the Federal Deposit Insurance Corporation (FDIC) in July of 2011. Because the FDIC places a different emphasis on the timing of charge offs than the OTS did, the Company determined that a change to its allowance for loan loss process was necessary. Previously, where a loan loss was considered likely and that loss was measured, a specific allocation of the Company's allowance for loan losses was made to cover this loss. Actual losses were charged off when the loan in question was foreclosed upon. Beginning in March of 2012, these likely losses are being charged-off against the allowance for loan losses when determined. The Company does not believe that these additional charge offs reflect any deterioration of the credit quality of the Company's loan portfolio. These charge offs did, however, reduce the balance of the Company's allowance for loan losses by a corresponding amount. Further, the Company believes that these charge offs have also reduced the risk perceived in the loan portfolio and that the loans loss allowance at September 30, 2012 is reasonable and adequate.

Edgar Filing: ESSA Bancorp, Inc. - Form 10-K

See Non-Performing Loans and Problem Assets. There can be no assurance that we will not experience a deterioration of our loan portfolio, including increases in non-performing loans, problem assets and charge-offs, in the future.

Table of Contents

Allocation of Allowance for Loan Losses. The following tables set forth the allowance for loan losses allocated by loan category, the percent of the allowance to the total allowance and the percent of loans in each category to total loans at the dates indicated. The allowance for loan losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

	2012			2011			2010		
	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans
(Dollars in thousands)									
Residential first mortgage loans:									
One- to four-family	\$ 5,401	73.97%	72.75%	\$ 5,220	63.89%	78.10%	\$ 4,462	59.91%	80.80%
Construction	29	0.40	0.40	8	0.10	0.10	15	0.20	0.20
Commercial	474	6.49	1.34	500	6.12	2.00	204	2.74	2.20
Commercial real estate	699	9.57	16.73	1,329	16.26	14.10	1,556	20.89	10.60
Obligations of states and political subdivisions	127	1.74	3.52						
Home equity loans and lines of credit	499	6.83	5.00	622	7.62	5.40	569	7.64	5.90
Other	22	0.30	0.26	80	0.98	0.30	22	0.29	0.30
Total allocated allowance	7,251	99.30	100.00	7,759	94.97	100.00	6,828	91.67	100.00
Unallocated allowance	51	0.70		411	5.03		620	8.33	
Total allowance for loan losses	\$ 7,302	100.00%	100.00%	\$ 8,170	100.00%	100.00%	\$ 7,448	100.00%	100.00%

	2009			2008		
	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans
(Dollars in thousands)						
Residential first mortgage loans:						
One- to four-family	\$ 3,796	65.28%	81.70%	\$ 2,862	58.23%	80.30%
Construction	11	0.19	0.20	41	0.83	1.16
Commercial	248	4.27	2.20	182	3.70	1.68
Commercial real estate	1,116	19.19	9.20	1,222	24.86	9.76
Obligations of states and political subdivisions						
Home equity loans and lines of credit	510	8.77	6.30	475	9.67	6.67
Other	33	0.56	0.40	30	0.61	0.43
Total allocated allowance	5,714	98.26	100.00	4,812	97.90	100.00
Unallocated allowance	101	1.74		103	2.10	
Total allowance for loan losses	\$ 5,815	100.00%	100.00%	\$ 4,915	100.00%	100.00%

Table of Contents

We use the accrual method of accounting for all performing loans. The accrual of interest income is generally discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan is currently performing. When a loan is placed on nonaccrual status, unpaid interest previously credited to income is reversed. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management's judgment as to the collectibility of principal. Generally, residential and consumer loans are restored to accrual status when the obligation is brought current in accordance with the contractual terms for a reasonable period of time and ultimate collectibility of total contractual principal and interest is no longer in doubt. Commercial loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time and ultimate collectibility of total contractual principal and interest no longer is in doubt.

In our collection efforts, we will first attempt to cure any delinquent loan. If a real estate secured loan is placed on nonaccrual status, it will be subject to transfer to the real estate owned (REO) portfolio (properties acquired by or in lieu of foreclosure), upon which our loan servicing department will pursue the sale of the real estate. Prior to this transfer, the loan balance will be reduced, if necessary, to reflect its current market value less estimated costs to sell. Write downs of REO that occur after the initial transfer from the loan portfolio and costs of holding the property are recorded as other operating expenses, except for significant improvements which are capitalized to the extent that the carrying value does not exceed estimated net realizable value.

Fair values for determining the value of collateral are estimated from various sources, such as real estate appraisals, financial statements and from any other reliable sources of available information. For those loans deemed to be impaired, collateral value is reduced for the estimated costs to sell. Reductions of collateral value are based on historical loss experience, current market data, and any other source of reliable information specific to the collateral.

This analysis process is inherently subjective, as it requires us to make estimates that are susceptible to revisions as more information becomes available. Although we believe that we have established the allowance at levels to absorb probable and estimable losses, future additions may be necessary if economic or other conditions in the future differ from the current environment.

Securities Activities

Our securities investment policy is established by our Board of Directors. This policy dictates that investment decisions be made based on the safety of the investment, liquidity requirements, potential returns, cash flow targets, and consistency with our interest rate risk management strategy. Our investment policy is reviewed annually by our ALCO/Investment management committee. All policy changes recommended by this management committee must be approved by the Board of Directors. The Committee is comprised of the Chief Executive Officer, Chief Financial Officer, Controller, Lending Services Division Manager, Retail Services Division Manager and the Delivery Systems Division Manager. Authority to make investments under the approved guidelines is delegated by the Committee to appropriate officers. While general investment strategies are developed and authorized by the ALCO/Investment management committee, the execution of specific actions rests with the Chief Financial Officer.

The approved investment officers are authorized to execute investment transactions up to \$5.0 million per transaction without the prior approval of the ALCO/Investment management committee and within the scope of the established investment policy. These officers are also authorized to execute investment transactions between \$5.0 million and \$10.0 million with the additional approval from the Chief Executive Officer. Each transaction in excess of \$10.0 million must receive prior approval of the ALCO/Investment Committee.

Our current investment policy generally permits investments in debt securities issued by the U.S. government and U.S. agencies, municipal bonds, and corporate debt obligations, as well as investments in the Federal Home Loan Bank of Pittsburgh (federal agency securities) and, to a much lesser extent, other equity securities. Securities in these categories are classified as investment securities for financial reporting purposes.

Table of Contents

The policy also permits investments in mortgage-backed securities, including pass-through securities issued and guaranteed by Fannie Mae, Freddie Mac and Government National Mortgage Association (GNMA) as well as commercial paper, corporate debt and municipal securities. Our current investment strategy uses a risk management approach of diversified investing in fixed-rate securities with short- to intermediate-term maturities, as well as adjustable-rate securities, which may have a longer term to maturity. The emphasis of this approach is to increase overall investment securities yields while managing interest rate risk.

At the time of purchase, we designate a security as held to maturity, available-for-sale, or trading, depending on our ability and intent. Securities available-for-sale are reported at fair value, while securities held to maturity are reported at amortized cost.

Mortgage-Backed Securities. We purchase mortgage-backed securities in order to generate positive interest rate spreads with minimal administrative expense, lower credit risk as a result of the guarantees provided by Freddie Mac, Fannie Mae and GNMA and increased liquidity. We invest primarily in mortgage-backed securities issued or sponsored by Fannie Mae, Freddie Mac, and GNMA. At September 30, 2012, our mortgage-backed securities portfolio had a fair value of \$215.8 million, consisting primarily of Freddie Mac, Fannie Mae and GNMA mortgage-backed securities.

Mortgage-backed securities are created by pooling mortgages and issuing a security collateralized by the pool of mortgages with an interest rate that is less than the interest rate on the underlying mortgages. Mortgage-backed securities typically represent a participation interest in a pool of single-family or multi-family mortgages, although most of our mortgage-backed securities are collateralized by single-family mortgages. The issuers of such securities (generally U.S. government agencies and U.S. government sponsored enterprises, including Fannie Mae, Freddie Mac and GNMA) pool and resell the participation interests in the form of securities to investors, such as ESSA Bank & Trust, and guarantee the payment of principal and interest to these investors. Investments in mortgage-backed securities involve a risk that actual prepayments will be greater or less than the prepayment rate estimated at the time of purchase, which may require adjustments to the amortization of any premium or accretion of any discount relating to such instruments, thereby affecting the net yield on such securities. We review prepayment estimates for our mortgage-backed securities at the time of purchase to ensure that prepayment assumptions are reasonable considering the underlying collateral for the securities at issue and current interest rates, and to determine the yield and estimated maturity of the mortgage-backed securities portfolio. Periodic reviews of current prepayment speeds are performed in order to ascertain whether prepayment estimates require modification that would cause amortization or accretion adjustments.

Equity Securities. At September 30, 2012, our equity securities had a fair value of \$3.4 million.

In addition, we hold Federal Home Loan Bank of Pittsburgh (FHLB-Pittsburgh) common stock to qualify for membership in the Federal Home Loan Bank System and to be eligible to borrow funds under the FHLB advance program. There is no market for the common stock.

The aggregate fair value of our FHLB-Pittsburgh common stock as of September 30, 2012 was \$21.9 million based on its par value. No unrealized gains or losses have been recorded because we have determined that the par value of the common stock represents its fair value. We owned shares of FHLB-Pittsburgh common stock at September 30, 2012 with a par value that was \$10.3 million more than we were required to own to maintain our membership in the Federal Home Loan Bank System and to be eligible to obtain advances. We are required to purchase additional stock as our outstanding advances increase. Any excess stock we own was redeemed monthly by the FHLB-Pittsburgh. On December 23, 2008, the FHLB notified its members, including the Company, that it was suspending the payment of dividends on its capital stock and the repurchase of excess capital stock until further notice. The FHLB-Pittsburgh resumed limited repurchases of excess capital stock in February 2011.

We review equity and debt securities with significant declines in fair value on a periodic basis to determine whether they should be considered temporarily or other than temporarily impaired. If a decline in the fair value of a security is determined to be other than temporary, we are required to reduce the carrying value of the security to its fair value and record a non-cash, credit related impairment charge in the amount of the decline, net of tax effect, against our current income.

Table of Contents

Our investment securities portfolio contains unrealized losses on securities, including mortgage-related instruments issued or backed by the full faith and credit of the United States government, or generally viewed as having the implied guarantee of the United States government, and debt obligations of a State or political subdivision.

Our policy is to recognize an other-than-temporary impairment of equity securities where the fair value has been significantly below cost for four consecutive quarters. For fixed maturity investments with unrealized losses due to interest rates where the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security before its anticipated recovery in market value, declines in value below cost are not assumed to be other than temporary. We review our position quarterly and concluded that at September 30, 2012, declines included in the table below represent temporary declines due to interest rate change, and we do not intend to sell those securities and it is more likely than not that we will not have to sell those securities before their anticipated recovery in market value.

The following table sets forth the composition of our securities portfolio (excluding FHLB-Pittsburgh common stock) at the dates indicated.

	2012		At September 30, 2011		2010	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Investment securities available for sale:						
Mortgage-backed securities	\$ 208,265	\$ 215,804	\$ 196,641	\$ 204,209	\$ 182,046	\$ 187,288
Obligations of state and political subdivisions	18,611	19,517	13,760	14,499	10,637	10,904
U.S. Government agency obligations	74,106	74,484	21,797	22,083	52,177	52,434
Corporate obligations	8,602	8,657	4,598	4,584	1,654	1,677
Trust-preferred securities	5,852	6,233				
Other debt securities	1,476	1,512				
Total debt securities	316,912	326,207	236,796	245,375	246,514	252,303
Equity securities	3,267	3,378	11	18	12	38
Total investment securities available-for-sale	\$ 320,179	\$ 329,585	\$ 236,807	\$ 245,393	\$ 246,526	\$ 252,341
Investment securities held-to-maturity:						
Mortgage-backed securities					12,795	13,254
Total securities held to maturity	\$	\$	\$	\$	\$ 12,795	\$ 13,254

Table of Contents

Portfolio Maturities and Yields. The composition and maturities of the investment securities portfolio at September 30, 2012 are summarized in the following table. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur.

	One Year or Less		More than One Year through Five Years		More than Five Years through Ten Years		More than Ten Years		Total Securities		
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Fair Value	Weighted Average Yield
Investment securities available for sale:											
U.S. Government agency obligations	\$	0.00%	\$ 52,471	0.70%	\$ 13,832	1.44%	\$ 7,803	0.79%	\$ 74,106	\$ 74,484	0.85%
Obligations of state and political subdivisions	901	1.52%	6,335	2.64%	9,760	3.08%	1,615	5.57%	18,611	19,517	3.07%
Mortgage-backed securities		0.00%	372	4.82%	25,407	3.39%	182,486	2.87%	208,265	215,804	2.93%
Corporate obligations	1,560	1.98%	5,958	3.00%	500	3.10%	584	5.21%	8,602	8,657	2.97%
Trust preferred securities	999	3.17%		0.00%		0.00%	4,853	3.16%	5,852	6,233	3.16%
Other debt securities		0.00%		0.00%		0.00%	1,476	7.02%	1,476	1,512	7.02%
Total debt securities	3,460	2.20%	65,136	1.12%	49,499	2.78%	198,817	2.85%	316,912	326,207	2.48%
Equity securities		0.00%		0.00%		0.00%	3,267	5.04%	3,267	3,378	5.04%
Total investment securities available for-sale	\$ 3,460	2.20%	\$ 65,136	1.12%	\$ 49,499	2.78%	\$ 202,084	2.89%	\$ 320,179	\$ 329,585	2.51%

Table of Contents

Sources of Funds

General. Deposits, borrowings, repayments and prepayments of loans and securities, proceeds from maturing securities and cash flows from operations 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 deposit accounts consist of savings accounts, NOW accounts, checking accounts, money market accounts, club accounts, certificates of deposit and IRAs and other qualified plan accounts. We provide commercial checking accounts for businesses.

At September 30, 2012, our deposits totaled \$995.6 million. Interest-bearing NOW, savings and club and money market deposits totaled \$367.7 million at September 30, 2012. At September 30, 2012, we had a total of \$586.1 million in certificates of deposit. Noninterest-bearing demand deposits totaled \$41.8 million. Although we have a significant portion of our deposits in shorter-term certificates of deposit, we monitor activity on these accounts and, based on historical experience and our current pricing strategy, we believe we will retain a large portion of these accounts upon maturity.

Our deposits are obtained predominantly from the areas in which our branch offices are located. We rely on our favorable locations, customer service and competitive pricing to attract and retain these deposits. While we accept certificates of deposit in excess of \$100,000 for which we may provide preferential rates, we generally do not solicit such deposits as they are more difficult to retain than core deposits. At September 30, 2012, we had a total of \$156.8 million of brokered certificates of deposits, an increase of \$35.9 million from the prior fiscal year end. Our brokered certificates of deposits range from one- to six-year terms, and are purchased only through pre-approved brokers.

The following table sets forth the distribution of average deposit accounts, by account type, at the dates indicated.

	2012		For the Years Ended September 30,				2010		Average Rate Paid
	Average Balance	Percent	Average Rate Paid	Average Balance	Percent	Average Rate Paid	Average Balance	Percent	
(Dollars in thousands)									
Deposit type:									
Noninterest bearing demand accounts	\$ 37,064	5.21%	0.00%	\$ 30,236	4.93%	0.00%	\$ 27,703	5.98%	0.00%
Interest bearing NOW	65,747	9.25%	0.04	58,795	9.58%	0.04	55,796	12.03%	0.08
Money market	117,118	16.47%	0.28	117,946	19.23%	0.47	115,545	24.93%	1.07
Savings and club	78,943	11.10%	0.10	69,732	11.37%	0.22	67,549	14.58%	0.32
Certificates of deposit	412,207	57.97%	1.71	336,668	54.89%	2.01	196,863	42.48%	2.49
Total deposits	\$ 711,079	100.00%	1.05%	\$ 613,377	100.00%	1.22%	\$ 463,456	100.00%	1.88%

As of September 30, 2012, the aggregate amount of outstanding certificates of deposit in amounts greater than or equal to \$100,000 was approximately \$366.9 million. The following table sets forth the maturity of those certificates as of September 30, 2012.

	At September 30, 2012 (In thousands)
Three months or less	\$ 55,751
Over three months through six months	33,508
Over six months through one year	49,438
Over one year	228,250

Total	\$ 366,947
-------	------------

Table of Contents

At September 30, 2012, \$270.3 million of our certificates of deposit had maturities of one year or less. We monitor activity on these accounts and, based on historical experience and our current pricing strategy, we believe we will retain a significant portion of these accounts upon maturity.

Borrowings. Our short-term borrowings consist of Federal Home Loan Bank and Federal Reserve Bank advances. The following table sets forth information concerning balances and interest rates on all of our short-term borrowings at the dates and for the years indicated.

	At or For the Years Ended September 30,		
	2012	2011	2010
	(Dollars in thousands)		
Balance at end of year	\$ 43,281	\$ 4,000	\$ 14,719
Maximum outstanding at any month end	\$ 43,281	\$ 28,086	\$ 61,013
Average balance during year	\$ 11,712	\$ 6,439	\$ 22,947
Weighted average interest rate at end of year	0.30%	0.22%	0.65%
Average interest rate during year	0.27%	0.71%	0.38%

At September 30, 2012, we had the ability to borrow approximately \$577 million under our credit facilities with the FHLB-Pittsburgh.

Competition

We face significant competition in both originating loans and attracting deposits. The counties in which we operate have a significant concentration of financial institutions, many of which are significantly larger institutions and have greater financial resources than we, and many of which are our competitors to varying degrees. Our competition for loans comes principally from commercial banks, savings banks, mortgage banking companies, credit unions, leasing companies, insurance companies and other financial service companies. Our most direct competition for deposits has historically come from commercial banks, savings banks and credit unions. We face additional competition for deposits from nondepository competitors such as the mutual fund industry, securities and brokerage firms and insurance companies.

We seek to meet this competition by the convenience of our branch locations, emphasizing personalized banking and the advantage of local decision-making in our banking business. Specifically, we promote and maintain relationships and build customer loyalty within local communities by focusing our marketing and community involvement on the specific needs of individual neighborhoods. As of June 30, 2012, ESSA Bank & Trust had the largest deposit market share in Monroe County, Pennsylvania. We do not rely on any individual, group, or entity for a material portion of our deposits.

Employees

As of September 30, 2012, we had 224 full-time employees and 46 part-time employees. The employees are not represented by a collective bargaining unit and we consider our relationship with our employees to be good.

Subsidiary Activities

ESSA Bank & Trust has five wholly owned subsidiaries, ESSACOR, Inc., Pocono Investment Company, ESSA Advisory Services, LLC, Integrated Financial Corporation and its fully owned subsidiary Integrated Abstract Incorporated and Integrated Delaware, Inc. ESSACOR, Inc. is a Pennsylvania corporation that has been used to purchase properties at tax sales that represent collateral for delinquent loans of the Bank. Pocono Investment Company is a Delaware corporation formed as an investment company subsidiary to hold and manage certain investments of ESSA Bank & Trust, including certain intellectual property. ESSA Advisory Services, LLC is a Pennsylvania limited liability company owned 100% by ESSA Bank & Trust. ESSA Advisory Services, LLC is a full-service insurance benefits consulting company offering group services such as health insurance, life insurance, short term and long term disability, dental, vision and 401(K) retirement planning as well as individual health products. Integrated Financial Corporation is a Pennsylvania Corporation that provided investment advisory services

Table of Contents

to the general public as a former subsidiary of First Star Bank. Integrated Financial Corporation is currently inactive. Integrated Abstract Incorporated is a Pennsylvania Corporation that provides title insurance services. Integrated Delaware, Inc. is a Delaware Investment Corporation and was previously owned by First Star Bank.

Table of Contents

SUPERVISION AND REGULATION

General

ESSA Bancorp, Inc. is a Pennsylvania corporation. As a savings and loan holding company, we are required to file certain reports with, and otherwise comply with the rules and regulations of the Federal Reserve Board.

ESSA Bank & Trust is a Pennsylvania-chartered savings association and its deposit accounts are insured up to applicable limits by the Federal Deposit Insurance Corporation under the Deposit Insurance Fund (DIF). We are subject to extensive regulation by the Pennsylvania Department of Banking, our chartering agency, and by the Federal Deposit Insurance Corporation, our primary federal regulator. We must file reports with the Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation concerning our activities and financial condition, in addition to obtaining regulatory approvals prior to entering into certain transactions including, but not limited to, mergers with or acquisitions of other savings institutions. There are periodic examinations by the Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation to test our compliance with various regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the Federal Deposit Insurance Corporation insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and with their examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulation, whether by the Pennsylvania Department of Banking or the Federal Deposit Insurance Corporation could have a material adverse impact on us and our operations.

Federal Legislation

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act), enacted on July 21, 2010, has significantly changed the bank regulatory structure and is affecting the lending, investment, trading and operating activities of depository institutions and their holding companies. The Dodd-Frank Act eliminated, as of July 21, 2011, our former primary federal regulator, the Office of Thrift Supervision, and required ESSA Bank & Trust to be regulated by the Federal Deposit Insurance Corporation (the primary federal regulator for state-chartered banks that are not members of the Federal Reserve System). The Dodd-Frank Act also authorized the Federal Reserve Board to supervise and regulate all savings and loan holding companies such as ESSA Bancorp, Inc., in addition to the bank holding companies, that it currently regulates. The Dodd-Frank Act requires the Federal Reserve Board to set minimum capital levels for depository institution holding companies that are as stringent as those required for the insured depository subsidiaries, and the components of Tier 1 capital will be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions. Under the Dodd-Frank Act, the proceeds of trust preferred securities are excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by bank or savings and loan holding companies with less than \$15 billion of assets. The legislation also establishes a floor for capital of insured depository institutions that cannot be lower than the standards in effect today, and directs the federal banking regulators to implement new leverage and capital requirements within 18 months from the enactment of the Dodd-Frank Act that take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives.

The Dodd-Frank Act also created a new Consumer Financial Protection Bureau with substantial power to implement and oversee consumer protection laws. The Consumer Financial Protection Bureau has broad rulemaking authority for a wide range of consumer protection laws that apply to all banks and savings institutions such as ESSA Bank & Trust, including the authority to prohibit unfair, deceptive or abusive acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Banks and savings institutions with \$10 billion or less in assets will continue to be examined for compliance by their applicable bank regulators.

The legislation broadened the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a depository institution. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to

Table of Contents

\$250,000 per depositor, retroactive to January 1, 2008, and non-interest bearing transaction accounts have unlimited deposit insurance through December 31, 2012. The Dodd-Frank Act increased stockholder influence over boards of directors by requiring companies to give stockholders a non-binding vote on executive compensation and so-called "golden parachute" payments, and by authorizing the Securities and Exchange Commission to promulgate rules that would allow stockholders to nominate their own candidates using a company's proxy materials. The Dodd-Frank Act also provided for originators of certain securitized loans to retain a percentage of the risk for transferred loan, directed the Federal Reserve Board to regulate pricing of certain debit card interchange fees and contained a number of reforms related to mortgage origination.

Many of the provisions of the Dodd-Frank Act have delayed effective dates and the legislation requires various federal agencies to promulgate numerous and extensive implementing regulations over the next several years. Although the substance and scope of these regulations cannot be completely determined at this time, it is expected that the legislation and implementing regulations will increase our operating and compliance costs.

Regulation by the Pennsylvania Department of Banking

The Pennsylvania Savings Association Code of 1967, as amended (the "Savings Association Code") contains detailed provisions governing the organization, location of offices, rights and responsibilities of directors, officers, employees, and depositors, as well as corporate powers, savings and investment operations and other aspects of ESSA Bank & Trust and its affairs. The Savings Association Code delegates extensive rulemaking power and administrative discretion to the Pennsylvania Department of Banking so that the supervision and regulation of state-chartered savings associations may be flexible and readily responsive to changes in economic conditions and in savings and lending practices.

One of the purposes of the Savings Association Code is to provide savings associations with the opportunity to be competitive with each other and with other financial institutions existing under other Pennsylvania laws as well as other state, federal and foreign laws. A Pennsylvania savings association may locate or change the location of its principal place of business and establish an office anywhere in Pennsylvania, with the prior approval of the Pennsylvania Department of Banking.

The Pennsylvania Department of Banking generally examines each savings association not less frequently than once every two years. Although the Department may accept the examinations and reports of the Federal Deposit Insurance Corporation in lieu of the Department's examination, the current practice is for the Department to conduct individual examinations. The Department may order any savings association to discontinue any violation of law or unsafe or unsound business practice and may direct any trustee, officer, attorney, or employee of a savings association engaged in an objectionable activity, after the Department has ordered the activity to be terminated, to show cause at a hearing before the Department why such person should not be removed.

Regulation by the Federal Deposit Insurance Corporation

ESSA Bank & Trust is also subject to extensive regulation, examination and supervision, among other things, by the Federal Deposit Insurance Corporation, as its primary federal regulator. Such regulation and supervision:

establishes a comprehensive framework of activities in which ESSA Bank & Trust can engage;

limits the ability of ESSA Bank & Trust to extend credit to any given borrower;

significantly limits the transactions in which ESSA Bank & Trust may engage with its affiliates;

requires ESSA Bank & Trust to meet a qualified thrift lender test which requires ESSA Bank & Trust to invest in qualified thrift investments, which primarily include residential mortgage loans and related investments;

Table of Contents

places limitations on capital distributions by savings associations, such as ESSA Bank & Trust, including cash dividends;

establishes a continuing and affirmative obligation, consistent with ESSA Bank & Trust's safe and sound operation, to help meet the credit needs of its community, including low and moderate income neighborhoods;

establishes various capital categories resulting in various levels of regulatory scrutiny applied to the institutions in a particular category; and

establishes standards for safety and soundness.

The Federal Deposit Insurance Corporation generally examines each savings association not less frequently than once every two years. The Federal Deposit Insurance Corporation has the authority to order any savings association or its directors, trustees, officers, attorneys or employees to discontinue any violation of law or unsafe or unsound banking practice.

Transactions with Affiliates

Sections 23A and 23B of the Federal Reserve Act and its implementing regulations govern transactions between depository institutions and their affiliates. These provisions are made applicable to savings associations, such as ESSA Bank & Trust, by the Home Owners' Loan Act and federal regulations. In a holding company context, the parent holding company of a savings association and any companies that are controlled by the parent holding company are affiliates of the savings association.

Section 23A limits the extent to which a savings association or its subsidiaries may engage in certain transactions with its affiliates. These transactions include, among other things, the making of loans or other extensions of credit to an affiliate and the purchase of assets from an affiliate. Generally, these transactions between the savings association and any one affiliate cannot exceed 10% of the savings association's capital stock and surplus, and these transactions between the savings institution and all of its affiliates cannot, in the aggregate, exceed 20% of the savings institution's capital stock and surplus. Section 23A also establishes specific collateral requirements for loans or extensions of credit to an affiliate, and for guarantees or acceptances on letters of credit issued on behalf of an affiliate. Applicable regulations prohibit a savings association from lending to any affiliate engaged in activities not permissible for a bank holding company or for the purpose of acquiring the securities of most affiliates.

Section 23B requires that transactions covered by Section 23A and a broad list of other specified transactions be on terms and under circumstances substantially the same, or no less favorable to the savings association or its subsidiary, as similar transactions with non-affiliates. In addition to the restrictions on transactions with affiliates that Sections 23A and 23B of the Federal Reserve Act impose on depository institutions, federal law generally prohibits a savings association from purchasing or investing in securities issued by an affiliate (other than a subsidiary) or lending to an affiliate engaged in an activity not permitted for bank holding companies.

Insurance of Accounts and Regulation by the Federal Deposit Insurance Corporation

Deposit accounts in ESSA Bank & Trust are insured by the Federal Deposit Insurance Corporation generally up to a maximum of \$250,000 per separately insured depositor and up to a maximum of \$250,000 for self-directed retirement accounts. ESSA Bank & Trust, therefore, is subject to Federal Deposit Insurance Corporation deposit insurance assessments. The Dodd-Frank Act provided unlimited insurance for certain noninterest-bearing transaction accounts through December 31, 2012.

In the second quarter of 2009, the Federal Deposit Insurance Corporation increased its quarterly deposit insurance assessment rates and amended the method by which assessments are calculated. Institutions were assigned an initial base assessment rate ranging from 12 to 45 basis points of assessable deposits depending on risk category assignment by the Federal Deposit Insurance Corporation. The initial base assessment was then adjusted depending upon the institution's level of unsecured debt, secured liabilities and brokered deposits, to establish a total base assessment rate ranging from seven to 77.5 basis points, with riskier institutions paying higher assessments.

Table of Contents

As part of a plan to restore the Deposit Insurance Fund's reserve ratio, the Federal Deposit Insurance Corporation imposed a special assessment on all insured institutions equal to five basis points of assets less Tier 1 capital as of June 30, 2009, which was payable on September 30, 2009. ESSA Bank & Trust's special assessment approximated \$400,000.

On November 12, 2009, the FDIC approved a final rule requiring insured depository institutions to prepay, on December 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012. Estimated assessments for the fourth quarter of 2009 and for all of 2010 were based upon the assessment rate in effect on September 30, 2009, with three basis points added for the 2011 and 2012 assessment rates. In addition, a 5% annual growth in the assessment base was assumed. Prepaid assessments are being applied against the actual quarterly assessments until exhausted, and may not be applied to any special assessments that may occur in the future. Any unused prepayments will be returned to the institution on June 30, 2013. On December 30, 2009, ESSA Bank & Trust prepaid \$1.7 million in estimated assessment fees for the fourth quarter of 2009 through 2012. We recorded the payment as a prepaid expense to be amortized to expense over three years.

Effective April 1, 2011, the Federal Deposit Insurance Corporation implemented a requirement of the Dodd-Frank Act to revise its assessment system to base it on each institution's total assets less tangible capital instead of deposits. The FDIC also revised its assessment schedule so that it ranges from 2.5 basis points for the least risky institutions to 45 basis points for the riskiest.

Insurance of deposits may be terminated by the Federal Deposit Insurance Corporation upon a finding that an institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the Federal Deposit Insurance Corporation. ESSA Bank & Trust does not believe that it is taking or is subject to any action, condition or violation that could lead to termination of its deposit insurance.

All FDIC-insured institutions are required to pay a pro rata portion of the interest due on obligations issued by the Financing Corporation (FICO) for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the now defunct Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO are due to mature in 2017 through 2019. For the quarter ended September 30, 2012, the annualized FICO assessment was 0.66 basis point of an institution's total assets less tier 1 capital.

Capital Requirements

Federal regulations require savings associations to meet three minimum capital standards: a 1.5% tangible capital ratio, a 4% leverage ratio (3% for savings associations receiving the highest rating on the CAMELS rating system) and an 8% risk-based capital ratio.

The risk-based capital standard for savings associations requires the maintenance of Tier 1 (core) and total capital (which is defined as core capital and supplementary capital) to risk-weighted assets of at least 4% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100%, assigned by the regulatory, based on the risks believed inherent in the type of asset. Core capital is defined as common shareholders' equity (including retained earnings), certain non-cumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries, less intangibles other than certain mortgage servicing rights and credit card relationships. The components of supplementary capital currently include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock, the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital. Additionally, a savings association that retains credit risk in connection with an asset sale may be required to maintain additional regulatory capital because of the recourse back to the savings association.

Table of Contents

At September 30, 2012, the ESSA Bank & Trust's capital exceeded all applicable requirements.

Any state-chartered savings association that fails any of the capital requirements is subject to possible enforcement actions by the Federal Deposit Insurance Corporation. Such actions could include a capital directive, a cease and desist order, civil money penalties, the establishment of restrictions on an institution's operations, termination of federal deposit insurance, and the appointment of a conservator or receiver. Certain corrective actions are required by law.

We are also subject to more stringent capital guidelines of the Pennsylvania Department of Banking. Although not adopted in regulation form, the Pennsylvania Department of Banking utilizes capital standards of 6% leverage capital and 10% risk-based capital. The components of leverage and risk-based capital are substantially the same as those defined by the Federal Deposit Insurance Corporation.

The federal banking regulators have recently issued proposed rules that, if adopted, would significantly increase regulatory capital requirements. Among other things, the proposed rules would introduce a new minimum common equity tier 1 capital ratio of 4.5% of risk-weighted assets and increase the minimum Tier 1 capital risk-based capital ratio from 4.0% to 6.0% of risk-weighted assets. There would also be a new capital conservation buffer that would require an institution to hold an additional 2.5% of common equity tier 1 capital to risk-based assets in order to avoid restrictions on dividends and executive compensation. The proposed rules would impose stricter capital deduction requirements, incorporate and revise the current risk-weighting categories to increase risk sensitivity. If finalized, the new requirements would be phased in over a period of several years.

Dividends from ESSA Bank & Trust

Our ability to pay dividends depends, to a large extent, upon ESSA Bank & Trust's ability to pay dividends to ESSA Bancorp. The Savings Association Code states, in part, that dividends may be declared and paid by the Bank only out of net earnings for the then current year. A dividend may not be declared or paid if it would impair the general reserves of ESSA Bank & Trust that are required to be maintained under the Savings Association Code. The Federal Deposit Insurance Corporation also requires a prior notice or application of a capital distribution under certain circumstances. In addition, ESSA Bank & Trust is required to notify the Federal Reserve Board prior to declaring a dividend and receive the nonobjection of the Federal Reserve Board to any such dividend. No dividend may generally be paid that would result in ESSA Bank & Trust failing to comply with its regulatory capital requirements.

Qualified Thrift Lender Test

As a savings association, ESSA Bank & Trust must satisfy the qualified thrift lender, or QTL, test. Under the QTL test, ESSA Bank & Trust must maintain at least 65% of its portfolio assets in qualified thrift investments in at least nine months of the most recent 12 months. Portfolio assets generally means total assets of a savings institution, less the sum of specified liquid assets up to 20% of total assets, goodwill and other intangible assets, and the value of property used in the conduct of the savings bank's business.

Qualified thrift investments include various types of loans made for residential and housing purposes, investments related to such purposes, including certain mortgage-backed and related securities, and loans for personal, family, household and certain other purposes up to a limit of 20% of portfolio assets. Qualified thrift investments also include 100% of an institution's credit card loans, education loans and small business loans. ESSA Bank & Trust also may satisfy the QTL test by qualifying as a domestic building and loan association as defined in the Internal Revenue Code.

A savings association that fails the qualified thrift lender test is subject to certain operating restrictions. In addition, the Dodd-Frank Act made noncompliance with the QTL test potentially subject to agency enforcement action for violation of laws. At September 30, 2012, ESSA Bank & Trust held 86.1% of its portfolio assets in qualified thrift investments, and satisfied this test.

Table of Contents

Loans-to-One-Borrower Limitation

Under federal regulations, with certain limited exceptions, a Pennsylvania chartered savings association may lend to a single or related group of borrowers on an unsecured basis an amount equal to 15% of its unimpaired capital and surplus. An additional amount, equal to 10% of unimpaired capital and surplus, may be lent if such loan is secured by readily marketable collateral, which is defined to include certain securities, but generally does not include real estate. Our internal policy, however, is to not make a commercial loan in excess of \$5.0 million, nor to allow more than \$7.5 million in total loan relationships with any one borrower, including the borrower's residential mortgage and consumer loans. However, in special circumstances this limit may be exceeded subject to the approval of the Management Loan Committee in addition to a majority of the members of the Board of Directors.

Prompt Corrective Action

Under the federal Prompt Corrective Act regulations, a savings association is deemed to be (i) well capitalized if it has total risk-based capital of 10.0% or more, has a Tier 1 risk-based capital ratio of 6.0% or more, has a Tier I leverage capital ratio of 5.0% or more and is not subject to any written capital order or directive; (ii) adequately capitalized if it has a total risk-based capital ratio of 8.0% or more, a Tier I risk-based capital ratio of 4.0% or more and a Tier I leverage capital ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of well capitalized; (iii) undercapitalized if it has a total risk-based capital ratio that is less than 8.0%, a Tier I risk-based capital ratio that is less than 4.0% or a Tier I leverage capital ratio that is less than 4.0% (3.0% under certain circumstances); (iv) significantly undercapitalized if it has a total risk-based capital ratio that is less than 6.0%, a Tier I risk-based capital ratio that is less than 3.0% or a Tier I leverage capital ratio that is less than 3.0%; and (v) critically undercapitalized if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. Federal regulations also specify circumstances under which a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized 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).

Generally, the FDIC is required to appoint a receiver or conservator for a savings association that becomes critically undercapitalized within specific time frames. The regulations also provide that a capital restoration plan must be filed with the FDIC within 45 days of the date a savings association receives notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. Any holding company for the savings bank required to submit a capital restoration plan must guarantee the lesser of: an amount equal to 5% of a savings bank's assets at the time it was notified or deemed to be undercapitalized by the FDIC, or the amount necessary to restore the savings association to adequately capitalized status. This guarantee remains in place until the FDIC notifies the savings association that it has maintained adequately capitalized status for each of four consecutive calendar quarters. The FDIC may also take any one of a number of discretionary supervisory actions against an undercapitalized savings association, including the issuance of a capital directive and the replacement of senior executive officers and directors.

The recently proposed rules that would increase regulatory capital requirements would, if adopted, adjust the prompt corrective actions categories accordingly.

As of September 30, 2012, the Bank was a well-capitalized institution under the Prompt Corrective Action regulations.

Table of Contents

The USA PATRIOT Act

The USA PATRIOT Act of 2001 gave the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. The USA PATRIOT Act also required the federal banking agencies to take into consideration the effectiveness of controls designed to combat money laundering activities in determining whether to approve a merger or other acquisition application of a member institution. Accordingly, if we engage in a merger or other acquisition, our controls designed to combat money laundering would be considered as part of the application process. We have established policies, procedures and systems designed to comply with these regulations.

Holding Company Regulation

ESSA Bancorp, Inc. is a unitary savings and loan holding company, subject to regulation and supervision by the Federal Reserve Board. The Federal Reserve Board will have enforcement authority over ESSA Bancorp, Inc. and its non-savings institution subsidiaries. Among other things, this authority permits the Federal Reserve Board to restrict or prohibit activities that are determined to be a risk to ESSA Bank & Trust.

Under prior law, a unitary savings and loan holding company generally had no regulatory restrictions on the types of business activities in which it could engage, provided that its subsidiary savings association was a qualified thrift lender. The Gramm-Leach-Bliley Act of 1999, however, restricts unitary savings and loan holding companies not existing on, or applied for before, May 4, 1999 to those activities permissible for financial holding companies or for multiple savings and loan holding companies. The Company is not a grandfathered unitary savings and loan holding company and, therefore, is limited to the activities permissible for financial holding companies or for multiple savings and loan holding companies. A financial holding company may engage in activities that are financial in nature, including underwriting equity securities and insurance as well as activities that are incidental to financial activities or complementary to a financial activity. The Dodd-Frank Act specifies that a savings and loan holding company may only engage in financial holding company activities if it meets the qualitative criteria for a bank holding company to engage in such activities. A multiple savings and loan holding company is generally limited to activities permissible for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act, subject to the prior approval of the Federal Reserve Board, and certain additional activities authorized by federal regulations.

Federal law prohibits a savings and loan holding company, directly or indirectly, or through one or more subsidiaries, from acquiring control of another savings institution or holding company thereof, without prior written approval of the Federal Reserve Board. It also prohibits, with specified exceptions, the acquisition or retention of more than 5% of the equity securities of a company engaged in activities that are not closely related to banking or financial in nature or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings institutions, the Federal Reserve Board must consider such things as the financial and managerial resources and future prospects of the savings institution involved, the effect of the acquisition on the risk to the insurance fund, the convenience and needs of the community, the effectiveness of each parties' anti-money laundering program, and competitive factors.

Savings and loan holding companies are not currently subject to specific regulatory capital requirements. The Dodd-Frank Act, however, requires the Federal Reserve Board to promulgate consolidated capital requirements for depository institution holding companies that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to institutions themselves. Instruments such as cumulative preferred stock and trust preferred securities will no longer be includable as Tier 1 capital, as is currently permitted for bank holding companies. Instruments issued by May 19, 2010 may be grandfathered for companies with consolidated assets of \$15 billion or less. There is a five-year transition period (from the July 21, 2010 effective date of the Dodd-Frank Act) before the capital requirements should apply to savings and loan holding companies. However, the recent proposed rule that would establish such regulatory capital requirements fails to acknowledge the statutory transition period, thereby raising the possibility that the Federal Reserve Board will seek to apply the capital requirements sooner.

Table of Contents

The Federal Reserve Board has issued a policy statement regarding the payment of dividends by bank holding companies that is expected to apply to savings and loan holding companies as well. In general, the Federal Reserve Board's policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the holding company appears consistent with the organization's capital needs, asset quality and overall financial condition. Federal Reserve Board guidance provides for prior regulatory review of capital distributions in certain circumstances such as where the company's net income for the past four quarters, net of dividends previously paid over that period, is insufficient to fully fund the dividend or the company's overall rate of earnings retention is inconsistent with the company's capital needs and overall financial condition. The ability of a holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. These regulatory policies could affect the ability of the Company to pay dividends or otherwise engage in capital distributions.

Source of Strength. The Dodd-Frank Act extended the source of strength doctrine to savings and loan holding companies. The regulatory agencies must issue regulations requiring that all bank and savings and loan holding companies serve as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial stress.

Federal Securities Laws

Shares of ESSA Bancorp, Inc.'s common stock are registered with the SEC under Section 12(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act). ESSA Bancorp, Inc. is also subject to the proxy rules, tender offer rules, insider trading restrictions, annual and periodic reporting, and other requirements of the Exchange Act.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 was enacted in response to public concerns regarding corporate accountability in connection with certain accounting scandals. The stated goals of the Sarbanes-Oxley Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies, and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The Sarbanes-Oxley Act generally applies to all companies that file or are required to file periodic reports with the Securities and Exchange Commission, under the Securities Exchange Act of 1934.

The Sarbanes-Oxley Act includes specific additional disclosure requirements, requires the Securities and Exchange Commission and national securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules, and mandates further studies of certain issues by the Securities and Exchange Commission. The Sarbanes-Oxley Act represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

Although we have and will continue to incur additional expense in complying with the provisions of the Sarbanes-Oxley Act and the resulting regulations, management does not expect that such compliance will have a material impact on our results of operations or financial condition.

Regulatory Enforcement Authority

Federal law provides federal banking regulators 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.

Table of Contents

FEDERAL AND STATE TAXATION

Federal Taxation

General. ESSA Bancorp, Inc. and ESSA Bank & Trust are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. The following discussion of federal taxation is intended only to summarize material federal income tax matters and is not a comprehensive description of the tax rules applicable to ESSA Bancorp, Inc. and ESSA Bank & Trust.

Method of Accounting. For federal income tax purposes, ESSA Bancorp, Inc. currently reports its income and expenses on the accrual method of accounting and uses a tax year ending September 30th for filing its consolidated federal income tax returns. The Small Business Protection Act of 1996 eliminated the use of the reserve method of accounting for bad debt reserves by savings institutions, effective for taxable years beginning after 1995.

Bad Debt Reserves. Prior to the Small Business Protection Act of 1996, ESSA Bank & Trust was permitted to establish a reserve for bad debts for tax purposes and to make annual additions to the reserve. These additions could, within specified formula limits, be deducted in arriving at ESSA Bank & Trust's taxable income. As a result of the Small Business Protection Act of 1996, ESSA Bank & Trust must use the specific charge off method in computing its bad debt deduction for tax purposes.

Taxable Distributions and Recapture. Prior to the Small Business Protection Act of 1996, bad debt reserves created prior to 1988 were subject to recapture into taxable income if ESSA Bank & Trust failed to meet certain thrift asset and definition tests. The Small Business Protection Act of 1996 eliminated these thrift-related recapture rules. However, under current law, pre-1988 reserves remain subject to tax recapture should ESSA Bank & Trust make certain distributions from its tax bad debt reserve or cease to maintain a financial institution charter. At September 30, 2012, ESSA Bank & Trust's total federal pre-1988 reserve was approximately \$4.3 million. This reserve reflects the cumulative effects of federal tax deductions by ESSA Bank & Trust for which no federal income tax provision has been made.

Minimum Tax. The Internal Revenue Code of 1986, as amended, imposes an alternative minimum tax at a rate of 20% on a base of regular taxable income plus certain tax preferences, referred to as alternative minimum taxable income. The alternative minimum tax is payable to the extent alternative minimum tax income is in excess of the regular income tax. Net operating losses can, in general, 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. At September 30, 2012, ESSA Bank & Trust had no minimum tax credit carryforward.

Net Operating Loss Carryovers. A financial institution may carry back net operating losses to the preceding two taxable years (five years for losses incurred in 2001, 2002 and 2009) and forward to the succeeding 20 taxable years. At September 30, 2012, ESSA Bank & Trust had no net operating loss carryforward for federal income tax purposes.

Corporate Dividends. We may exclude from our income 100% of dividends received from ESSA Bank & Trust as a member of the same affiliated group of corporations.

Audit of Tax Returns. ESSA Bank & Trust's federal income tax returns have not been audited in the most recent five-year period. The 2008, 2009 and 2010 tax years remain open.

Table of Contents

State Taxation

Pennsylvania State Taxation. ESSA Bancorp, Inc. is subject to the Pennsylvania Corporate Net Income Tax, Capital Stock and Franchise Tax. The Corporation Net Income Tax rate for fiscal year 2012 is 9.9% 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. ESSA Bank & Trust 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 11.5%. The Mutual Thrift Institutions Tax exempts ESSA Bank & Trust 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 thrift's interest expense deduction in the proportion of interest income on those securities to the overall interest income of ESSA Bank & Trust. Net operating losses, if any, thereafter can be carried forward three years for Mutual Thrift Institutions Tax purposes.

Item 1A. Risk Factors

Financial reform legislation recently enacted has, among other things, changed our holding company and bank regulators, created a new Consumer Financial Protection Bureau, and will result in new laws and regulations that are expected to increase our costs of operations, as well as tightened capital standards.

On July 21, 2010 the President signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). This new law has significantly changed the current bank regulatory structure and affected the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years.

Certain provisions of the Dodd-Frank Act are expected to have a near term effect on us. For example, the Federal Reserve Board now supervises and regulates all savings and loan holding companies that were formerly regulated by the Office of Thrift Supervision, including ESSA Bancorp, Inc. The Federal Deposit Insurance Corporation, which is currently the primary federal regulator for state banks that are not members of the Federal Reserve System, has become the primary federal regulator for state savings association such as ESSA Bank & Trust.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit unfair, deceptive or abusive acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks with more than \$10 billion in assets. Banks with \$10 billion or less in assets such as ESSA Bank & Trust will continue to be examined for compliance with the consumer laws by their primary bank regulators. The Dodd-Frank Act also weakens the federal preemption rules that have been applicable for national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws.

The Dodd-Frank Act requires the implementation of regulations for bank and savings and loan holding companies which establish capital standards that are no less than those applicable to depository institutions themselves. Such regulations which will exclude certain instruments that previously have been eligible for inclusion by bank holding companies as Tier 1 capital, such as trust preferred securities. Savings and loan holding companies such as ESSA Bancorp, Inc. have not previously been subject to regulatory capital requirements.

Table of Contents

Capital distributions by ESSA Bank & Trust, including dividends paid to ESSA Bancorp, Inc., require notice to and nonobjection of the Federal Reserve Board as well as notice or application to the Federal Deposit Insurance Corporation in some circumstances. In addition, certain regulatory policies of the Federal Reserve Board may also limit ESSA Bancorp's ability to make capital distributions including paying dividends.

The Dodd-Frank Act eliminated the federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest bearing checking accounts. Depending on competitive responses, this significant change to existing law could have an adverse impact on our interest expense.

The Dodd-Frank Act broadened the base for Federal Deposit Insurance Corporation deposit insurance assessments. Assessments are now being based on the average consolidated total assets less tangible equity capital of a financial institution, rather than deposits. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per depositor, retroactive to January 1, 2008, and non-interest bearing transaction accounts have unlimited deposit insurance through December 31, 2013.

The Dodd-Frank Act will require publicly traded companies to give stockholders a non-binding vote on executive compensation and so-called golden parachute payments, and by authorizing the Securities and Exchange Commission to promulgate rules that would allow stockholders to nominate their own candidates using a company's proxy materials. The legislation also directs the Federal Reserve Board to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded or not.

It is difficult to predict at this time what specific impact the Dodd-Frank Act and certain yet-to-be written implementing rules and regulations will have on community banks. However, it is expected that at a minimum they will increase our operating and compliance costs and could increase our interest expense.

Increases to the Allowance for Credit Losses May Cause Our Earnings to Decrease.

Our customers may not repay their loans according to the original terms, and the collateral securing the payment of those loans may be insufficient to pay any remaining loan balance. In addition, the estimates used to determine the fair value of such loans as of the acquisition date may be inconsistent with the actual performance of the acquired loans. Hence, we may experience significant credit losses, which could have a material adverse effect on our operating results. We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of loans. In determining the amount of the allowance for credit losses, we rely on loan quality reviews, past loss experience, and an evaluation of economic conditions, among other factors. If our assumptions prove to be incorrect, our allowance for credit losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in additions to the allowance. Material additions to the allowance would materially decrease our net income.

Our emphasis on the origination of commercial real estate and business loans is one of the more significant factors in evaluating our allowance for credit losses. As we continue to increase the amount of these loans, additional or increased provisions for credit losses may be necessary and as a result would decrease our earnings.

Bank regulators periodically review our allowance for credit losses and may require us to increase our provision for credit losses or loan charge-offs. Any increase in our allowance for credit losses or loan charge-offs as required by these regulatory authorities could have a material adverse effect on our results of operations and/or financial condition.

Future Changes in Interest Rates Could Reduce Our Profits.

Our ability to make a profit largely depends on our net interest income, which could be negatively affected by changes in interest rates. Net interest income is the difference between:

1. the interest income we earn on our interest-earning assets, such as loans and securities; and
2. the interest expense we pay on our interest-bearing liabilities, such as deposits and borrowings.

Table of Contents

From September, 2007 through December, 2008, the Federal Reserve Board of Governors decreased its target for the federal funds rate from 5.25% to 0.25%. The federal funds rate has remained at 0.25% since December 2008 and is expected to remain at or around that level for an extended period of time. While these short term market interest rates (which we use as a guide to price our deposits) decreased, longer term market interest rates (which we use as a guide to price our longer term loans) have also decreased but not to the same degree. With the decline in shorter term market interest rates the Company's cost of funds declined. This decline in our cost of funds was initially beneficial to our net interest spread. However, as short term market rates have remained low and longer term interest rates have also declined, the Company's net interest margin decreased from 2.78% for the year ended September 30, 2010 to 2.65% for the year ended September 30, 2012. If market rates remain at these historic lows, there could be further negative pressure exerted on our net interest margin.

In addition, changes in interest rates can affect the average life of loans and mortgage-backed and related securities. A reduction in interest rates results in increased prepayments of loans and mortgage-backed and related securities, as borrowers refinance their loans in order to reduce their borrowing costs. This creates reinvestment risk, which is the risk that we may not be able to reinvest prepayments at rates that are comparable to the rates we earned on the prepaid loans or securities. Alternatively, increases in interest rates may decrease loan demand and/or make it more difficult for borrowers to repay adjustable rate loans.

Changes in interest rates also affect the current market value of our interest-earning securities portfolio. Generally, the value of securities moves inversely with changes in interest rates. At September 30, 2012, the fair value of our debt securities available for sale totaled \$329.6 million. Unrealized net gains on these available for sale securities totaled approximately \$9.4 million at September 30, 2012 and are reported as a separate component of stockholders' equity. Decreases in the fair value of securities available for sale in future periods would have an adverse effect on stockholders' equity.

We evaluate interest rate sensitivity by estimating the change in ESSA Bank & Trust's Economic Value of Equity (EVE) over a range of interest rate scenarios. EVE is the net present value of the Company's asset cash flows minus the net present value of the Company's liability cash flows. At September 30, 2012, in the event of an immediate 200 basis point increase in interest rates, the Company's model projects that we would experience an \$11.6 million, or 5.8%, decrease in net portfolio value. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Management of Market Risk.

Concentration of Loans in Our Primary Market Area, Which Has Experienced an Economic Downturn, May Increase the Risk of Increased Nonperforming Assets.

Our success depends primarily on the general economic conditions in the Pennsylvania counties of Monroe and Northampton, as nearly all of our loans are to customers in these markets. Accordingly, the local economic conditions in this market area have a significant impact on the ability of borrowers to repay loans as well as our ability to originate new loans. As such, a continuation of the decline in real estate values in this market area would also lower the value of the collateral securing loans on properties in this market area. In addition, continued weakening in general economic conditions such as inflation, recession, unemployment or other factors beyond our control could negatively affect our financial results.

Continued and Sustained Deterioration in the Housing Sector and Related Markets and Prolonged Elevated Unemployment Levels May Adversely Affect Our Business and Financial Results.

Over the last several years, general economic conditions continued to worsen nationally as well as in our market area. While we did not invest in sub-prime mortgages and related investments, our lending business is tied significantly to the housing market. Declines in home prices, and increases in foreclosures and unemployment levels, have adversely impacted the credit performance of real estate loans, resulting in the write-down of asset values. The continuing housing slump has resulted in reduced demand for the construction of new housing, further declines in home prices, and increased delinquencies on construction, residential and commercial mortgage loans. The ongoing concern about the economy in general has caused many lenders to reduce or cease providing funding to borrowers. These conditions may also cause a further reduction in loan demand, and increases in our

Table of Contents

non-performing assets, net charge-offs and provisions for loan losses. A worsening of these negative economic conditions could adversely affect our prospects for growth, asset and goodwill valuations and could result in a decrease in our interest income and a material increase in our provision for loan losses.

Negative Developments in the Financial Industry and the Domestic and International Credit Markets May Continue to Adversely Affect our Operations and Results.

Negative developments that began in the latter half of 2007 in the global credit and securitization markets resulted in uncertainty in the financial markets in general with the expectation of the general economic downturn would continue. Loan portfolio quality has deteriorated at many institutions. In addition, the values of real estate collateral supporting many commercial loans and home mortgages have declined and may continue to decline. Bank and bank holding company stock prices have been negatively affected, as has the ability of banks and bank holding companies to raise capital or borrow in the debt markets. As a result, the potential exists for new federal or state laws and regulations regarding lending and funding practices and liquidity standards, and bank regulatory agencies are expected to be active in responding to concerns and trends identified in examinations, including the expected issuance of many formal enforcement orders. Negative developments in the financial industry and the domestic and international credit markets, and the impact of new legislation in response to those developments, may negatively impact our operations by restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance. In addition, these risks could affect the value of our loan portfolio as well as the value of our investment portfolio, which would also negatively affect our financial performance.

Our Continued Emphasis On Commercial Real Estate Lending Increases Our Exposure To Increased Lending Risks.

Our business strategy centers on continuing our emphasis on commercial real estate lending. We have grown our loan portfolio in recent years with respect to this type of loan and intend to continue to emphasize this type of lending. At September 30, 2012, \$160.2 million, or 16.7%, of our total loan portfolio consisted of commercial real estate loans. Loans secured by commercial real estate generally expose a lender to greater risk of non-payment and loss than one- to four-family residential mortgage loans because repayment of the commercial real estate loans often depends on the successful operation of the property and the income stream of the underlying property. Additionally, such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one- to four-family residential mortgage loans. Accordingly, an adverse development with respect to one loan or one credit relationship can expose us to greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan. We seek to minimize these risks through our underwriting policies, which require such loans to be qualified on the basis of the property's collateral value, net income and debt service ratio; however, there is no assurance that our underwriting policies will protect us from credit-related losses.

At September 30, 2012, our largest commercial real estate lending relationship was \$5.7 million of loans located in Monroe County, Pennsylvania and secured by real estate. This loan was performing in accordance with its repayment terms. See Item 1. Business Lending Activities Commercial Real Estate Loans.

Strong Competition Within Our Market Areas May Limit Our Growth and Profitability.

Competition in the banking and financial services industry is intense. In our market areas, we compete with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies, and brokerage and investment banking firms operating locally and elsewhere. Some of our competitors have greater name recognition and market presence that benefit them in attracting business, and offer certain services that we do not or cannot provide. In addition, larger competitors may be able to price loans and deposits more aggressively than we do, which could affect our ability to grow and remain profitable on a long-term basis. Our profitability depends upon our continued ability to successfully compete in our market areas. For additional information see Item 1. Business Competition.

Table of Contents

Economic Conditions May Adversely Affect Our Liquidity and Financial Condition.

Recent significant declines in the values of mortgage-backed securities and derivative securities issued by financial institutions, government sponsored entities, and major commercial and investment banks have led to decreased confidence in financial markets among borrowers, lenders, and depositors, as well as disruption and extreme volatility in the capital and credit markets and the failure of some entities in the financial sector. As a result, many lenders and institutional investors have reduced or ceased to provide funding to borrowers. Continued turbulence in the capital and credit markets may adversely affect our liquidity and financial condition and the willingness of certain counterparties and customers to do business with us.

We Operate in a Highly Regulated Environment and May Be Adversely Affected by Changes in Laws and Regulations.

We are subject to extensive regulation, supervision, and examination by the Federal Reserve Board, as successor regulator to Office of Thrift Supervision, the FDIC and the Pennsylvania Department of Banking. Such regulators govern the activities in which we may engage, primarily for the protection of depositors. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of a bank, the classification of assets by a bank, the imposition of higher capital requirements, and the adequacy of a bank's allowance for credit losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, or legislation, could have a material impact on us and our operations. Notably, the federal banking agencies have recently proposed regulations which, if finalized, would significantly increase regulatory capital requirements for insured depository institutions as well as applying such requirements to savings and loan holding companies. We believe that we are in substantial compliance with applicable federal, state and local laws, rules and regulations. Because our business is highly regulated, the laws, rules and applicable regulations are subject to regular modification and change. There can be no assurance that proposed laws, rules and regulations, or any other laws, rules or regulations, will not be adopted in the future, which could make compliance more difficult or expensive or otherwise adversely affect our business, financial condition or prospects.

The Soundness of Other Financial Services Institutions May Adversely Affect Our Credit Risk.

We rely on other financial services institutions through trading, clearing, counterparty, and other relationships. We maintain limits and monitor concentration levels of our counterparties as specified in our internal policies. Our reliance on other financial services institutions exposes us to credit risk in the event of default by these institutions or counterparties. These losses could adversely affect our results of operations and financial condition.

Any Future FDIC Insurance Premium Increases May Adversely Affect our Earnings.

We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional bank or financial institution failures we may be required to pay even higher FDIC premiums than the recently increased levels. Such increases and any future increases or required prepayments of FDIC insurance premiums may adversely impact our earnings. See [Supervision and Regulation](#) [Deposit Insurance](#) for more information about FDIC insurance premiums.

Our Information Systems May Experience an Interruption or Security Breach.

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the possible failure, interruption or security breach of our information systems, there can be no assurance that any such failure, interruption or security breach will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failure, interruption or security breach of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny or expose us to civil litigation and possible financial liability.

Table of Contents

A Substantial Decline in the Value of Our FHLB-Pittsburgh Common Stock May Adversely Affect Our Financial Condition.

We own common stock of the FHLB-Pittsburgh in order to qualify for membership in the Federal Home Loan Bank system, which enables us to borrow funds under the Federal Home Loan Bank advance program. The carrying value and fair value of our FHLB-Pittsburgh common stock was \$21.9 million as of September 30, 2012.

Recent published reports indicate that certain member banks of the Federal Home Loan Bank system may be subject to asset quality risks that could result in materially lower regulatory capital levels. In an extreme situation, it is possible that the capitalization of a Federal Home Loan Bank, including the FHLB-Pittsburgh, could be substantially diminished or reduced to zero. Consequently, given that there is no market for our FHLB-Pittsburgh common stock, we believe that there is a risk that our investment could be deemed other than temporarily impaired at some time in the future. If this occurs, it may adversely affect our results of operations and financial condition.

If the capitalization of the FHLB-Pittsburgh is substantially diminished and if it reduces or suspends its dividend, our liquidity may be adversely impaired if we are not able to obtain an alternative source of funding.