

Edgar Filing: Kearny Financial Corp. - Form 10-K

Kearny Financial Corp.  
Form 10-K  
September 13, 2006

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

(Mark One)

Annual report pursuant to section 13 OR 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended June 30, 2006

- or -

Transition Report pursuant to section 13 OR 15(d) of the Securities Exchange Act of 1934

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

Commission Number: 0-51093

Kearny Financial Corp.

(Exact name of Registrant as specified in its Charter)

United States

22-3803741

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

120 Passaic Avenue, Fairfield, New Jersey

07004

(Address of principal executive offices)

Zip Code

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

Securities registered pursuant to Section 12(b) of the Act:  
Common Stock, par value \$0.10 per share

(Title of Class)

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 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has

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been subject to such filing requirements for the past 90 days.

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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer                       Accelerated filer   
Non-accelerated filer

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

YES     NO

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant on December 31, 2005, (the last day of the Registrant's most recently completed second fiscal quarter) was \$236.9 million.

As of September 8, 2006 there were issued and outstanding 72,667,600 shares of the Registrant's Common Stock.

### DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Proxy Statement for the 2006 Annual Meeting of Stockholders. (Part III)

### PART I

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

These forward-looking statements involve risks and uncertainties, such as statements of the Company's plans, objectives, expectations, estimates and intentions, that are subject to change based on various important factors (some of which are beyond the Company's control). The following factors, among others, could cause the Company's financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economy in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System, inflation, interest rates, market and monetary fluctuations; the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities and insurance); changes in accounting policies and practices, as may be adopted by regulatory agencies, the Financial Accounting Standards Board or the Public Company Accounting Oversight Board; technological changes; competition among financial services providers; and the success of the Company at managing the risks involved in the foregoing and

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managing its business.

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

### Item 1. Business

#### General

The Company is a federally-chartered corporation that was organized on March 30, 2001 for the purpose of being a holding company for Kearny Federal Savings Bank (the "Bank"), a federally-chartered stock savings bank. On February 23, 2005, the Company completed a minority stock offering in which it sold 21,821,250 shares, or 30% of its outstanding common stock. The remaining 70% of the outstanding common stock, or 50,916,250 shares, are owned by Kearny MHC (the "MHC"). The MHC is a federally-chartered mutual holding company, and so long as the MHC is in existence, it will at all times own a majority of the outstanding common stock of the Company. The MHC and the Company are regulated by the Office of Thrift Supervision.

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

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

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Our primary business is attracting retail deposits from the general public and using those deposits, together with funds generated from operations, principal repayments on securities and loans and borrowed funds, for our investing and lending activities. We invest in mortgage-backed securities, U.S. government obligations, obligations of state and political subdivisions and other securities. Our loan portfolio consists of one-to-four family residential mortgage loans, multi-family and commercial mortgage loans, construction loans, commercial business loans, home equity loans and lines of credit, and other consumer loans. At June 30, 2006, mortgage-backed securities and investment securities comprised 45.7% of our total assets while loans receivable, net, comprised 35.0% of our total assets. At June 30, 2005 mortgage-backed securities and investment securities were 59.9% and loans were 26.5% of our total assets, and at June 30, 2004 these percentages were 64.5% and 26.1%, respectively. It is our intention to continue to increase the balance of our loan portfolio relative to the size of our securities portfolio.

Market Area. We operate from administrative headquarters in Fairfield, New Jersey, and as of June 30, 2006 had 26 branch offices located in Bergen, Hudson, Passaic, Morris, Middlesex, Essex, Union and Ocean Counties, New Jersey. We also consider Monmouth County, New Jersey to be part of our market area. Our lending is concentrated in these nine New Jersey counties, and our predominant sources of deposits are the communities in which our offices are located as well

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as the neighboring communities.

Our primary market area is largely urban and suburban with a broad economic base as is typical within the New York metropolitan area. Service jobs represent the largest employment sector followed by wholesale/retail trade.

Our business of attracting deposits and making loans is primarily conducted within our market area. A downturn in the local economy could reduce the amount of funds available for deposit and the ability of borrowers to repay their loans. As a result, our profitability could decrease.

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

Our competition for deposits and loans historically has come from other insured financial institutions such as local and regional commercial banks, savings institutions, and credit unions located in our primary market area. We also compete with mortgage banking and finance companies for real estate loans and with commercial banks and savings institutions for consumer loans, and we face competition for funds from investment products such as mutual funds, short-term money funds and corporate and government securities. There are large competitors operating throughout our total market area, including Bank of America, Commerce Bank, Wachovia Bank and PNC Bank, and we also face strong competition from other community-based financial institutions.

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### Lending Activities

General. We have traditionally focused on the origination of one-to-four family loans, which comprise a significant majority of our total loan portfolio. Our next largest category of lending is commercial real estate which includes multi-family dwellings, mixed-use properties and other commercial properties. We also offer consumer loans (primarily composed of home equity loans and lines of credit), construction loans (to builders and developers as well as individual homeowners) and commercial business loans, generally secured by real estate.

	At June 30,						
	2006		2005		2004		
	Amount	Percent	Amount	Percent	Amount	Percent	Amo
Type of Loans:							(In t
-----							
Real estate mortgage -							
One-to-four family.....	\$465,822	65.80%	\$382,766	68.04%	\$358,241	70.22%	\$366
Real estate mortgage -							
multi-family and							
commercial.....	107,111	15.13	96,685	17.18	83,426	16.35	71
Commercial business.....	3,208	0.45	2,930	0.52	5,161	1.01	2
Consumer:							

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Home equity loans.....	93,639	13.23	54,199	9.63	37,381	7.33	37
Equity lines of credit.....	12,988	1.83	14,850	2.64	15,677	3.07	19
Passbook or certificate....	2,884	0.41	2,831	0.50	2,746	0.54	2
Other.....	247	0.03	264	0.05	336	0.07	1
Construction.....	22,078	3.12	8,094	1.44	7,212	1.41	11
	-----	-----	-----	-----	-----	-----	-----
Total loans.....	707,977	100.00%	562,619	100.00%	510,180	100.00%	512
	-----	=====	-----	=====	-----	=====	-----
Less:							
Allowance for loan losses..	5,451		5,416		5,144		5
Deferred loan (costs) and fees, net.....	(1,087)		(815)		(758)		(1)
	-----		-----		-----		-----
	4,364		4,601		4,386		3
	-----		-----		-----		-----
Total loans, net.....	\$703,613		\$558,018		\$505,794		\$509
	=====		=====		=====		=====

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Loan Maturity Schedule. The following table sets forth the maturity of our loan portfolio at June 30, 2006. Demand loans, loans having no stated maturity, and overdrafts are shown as due in one year or less. Loans are stated in the following tables at contractual maturity and actual maturities could differ due to prepayments.

At June 30, 2006

	Real estate mortgage - one-to-four family	Real estate mortgage - multi- family and commercial	Commercial business	Home equity loans	Home equity lines of credit	Passbook certifica
	-----	-----	-----	-----	-----	-----
	(In thousands)					
Amounts Due:						
Within 1 Year .....	\$ 155	\$ 135	\$ 3,175	\$ 53	\$ 58	\$ 2,460
	-----	-----	-----	-----	-----	-----
After 1 year:						
1 to 3 years .....	3,269	638	33	4,068	242	414
3 to 5 years .....	12,015	2,491	-	7,248	47	-
5 to 10 years .....	77,974	12,118	-	29,553	2,626	-
10 to 15 years .....	129,230	35,252	-	37,326	9,057	10
Over 15 years .....	243,179	56,477	-	15,391	958	-
	-----	-----	-----	-----	-----	-----
Total due after one year ...	465,667	106,976	33	93,586	12,930	424
	-----	-----	-----	-----	-----	-----
Total amount due .....	\$465,822	\$107,111	\$ 3,208	\$ 93,639	\$ 12,988	\$ 2,884
	=====	=====	=====	=====	=====	=====

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The following table shows the dollar amount of loans as of June 30, 2006 that are due after June 30, 2007 according to rate type and loan category.

	Fixed Rates -----	Floating or Adjustable Rates -----	Total -----
(In thousands)			
Real estate mortgage -			
one-to-four family .....	\$387,701	\$ 77,966	\$465,667
Real estate mortgage -			
multi-family and commercial .....	79,987	26,989	106,976
Commercial business .....	33	-	33
Consumer:			
Home equity loans .....	93,586	-	93,586
Home equity lines of credit .....	2,254	10,676	12,930
Passbook or certificate .....	-	424	424
Other .....	118	3	121
Construction .....	-	6,863	6,863
	-----	-----	-----
Total .....	\$563,679	\$122,921	\$686,600
	=====	=====	=====

One-to-Four Family Mortgage Loans. Our primary lending activity consists of the origination of one-to-four family first mortgage loans, nearly all of which are secured by property located within New Jersey.

We will originate a one-to-four family mortgage loan on an owner occupied property with a principal amount of up to 95% of the lesser of the appraised value or the purchase price of the property, with private mortgage insurance required if the loan to value ratio exceeds 80%. Our loan to value limit on a non-owner occupied property is 75%. Loans in excess of \$750,000 are handled on a case-by-case basis and are subject to lower loan to value limits, generally no more than 50%.

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

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

We offer a first time home buyer program for persons who have not

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previously owned real estate and are purchasing a one-to-four family property in Bergen, Passaic, Morris, Essex, Hudson, Middlesex, Monmouth, Ocean and Union Counties, New Jersey for use as a primary residence. This program is also available outside these areas only to persons who are existing deposit or loan customers of Kearny Federal Savings Bank and/or members of their immediate families. The financial incentives offered under this program are a one-quarter of one percent rate reduction on all first mortgage loan types and the refund of the application fee at closing.

The fixed rate mortgage loans that we originate generally meet the secondary mortgage market standards of the Federal Home Loan Mortgage Corporation. However, as our focus is on growing the size of

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the loan portfolio, we generally do not sell loans in the secondary market and do not currently anticipate that we will commence doing so in any large capacity. There were no residential mortgage loan sales during the last three fiscal years.

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

Multi-family and Commercial Real Estate Mortgage Loans. We also originate mortgage loans on multi-family and commercial real estate properties, including loans on apartment buildings, retail/service properties, and other income-producing properties, such as mixed-use properties combining residential and commercial space.

We generally require no less than a 30% down payment or equity position for mortgage loans on multi-family and commercial real estate properties, and we require personal guarantees on all such loans. Currently, these loans are made with a maturity of up to 20 years. We also offer a five-year balloon loan with a twenty-year amortization schedule. All of our multi-family and commercial real estate mortgage loans are on properties within New Jersey.

Multi-family and commercial real estate mortgage loans generally are considered to entail significantly greater risk than that which is involved with one-to-four family real estate lending. The repayment of these loans typically is dependent on the successful operations and income stream of the borrower and the real estate securing the loan as collateral. These risks can be significantly affected by economic conditions. In addition, multi-family and commercial real estate mortgage loans generally carry larger balances to single borrowers or related groups of borrowers than one-to-four family loans. Multi-family and commercial real estate lending typically requires substantially greater evaluation and oversight efforts compared to residential real estate lending.

Commercial Business Loans. We also originate commercial term loans and lines of credit to a variety of professionals, sole proprietorships and small businesses in our market area. These loans are normally secured by real estate, and we require personal guarantees on all commercial loans. Marketable

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securities may also be accepted as collateral on lines of credit, but with a loan to value limit of 50%. The loan to value limit on secured commercial lines of credit and term loans is otherwise generally limited to 70%. We also make unsecured commercial loans in the form of overdraft checking authorization up to \$25,000 and unsecured lines of credit up to \$25,000.

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

Unlike single-family residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment and other income and which are secured by real property whose value tends to be more easily ascertainable, commercial business loans typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself and the general economic environment. Commercial business loans, therefore, have greater credit risk than residential mortgage loans. In addition, commercial loans generally

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carry larger balances to single borrowers or related groups of borrowers than one-to-four family loans. Commercial lending requires substantially greater evaluation and oversight efforts compared to residential or non-residential real estate lending.

**Home Equity Loans and Lines of Credit.** Our home equity loans are fixed rate loans for terms of generally up to twenty years. We also offer fixed and adjustable rate home equity lines of credit with terms of up to fifteen years. Collateral value is determined through an Automated Valuation Module (AVM), specifically, the Freddie Mac's Home Valuation Explorer (HVE), or property value analysis report (FHLMC Form 704) provided by a state certified or licensed independent appraiser. In some cases, we determine collateral value by a full appraisal performed by a state certified or licensed independent appraiser. Home equity loans and lines of credit do not require title insurance but do require homeowner, liability and fire insurance and, if applicable, flood insurance.

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

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

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

Our underwriting standards for consumer loans include a determination



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

Construction Lending. Our construction lending includes loans to individuals for construction of one-to-four family residences or for major renovations or improvements to an existing dwelling. Our construction lending also includes loans to builders and developers for multi-unit buildings or multi-house projects. All of our construction lending is in New Jersey.

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

We have no formal limits as to the number of projects a builder has under construction or development, and make a case-by-case determination on loans to builders and developers who have multiple projects under development. The Board of Directors reviews the Bank's business relationship with a builder or developer prior to accepting a loan application for processing. We generally do not make construction loans to builders on a speculative basis, without a contract in place. Financing is only provided for up to two houses at

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a time in a multi-house project, requiring a contract on one of the two houses before financing for the next house may be obtained.

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

Loans to One Borrower. Under federal law, savings institutions have, subject to certain exemptions, lending limits to one borrower in an amount equal to the greater of \$500,000 or 15% of the institution's unimpaired capital and surplus. Accordingly, as of June 30, 2006, our loans to one borrower limit was approximately \$55.3 million.

At June 30, 2006, our largest single borrower had an aggregate loan balance of approximately \$9.5 million, representing two mortgage loans secured by commercial real estate. Our second largest single borrower had an aggregate loan balance of approximately \$9.3 million, representing two loans secured by commercial real estate, one commercial line of credit secured by real estate and one residential mortgage loan. Our third largest borrower had an aggregate loan balance of approximately \$9.2 million, representing one loan, a participation in a construction loan secured by commercial real estate. At June 30, 2006, all of these lending relationships were current and performing in accordance with the terms of their loan agreements.

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

	For the Year Ended June 30,		
	2006	2005	2004
	(In thousands)		
Loan originations and purchases:			
Loan originations:			
Real estate mortgage - one-to-four family.....	\$118,371	\$ 86,026	\$ 60,000
Real estate mortgage - multi-family and commercial...	23,444	24,622	20,000
Commercial business.....	708	1,422	1,000
Construction.....	22,638	7,378	1,000
Consumer:			
Home equity loans and lines of credit.....	66,456	39,598	30,000
Passbook or certificate.....	1,578	1,618	1,000
Other.....	412	324	1,000
Total loan originations.....	233,607	160,988	140,000
Loan purchases:			
Real estate mortgage - one-to-four family.....	24,434	1,515	1,000
Real estate mortgage - multi-family and commercial...	-	-	1,000
Total loan purchases.....	24,434	1,515	2,000
Loan principal repayments.....	(113,786)	(111,740)	(150,000)
Increase (decrease) due to other items.....	1,340	1,461	(1,000)
Net increase (decrease) in loan portfolio.....	\$145,595	\$ 52,224	\$ (10,000)

Our customary sources of loan applications include repeat customers, referrals from realtors and other professionals and "walk-in" customers. Our residential loan originations are largely advertising driven.

We primarily originate our own loans and retain them in our portfolio. As part of our loan growth strategy, we generally do not sell loans in the secondary market and do not currently anticipate that we will commence doing so in any large capacity. There were no whole loan sales during the three years ended June 30, 2006. Gross loan originations totaled \$233.6 million for the year ended June 30, 2006 and exceeded principal repayments by approximately \$119.8 million.

In October 2005, the Bank entered into a loan purchase and servicing agreement with Countrywide Home Loans Inc. located in Westlake Village, California. The agreement with Countrywide calls for the purchase of loan pools that contain mortgages on properties in our lending area. All loan pools presented to the Bank must meet the Bank's underwriting requirements as outlined in the purchase and servicing agreement. Countrywide services these mortgages. During the year ended June 30, 2006, a total of \$6.6 million of adjustable rate

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loans and \$12.6 million of fixed rate loans were purchased from Countrywide.

Purchase agreements have also been executed with a limited number of smaller, local mortgage companies in an effort to maintain the Bank's loan production pipeline. These agreements call for the purchase, on a flow basis, of adjustable rate and/or 10 or 15 year fixed rate mortgage loans with servicing released to the Bank. During the year ended June 30, 2006 a total of \$2.4 million adjustable loans and \$2.7 million of fixed rate loans were purchased from these companies.

In addition to purchasing one-to-four family loans, we also occasionally purchase participations in loans originated by other banks and also through the Thrift Institutions Community Investment Corporation of New Jersey ("TICIC"). Our TICIC participations include multi-family and commercial real estate properties.

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The aggregate balance of TICIC participations at June 30, 2006 was \$8.9 million and the average balance on a single participation was approximately \$256,000. At June 30, 2006, we had a total of six non-TICIC participations with an aggregate balance of \$22.7 million, consisting of loans on commercial real estate properties, including a medical center, a self-storage facility, a shopping plaza, commercial buildings with a combination of retail and office space and a construction loan to build townhouses.

Loan Approval Procedures and Authority. Senior management recommends and the Board of Directors approves our lending policies and loan approval limits. Our Senior Vice President and Chief Lending Officer may approve loans up to \$500,000. Loan department personnel of Kearny Federal Savings Bank serving in the following positions may approve loans as follows: mortgage loan managers, mortgage loans up to \$250,000; consumer loan managers, consumer loans up to \$100,000; and consumer loan underwriters, consumer loans up to \$50,000. In addition to these principal amount limits, there are established limits for different levels of approval authority as to minimum credit scores and maximum loan to value ratios and debt ratios. Our President and Chief Executive Officer, Senior Vice President and Chief Financial Officer and Senior Vice President and Treasurer each have authorization to countersign loans for amounts that exceed \$500,000 up to a limit of \$750,000. Our Senior Vice President and Chief Lending Officer must approve loans between \$500,000 and \$750,000 and one member of senior management as outlined above. Non-conforming mortgage loans and loans over \$750,000 require the approval of the Board of Directors.

### Asset Quality

Loan Delinquencies and Collection Procedures. The borrower is notified by both mail and telephone when a loan is thirty days past due. If the delinquency continues, subsequent efforts are made to contact the delinquent borrower and additional collection notices and letters are sent. When a loan is ninety days delinquent, it is our general practice to refer it to an attorney for repossession or foreclosure. All reasonable attempts are made to collect from borrowers prior to referral to an attorney for collection. In certain instances, we may modify the loan or grant a limited moratorium on loan payments to enable the borrower to reorganize his or her financial affairs, and we attempt to work with the borrower to establish a repayment schedule to cure the delinquency.

As to mortgage loans, if a foreclosure action is taken and the loan is not reinstated, paid in full or refinanced, the property is sold at judicial sale at which we may be the buyer if there are no adequate offers to satisfy the

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debt. Any property acquired as the result of foreclosure or by deed in lieu of foreclosure is classified as real estate owned until it is sold or otherwise disposed of. When real estate owned is acquired, it is recorded at the lower of the unpaid principal balance of the related loan or its fair market value less estimated selling costs. The initial writedown of the property is charged to the allowance for loan losses. Adjustments to the carrying value of the properties that result from subsequent declines in value are charged to operations in the period in which the declines occur. At June 30, 2006, we held real estate owned totaling \$109,000, consisting of one parcel of vacant land, currently under a contract of sale.

Loans are reviewed on a regular basis and are placed on non-accrual status when they are more than ninety days delinquent, with the exception of a passbook loan, the outstanding balance of which is collected from the related passbook account along with accrued interest and a penalty when the loan is 120 days delinquent. Loans may be placed on a non-accrual status at any time if, in the opinion of management, the collection of additional interest is doubtful. Interest accrued and unpaid at the time a loan is placed on non-accrual status is charged against interest income. Subsequent payments are either applied to the outstanding principal balance or recorded as interest income, depending on the assessment of the ultimate collectibility of the loan. At June 30, 2006, we had approximately \$942,000 of loans that were held on a non-accrual basis.

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Non-Performing Assets. The following table provides information regarding the Bank's non-performing loans and other non-performing assets. As of each of the dates indicated, we did not have any troubled debt restructurings. At June 30, 2006, the allowance for loan losses totaled \$5.5 million, non-performing loans totaled \$942,000, and the ratio of allowance for loan losses to non-performing loans was 578.7%.

	At June 30		
	2006	2005	2004
	(Dollars in thousand)		
Loans accounted for on a non-accrual basis:			
Real estate mortgage - one-to-four family...	\$ 329	\$ 846	\$ 771
Real estate mortgage - multi-family and commercial.....	592	1,004	1,414
Commercial business.....	-	31	39
Consumer:			
Home equity loans.....	21	20	65
Home equity lines of credit.....	-	17	-
Other.....	-	4	-
Construction.....	-	-	-
Total.....	942	1,922	2,289
Accruing loans which are contractually past due 90 days or more:			
Real estate mortgage - one-to-four family...	-	-	-
Real estate mortgage - multi-family and commercial.....	-	-	-
Commercial business.....	-	-	-
Consumer:			

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Home equity loans and lines of credit.....	-	-	-
Passbook or certificate.....	-	-	39
Other.....	-	-	-
Construction.....	-	-	-
	-----	-----	-----
Total.....	-	-	39
	-----	-----	-----
Total non-performing loans.....	\$ 942	\$ 1,922	\$ 2,328
	=====	=====	=====
Real estate owned.....	\$ 109	\$ 209	\$ 209
	=====	=====	=====
Other non-performing assets.....	\$ -	\$ -	\$ -
	=====	=====	=====
Total non-performing assets.....	\$ 1,051	\$ 2,131	\$ 2,537
	=====	=====	=====
Total non-performing loans to total loans.....	0.13%	0.34%	0.46%
	=====	=====	=====
Total non-performing loans to total assets....	0.05%	0.09%	0.12%
	=====	=====	=====
Total non-performing assets to total assets...	0.05%	0.10%	0.13%
	=====	=====	=====

During the year ended June 30, 2006, gross interest income of \$81,000 would have been recorded on loans accounted for on a non-accrual basis if those loans had been current, and \$9,000 of interest on such loans was included in income for the year ended June 30, 2006.

Classified Assets. Management, in compliance with Office of Thrift Supervision guidelines, has instituted an internal loan review program, whereby non-performing loans are classified as substandard, doubtful or loss. It is our policy to review the loan portfolio, in accordance with regulatory classification procedures, on at least a quarterly basis. When a loan is classified as substandard or doubtful, management is required to evaluate the loan for impairment. When management classifies a portion of a loan as loss, a reserve equal to 100% of the loss amount is required to be established or the loan is to be charged-off.

An asset is considered "substandard" if it is inadequately protected by the paying capacity and net worth of the obligor or the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. Assets classified as "doubtful" have all of the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and

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improbable, on the basis of currently existing facts, conditions, and values. Assets, or portions thereof, classified as "loss" are considered uncollectible and of so little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets which do not currently expose the insured institution to a sufficient degree of risk to warrant classification in one of the aforementioned categories but which have credit deficiencies or potential weaknesses are required to be designated "special mention" by management.

Management's classification of assets is reviewed by the Board on a regular basis and by the regulatory agencies as part of their examination

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process. An independent loan review firm performs a review of our residential and commercial loan portfolios, and we downgrade our classifications to match those of this reviewing firm if there is disagreement between our assessment and the independent assessment. The following table discloses our classification of assets and designation of certain loans as special mention as of June 30, 2006. At June 30, 2006, all of the classified assets and special mention designated assets were loans.

	June 30,		
	2006	2005	2004
	(In thousands)		
Special Mention.....	\$ 236	\$ 3,161	\$ 734
Substandard.....	1,448	2,343	6,264
Doubtful.....	2,001	1,936	1,149
Loss.....	-	6	-
	-----	-----	-----
Total.....	\$ 3,685	\$ 7,446	\$ 8,147
	=====	=====	=====

At June 30, 2006, none of the loans classified as "special mention", approximately \$350,000 classified as "substandard" and approximately \$592,000 classified as "doubtful" are included under non-performing assets, as shown in the table on Page 12.

**Allowance for Loan Losses.** The allowance for loan losses is a valuation account that reflects our estimation of the losses in our loan portfolio to the extent they are both probable and reasonable to estimate. The allowance is maintained through provisions for loan losses that are charged to income in the period they are established. We charge losses on loans against the allowance for loan losses when we believe the collection of loan principal is unlikely. Recoveries on loans previously charged-off are added back to the allowance.

Management, in determining the allowance for loan losses, considers the losses inherent in the loan portfolio and changes in the nature and volume of our loan activities, along with general economic and real estate market conditions. We utilize a two-tier approach: (1) identification of impaired loans and establishment of specific loss allowances on such loans; and (2) establishment of general valuation allowances on the remainder of our loan portfolio by type of loan.

A loan evaluated for impairment is deemed to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Payments received on impaired loans are applied first to interest receivable and then to principal.

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 loan, type of collateral and financial condition of the borrower. Large groups of smaller balance homogeneous loans, such as residential real estate and home equity and consumer loans are

evaluated in the aggregate using historical loss factors and current economic

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conditions. Large balance and/or more complex loans, such as multi-family and commercial real estate loans, are evaluated individually for impairment.

Specific loan loss allowances are established for identified loans based on a review of such information and/or appraisals of the underlying collateral. 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 and management's judgment.

The estimation of the allowance for loan losses is inherently subjective as it requires estimates and assumptions that are susceptible to significant revisions as more information becomes available or as future events change. Future additions to the allowance for loan losses may be necessary if economic and other conditions in the future differ substantially from the current operating environment. In addition, the Office of Thrift Supervision, as an integral part of its examination process, periodically reviews our loan and foreclosed real estate portfolios and the related allowance for loan losses and valuation allowance for foreclosed real estate. The Office of Thrift Supervision may require the allowance for loan losses or the valuation allowance for foreclosed real estate to be increased based on its review of information available at the time of the examination, which would negatively affect our earnings.

The following table sets forth information with respect to the allowance for loan losses at the dates indicated.

	For the Year Ended		
	2006	2005	2004
Allowance balance (at beginning of period).....	\$ 5,416	\$ 5,144	\$ 5,180
Provision for loan losses.....	72	68	-
Charge-offs:			
Real estate mortgage - one-to-four family.....	-	-	12
Commercial business.....	30	5	24
Other.....	12	4	-
Total charge-offs.....	42	9	36
Recoveries:			
Real estate mortgage - one-to-four family.....	-	213	-
Commercial business.....	5	-	-
Total recoveries.....	5	213	-
Net (charge-offs) recoveries.....	(37)	204	(36)
Allowance balance (at end of period).....	\$ 5,451	\$ 5,416	\$ 5,144
Total loans outstanding.....	\$ 707,977	\$ 562,619	\$ 510,180
Average loans outstanding.....	\$ 628,245	\$ 517,746	\$ 499,510
Allowance for loan losses as a percent of total loans outstanding.....	0.77%	0.96%	1.01%
Net loans charged off as a percent			

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of average loans outstanding.....	0.01%	0.00%	0.01%
	=====	=====	=====
Allowance for loan losses to non-performing loans.....	578.66%	281.79%	220.96%
	=====	=====	=====

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

	At June 30,						
	2006		2005		2004		2003
	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount
	(Dollars in thousands)						
At end of period allocated to:							
Real estate mortgage - one-to-four family....	\$1,582	65.80%	\$1,514	68.04%	\$1,422	70.22%	\$1,980
Real estate mortgage - multi-family and commercial.....	3,133	15.13	3,368	17.18	3,358	16.35	2,198
Commercial business.....	34	0.45	50	0.52	57	1.01	59
Consumer:							
Home equity loans.....	286	13.23	182	9.63	131	7.33	214
Home equity lines of credit.....	39	1.83	47	2.64	52	3.07	218
Passbook or certificate.....	-	0.41	-	0.50	-	0.54	-
Other.....	27	0.03	120	0.05	4	0.07	10
Construction.....	350	3.12	135	1.44	120	1.41	501
Total allowance.....	\$5,451	100.00%	\$5,416	100.00%	\$5,144	100.00%	\$5,180
	=====	=====	=====	=====	=====	=====	=====

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Securities Portfolio

General. Our deposits have traditionally exceeded our loan originations, and we have invested these deposits primarily in mortgage-backed securities and investment securities. Our mortgage-backed securities and investment securities comprised 45.7% of our total assets at June 30, 2006. We intend to increase the balance of our loan portfolio relative to the size of our securities portfolio, however, such a change will take time and in the near



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future, our assets will continue to be primarily in securities.

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

All of our securities carry market risk insofar as increases in market rates of interest may cause a decrease in their market value. Investments in securities are made based on certain considerations, which include the interest rate, tax considerations, volatility, yield, settlement date and maturity of the security, our liquidity position, and anticipated cash needs and sources. The effect that the proposed security would have on our credit and interest rate risk and risk-based capital is also considered.

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

Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities," requires that securities be categorized as "held to maturity," "trading securities" or "available for sale," based on management's intent as to the ultimate disposition of each security. Statement No. 115 allows debt securities to be classified as "held to maturity" and reported in financial statements at amortized cost only if the reporting entity has the positive intent and ability to hold these securities to maturity. Securities that might be sold in response to changes in market interest rates, changes in the security's prepayment risk, increases in loan demand, or other similar factors cannot be classified as "held to maturity."

We do not currently use or maintain a trading account. Securities not classified as "held to maturity" are classified as "available for sale." These securities are reported at fair value, and unrealized gains and losses on the securities are excluded from earnings and reported, net of deferred taxes, as a separate component of equity.

At June 30, 2006, our mortgage-backed securities portfolio included securities issued by the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association,

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and our investment securities portfolio included U.S. government obligations and obligations of states and political subdivisions.

In the fiscal year ended June 30, 2005, we sold 120,000 shares of Freddie Mac common stock, representing 48% of our investment in Freddie Mac common stock at that time, which resulted in a pre-tax gain of \$7.6 million. During the year ended June 30, 2006, we sold the rest of our Freddie Mac investment, 131,088 shares, and sold \$249.1 million of government agency notes with an average yield of 3.22%. This sale included our entire portfolio of government agency notes. The loss on the sale of the government agency notes partially offset the gain on the remainder of our Freddie Mac shares and mutual fund shares issued by Dryden Government Income Fund, Inc. The net pre-tax gain on the fiscal 2006 securities sales was approximately \$1.0 million. We have now sold all of our Freddie Mac stock and at June 30, 2006, we had no government agency notes remaining in our securities portfolio.

At June 30, 2006, we also held the following securities: mutual fund shares issued by AMF Adjustable Mortgage Rate Fund with an aggregate carrying value of \$7.4 million; and trust preferred securities with an aggregate carrying value of \$10.9 million. Currently, our policy does not permit new investments in corporate equity securities beyond what we currently hold, and we do not invest in mortgage-related securities of private corporate issuers, only those issued by U.S. government agencies or government-sponsored entities.

At June 30, 2006, our securities portfolio contained mortgage-backed securities issued by the Federal Home Loan Mortgage Corporation with an aggregate book value in excess of 10% of our equity. The aggregate book value at June 30, 2006 of mortgage-backed securities in our portfolio issued by the Federal National Mortgage Association also exceeded 10% of our equity. The aggregate book value and aggregate market value for mortgage-backed securities issued by the Federal Home Loan Mortgage Corporation that we held at June 30, 2006 totaled \$264.7 million and \$256.0 million, respectively. The aggregate book value and aggregate market value for mortgage-backed securities issued by the Federal National Mortgage Association that we held at June 30, 2006 totaled \$382.9 million and \$371.6 million, respectively. At June 30, 2006, management classified all mortgage-backed securities issued by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association as held to maturity. Other than mortgage-backed securities issued by the U.S. government or its agencies, at June 30, 2006 we did not hold securities of any other issuer having an aggregate book value in excess of 10% of our equity.

We do not currently participate in hedging programs, interest rate caps, floors or swaps, or other activities involving the use of off-balance sheet derivative financial instruments. Further, we do not purchase securities, which are not rated investment grade.

Actual maturities of the securities held by us may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without prepayment penalties. At June 30, 2006, the aggregate book value and aggregate market value of callable securities in our portfolio totaled \$138.4 million and \$136.2 million, respectively.

Mortgage-backed Securities. We only invest in mortgage-backed securities issued by U.S. government agencies or government-sponsored entities, such as Government National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association. Mortgage-backed securities are pass-through securities typically issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans

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with interest rates that are within a specific range and have varying maturities. The life of a mortgage-backed security thus approximates the life of the underlying mortgages. Mortgage originators use intermediaries (generally government agencies and government-sponsored enterprises, but also a variety of private corporate issuers) to pool and repackage the participation interests in the form of securities, with investors such as us receiving the principal and interest payments on the mortgages. The characteristics of the underlying pool of mortgages, i.e., fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the certificate holder. Mortgage-backed securities are generally referred to as mortgage participation certificates or pass-through certificates.

We do not currently invest in mortgage-backed securities of private issuers or collateralized mortgage obligations. Mortgage-backed securities issued or sponsored by U.S. government agencies and government-sponsored entities are guaranteed as to the payment of principal and interest to investors. Mortgage-backed securities generally yield less than the mortgage loans underlying such securities because of their payment guarantees or credit enhancements, which offer nominal credit risk to the security holder.

The following table sets forth the carrying value of our securities portfolio at the dates indicated.

	At June 30,		
	2006	2005	2004
	(In thousands)		
<b>Securities Available for Sale:</b>			
<hr style="border-top: 1px dashed black;"/>			
Mutual funds.....	\$ 7,424	\$ 14,140	\$ 13,899
Common stock.....	-	8,551	15,894
Trust preferred securities due after ten years.....	10,922	10,900	11,771
Total securities available for sale..	18,346	33,591	41,564
 <b>Investment Securities Held to Maturity:</b>			
<hr style="border-top: 1px dashed black;"/>			
U.S. government obligations.....	8,736	265,469	274,401
Obligations of states and political subdivisions.....	200,312	204,629	161,469
Total investment securities held to maturity.....	209,048	470,098	435,870
 <b>Mortgage-Backed Securities Held to Maturity:</b>			
<hr style="border-top: 1px dashed black;"/>			
Government National Mortgage Association.....	42,323	63,399	94,499
Federal Home Loan Mortgage Corporation.....	264,747	305,059	314,221
Federal National Mortgage Association.....	382,892	389,663	362,633
Collateralized mortgage obligations issued by U.S. government agencies.....	-	-	-
Other.....	-	-	-
Total mortgage-backed securities held to maturity.....	689,962	758,121	771,353

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Total.....	\$ 917,356	\$ 1,261,810	\$ 1,248,787	\$
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The following table sets forth certain information regarding the carrying values, weighted average yields and maturities of our securities portfolio at June 30, 2006. This table shows contractual maturities and does not reflect repricing or the effect of prepayments. Actual maturities may differ.

	At June 30, 2006							
	One Year or Less		One to Five Years		Five to Ten Years		More than Ten Years	
	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield
	(Dollars in thousands)							
Mutual funds.....	\$ 7,424	4.60%	\$ -	-%	\$ -	-%	\$ -	-
Common stock.....	-	-	-	-	-	-	-	-
Trust preferred securities								
due after ten years.....	-	-	-	-	-	-	10,922	
U.S. government obligations....	-	-	-	-	963	8.30	7,773	
Obligations of states and political subdivisions.....	4,339	3.64	17,194	3.22	120,775	3.80	58,004	
Government National Mortgage Association.....	87	7.54	461	8.97	482	11.08	41,293	
Federal Home Loan Mortgage Corporation.....	5	8.71	1,876	4.25	1,115	3.79	261,751	
Federal National Mortgage Association.....	-	-	6,076	5.55	10,687	5.58	366,129	
Total.....	\$11,855	4.27%	\$25,607	3.95%	\$134,022	4.00%	\$745,872	

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Sources of Funds

General. Deposits are our major source of funds for lending and other investment purposes. In addition, we derive funds from loan and mortgage-backed securities principal repayments, and proceeds from the maturity and call of investment securities. Loan and securities payments are a relatively stable source of funds, while deposit inflows are significantly influenced by general interest rates and money market conditions. Borrowings (principally from the Federal Home Loan Bank) are also used to supplement the amount of funds for lending and investment.

Deposits. Our current deposit products include checking and savings accounts, certificates of deposit accounts ranging in terms from thirty days to five years, and individual retirement accounts. Deposit account terms vary,

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primarily as to the required minimum balance amount, the amount of time that the funds must remain on deposit and the applicable interest rate.

Deposits are obtained primarily from within New Jersey. Traditional methods of advertising are used to attract new customers and deposits, including radio, print media, direct mail and inserts included with customer statements. We do not utilize the services of deposit brokers. Premiums or incentives for opening accounts are sometimes offered. We periodically select particular certificate of deposit maturities for promotion, with terms of five, nine and 13 months being the most popular. We may also offer a twenty-five basis point premium on certificate accounts with a term of at least one year to certificate of deposit account holders that have \$200,000 or more on deposit with Kearny Federal Savings Bank. We also offer the opportunity one time during the term of the certificate to "bump up" the rate paid on all 17-month and 29-month certificates of deposit from the rate set on such certificate to the current rate being offering by Kearny Federal Savings Bank on certificates of that particular maturity.

The determination of interest rates is based upon a number of factors, including: (1) our need for funds based on loan demand, current maturities of deposits and other cash flow needs; (2) a current survey of a selected group of competitors' rates for similar products; (3) our current cost of funds, yield on assets and asset/liability position; and (4) the alternate cost of funds on a wholesale basis, in particular the cost of advances from the Federal Home Loan Bank. Interest rates are reviewed by senior management on a weekly basis and rates are set generally with the intent to be in the top five to ten percent of the competition.

A large percentage of our deposits are in certificates of deposit, which represented 61.2% of total deposits at June 30, 2006. Our liquidity could be reduced if a significant amount of certificates of deposit maturing within a short period of time were not renewed. Historically, a significant portion of the certificates of deposit remain with us after they mature and we believe that this will continue. At June 30, 2006, \$206.0 million, or 23.3%, of our certificates of deposit were "jumbo" certificates of \$100,000 or more. Deposit inflows are significantly influenced by general interest rates and money market conditions. The inflow of jumbo certificates of deposit and the retention of such deposits upon maturity are particularly sensitive to general interest rates and money market conditions, making jumbo certificates of deposit traditionally a more volatile source of funding than core deposits. In order to retain jumbo certificates of deposit, we may have to pay a premium rate, resulting in an increase in our cost of funds. In a rising rate environment, we may be unwilling or unable to pay a competitive rate. To the extent that such deposits do not remain with us, they may need to be replaced with borrowings, which could increase our cost of funds and negatively impact our interest rate spread and our financial condition.

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

For the Year Ended June 30,	
2006	2005
Weighted	Weighted

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	Amount	Percent of Total Deposits	Average Nominal Rate	Amount	Percent of Total Deposits	Average Nominal Rate
	-----	-----	----	-----	-----	----
(Dollars in thousands)						
Non-interest-bearing demand.....	\$ 56,517	3.82%	0.00%	\$ 55,112	3.52%	0.00%
Interest-bearing demand.....	103,397	7.00	0.90	105,503	6.73	0.71
Savings and club.....	429,019	29.03	1.18	533,131	34.01	1.02
Certificates of deposit.....	888,810	60.15	3.27	873,907	55.74	2.33
	-----	-----	----	-----	-----	----
Total deposits.....	\$1,477,743	100.00%	2.37%	\$1,567,653	100.00%	1.69%
	=====	=====	----	=====	=====	----

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

	At June 30,		
	2006	2005	2004
	-----	-----	-----
	(In thousands)		
Interest Rate			
0.00-1.99%.....	\$ 24,638	\$ 189,266	\$ 582,665
2.00-2.99%.....	46,588	343,916	173,505
3.00-3.99%.....	496,755	349,320	100,138
4.00-4.99%.....	162,070	32,750	25,956
5.00-5.99%.....	153,047	7,223	11,957
6.00-6.99%.....	-	641	2,716
7.00-7.99%.....	-	-	82
	-----	-----	-----
Total.....	\$ 883,098	\$ 923,116	\$ 897,019
	=====	=====	=====

The following table sets forth the amount and maturities of certificates of deposit at June 30, 2006.

	Amount Due				
	Within 1 year	1-2 years	2-3 years	3-4 years	4-5 years
	-----	-----	-----	-----	-----
	(In thousands)				
Interest Rate					
0.00-1.99%.....	\$ 24,637	\$ 1	\$ -	\$ -	\$ -
2.00-2.99%.....	46,314	270	4	-	-
3.00-3.99%.....	403,661	72,588	18,781	1,724	-
4.00-4.99%.....	101,368	35,941	1,696	16,151	6,826
5.00-5.99%.....	82,238	70,809	-	-	-
6.00-6.99%.....	-	-	-	-	-
7.00-7.99%.....	-	-	-	-	-
	-----	-----	-----	-----	-----

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Total.....	\$ 658,218	\$ 179,609	\$ 20,481	\$ 17,875	\$ 6,826
	=====	=====	=====	=====	=====

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

	At June 30, 2006
	-----
	(In thousands)
Maturity Period	
Within three months.....	\$ 44,553
Three through six months.....	31,125
Six through twelve months.....	73,269
Over twelve months.....	57,008
	-----
	\$ 205,955

Borrowings. To supplement our deposits as a source of funds for lending or investment, we borrow funds in the form of advances from the Federal Home Loan Bank. We make use of Federal Home Loan Bank advances as part of our interest rate risk management, primarily to extend the duration of funding to match the longer-term fixed rate loans held in the loan portfolio as part of our growth strategy.

Advances from the Federal Home Loan Bank are typically secured by the Federal Home Loan Bank stock we own and a portion of our residential mortgage loans and may be secured by other assets, mainly securities, which are obligations of or guaranteed by the U.S. government. Additional information regarding our Federal Home Loan Bank advances is included under Note 12 to consolidated financial statements.

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Short-term Federal Home Loan Bank advances generally have original maturities of less than one year. The details of these short-term advances are presented below for the dates and periods indicated.

	At or For the Year Ended June 30,		
	-----	-----	-----
	2006	2005	2004
	----	----	----
	(Dollars in thousands)		
Federal Home Loan Bank Advances:			
Average balance outstanding.....	\$ 3,958	\$17,805	\$ 1,151
Maximum amount outstanding at any month-end during the period.....	28,000	20,000	30,000
Balance outstanding at end of period.....	-	-	30,000
Weighted average interest rate during the period.....	4.48%	2.24%	1.43%
Weighted average interest rate at end of period.....	-%	-%	1.43%

At June 30, 2006, long-term Federal Home Loan Bank advances totaled

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\$61.1 million. Advances consist of fixed-rate advances that will mature within one to seven years. The advances are collateralized by Federal Home Loan Bank stock and certain first mortgage loans and mortgage-backed securities. These advances had a weighted average interest rate of 5.46% at June 30, 2006. Unused overnight lines of credit at the Federal Home Loan Bank at June 30, 2006 were \$200.0 million.

As of June 30, 2006, long-term advances mature as follows:

Twelve Months Ending June 30, -----	(In thousands)
2007.....	\$ 5,618
2008.....	37,487
2009.....	8,000
2010.....	-
2011.....	10,000
Thereafter.....	-
	-----
Total.....	\$ 61,105
	=====

### Subsidiary Activity

Kearny Financial Corp. has two wholly owned subsidiaries: Kearny Federal Savings Bank and Kearny Financial Securities, Inc. Kearny Financial Securities, Inc., was organized in April 2005 under Delaware law as a Delaware investment company primarily to hold investment and mortgage-backed securities. Kearny Financial Securities, Inc. is currently inactive.

Kearny Federal Savings Bank has two wholly owned subsidiaries: KFS Financial Services, Inc. and Kearny Federal Investment Corp. KFS Financial Services, Inc. was incorporated as a New Jersey corporation in 1994 under the name of South Bergen Financial Services, Inc., was acquired in Kearny's merger with South Bergen Savings Bank in 1999 and was renamed KFS Financial Services, Inc. in 2000. It is a service corporation subsidiary organized for the purpose of selling insurance products, including annuities, to bank customers and the general public through a third party networking arrangement. KFS Financial Services, Inc. is not a licensed insurance agency, and it may only offer insurance products through an agreement with a licensed insurance agency. KFS Financial Services, Inc. has entered into an agreement with Savings Bank Life Insurance of Massachusetts, a licensed insurance agency, through which it offers insurance products.

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Kearny Federal Investment Corp. was organized in June 2004 under New Jersey law as a New Jersey investment company primarily to hold investment securities. At June 30, 2006, it held assets totaling \$563.2 million.

### Personnel

As of June 30, 2006, we had 268 full-time employees and 19 part-time employees. The employees are not represented by a collective bargaining unit. We believe our relationship with our employees is good.

### Regulation

The Bank and the Company operate in a highly regulated industry. This regulation establishes a comprehensive framework of activities in which a savings and loan holding company and federal savings bank may engage and is



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intended primarily for the protection of the deposit insurance fund and depositors. Set forth below is a brief description of certain laws that relate to the regulation of the Bank and the Company. The description does not purport to be complete and is qualified in its entirety by reference to applicable laws and regulations.

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

### Regulation of the Bank

General. As a federally chartered, Federal Deposit Insurance Corporation-insured savings bank, the Bank is subject to extensive regulation by the Office of Thrift Supervision and the Federal Deposit Insurance Corporation. This regulatory structure gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies regarding the classification of assets and the level of the allowance for loan losses. The activities of federal savings banks are subject to extensive regulation including restrictions or requirements with respect to loans to one borrower, the percentage of non-mortgage loans or investments to total assets, capital distributions, permissible investments and lending activities, liquidity, transactions with affiliates and community reinvestment. Federal savings banks are also subject to reserve requirements imposed by the Federal Reserve System. A federal savings bank's relationship with its depositors and borrowers is regulated by both state and federal law, especially in such matters as the ownership of savings accounts and the form and content of the bank's mortgage documents.

The Bank must file reports with the Office of Thrift Supervision concerning its activities and financial condition, and must obtain regulatory approvals prior to entering into certain transactions such as mergers with or acquisitions of other financial institutions. The Office of Thrift Supervision regularly examines the Bank and prepares reports to the Bank's Board of Directors on deficiencies, if any, found in its operations. The Office of Thrift Supervision has substantial discretion to impose enforcement action on an institution that fails to comply with applicable regulatory requirements, particularly with respect to its capital requirements. In addition, the Federal Deposit Insurance Corporation has the authority to recommend to the Director of the Office of Thrift Supervision that enforcement action be taken with respect to a particular federally chartered

savings bank and, if action is not taken by the Director, the Federal Deposit Insurance Corporation has authority to take such action under certain circumstances.

Insurance of Deposit Accounts. Deposit accounts in Kearny Federal Savings Bank are insured by the Deposit Insurance Fund of the Federal Deposit

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Insurance Corporation, generally up to a maximum of \$100,000 for standard accounts and \$250,000 for individual retirement accounts. The Federal Deposit Insurance Corporation maintains a risk-based deposit insurance assessment system by which institutions are assigned to one of three categories based on their capitalization and one of three subcategories based on examination ratings and other supervisory information. An institution's assessment rate depends upon the categories to which it is assigned. Assessment rates for Savings Association Insurance Fund member institutions are determined semi-annually by the Federal Deposit Insurance Corporation and currently range from zero basis points of assessable deposits for the healthiest institutions to 27 basis points of assessable deposits for the riskiest. The assessment rate for Kearny Federal Savings Bank is currently 0%.

In addition to assessments for deposit insurance, all Federal Deposit Insurance Corporation-insured institutions are required to pay assessments to the Federal Deposit Insurance Corporation to fund payments on bonds issued in the late 1980s by a federal agency to recapitalize the predecessor to the Savings Association Insurance Fund. These assessments will continue until the Financing Corporation bonds mature in 2017.

The Federal Deposit Insurance Corporation may terminate an institution's deposit insurance upon a finding that the 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 or the Office of Thrift Supervision.

Federal Deposit Insurance Reform. As a result of the Federal Deposit Insurance Reform Act of 2005, the Bank Insurance Fund and the Savings Association Insurance Fund have been merged into a new combined fund, called the Deposit Insurance Fund. The Federal Deposit Insurance Reform Act also (i) increases deposit insurance coverage for retirement accounts to \$250,000, (ii) indexes the current \$100,000 insurance coverage limit for standard accounts and the new \$250,000 limit for retirement accounts to reflect inflation (with adjustments for inflation every five years, commencing January 1, 2011), (iii) requires the Federal Deposit Insurance Corporation to assess annual deposit insurance premiums on all banks and savings institutions, (iv) gives a one-time insurance assessment credit totaling \$4.7 billion to banks and savings institutions in existence on December 31, 1996 that can be used to offset premiums otherwise due, (v) imposes a cap on the level of the Deposit Insurance Fund and provide for dividends or rebates when the fund grows beyond a specified threshold, (vi) adopts a historical basis concept for distributing the aforementioned one-time credit and dividends (with each institution's historical basis to be determined by a formula that looks back to the institution's assessment base in 1996 and adds premiums paid since that time) and (vii) authorizes revisions to the current risk-based system for assessing premiums, including replacing the current fixed reserve ratio requirement of 1.25% with a range of between 1.15% and 1.5% of insured deposits.

The merger of the two deposit insurance funds required by the Federal Deposit Insurance Reform Act was effective as of March 31, 2006. The Federal Deposit Insurance Corporation is required to adopt final rules for the rest of the provisions no later than 270 days after enactment. Such regulations will result in the imposition of deposit insurance assessments on all members of the Deposit Insurance Fund, including Kearny Federal Savings Bank, and such assessments could have an adverse effect on operating expenses and results of operations. Management cannot predict, however, the rate of any such insurance assessments or the effect of the assessments on operations.

Regulatory Capital Requirements. Office of Thrift Supervision capital regulations require savings institutions to meet three minimum capital standards: (1) tangible capital equal to 1.5% of total adjusted assets,

(2) "Tier 1" or "core" capital equal to at least 4% (3% if the institution has received the highest possible rating on its most recent examination) of total adjusted assets, and (3) risk-based capital equal to 8% of total risk-weighted assets. For information on the Bank's compliance with these regulatory capital standards, see Note 14 to consolidated financial statements. In assessing an institution's capital adequacy, the Office of Thrift Supervision takes into consideration not only these numeric factors but also qualitative factors as well, and has the authority to establish higher capital requirements for individual institutions where necessary.

In addition, the Office of Thrift Supervision may require that a savings institution that has a risk-based capital ratio of less than 8%, a ratio of Tier 1 capital to risk-weighted assets of less than 4% or a ratio of Tier 1 capital to total adjusted assets of less than 4% (3% if the institution has received the highest rating on its most recent examination) take certain action to increase its capital ratios. If the savings institution's capital is significantly below the minimum required levels of capital or if it is unsuccessful in increasing its capital ratios, the Office of Thrift Supervision may restrict its activities.

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

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

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

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to 100% for delinquent loans, property acquired through foreclosure, commercial loans, and certain other assets.

The Federal Deposit Insurance Corporation Improvement Act, or FDICIA, requires that the Office of Thrift Supervision and other federal banking agencies revise their risk-based capital standards, with appropriate transition rules, to ensure that they take into account interest rate risk, or IRR, concentration of risk and the risks of non-traditional activities. The Office of Thrift Supervision adopted regulations, effective January 1, 1994, that set forth the methodology for calculating an IRR component to be incorporated into the Office of Thrift Supervision risk-based capital regulations. On May 10, 2002, the Office of Thrift Supervision adopted an amendment to its capital regulations which eliminated the IRR component of the risk-based capital requirement. Pursuant to the amendment, the Office of Thrift Supervision will continue to monitor the IRR of

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individual institutions through the Office of Thrift Supervision requirements for IRR management, the ability of the Office of Thrift Supervision to impose individual minimum capital requirements on institutions that exhibit a high degree of IRR, and the requirements of Thrift Bulletin 13a, which provides guidance on the management of IRR and the responsibility of boards of directors in that area.

The Office of Thrift Supervision continues to monitor the IRR of individual institutions through analysis of the change in net portfolio value, or NPV. NPV is defined as the net present value of the expected future cash flows of an entity's assets and liabilities and, therefore, hypothetically represents the value of an institution's net worth. The Office of Thrift Supervision has also used this NPV analysis as part of its evaluation of certain applications or notices submitted by thrift institutions. The Office of Thrift Supervision, through its general oversight of the safety and soundness of savings associations, retains the right to impose minimum capital requirements on individual institutions to the extent the institution is not in compliance with certain written guidelines established by the Office of Thrift Supervision regarding NPV analysis.

**Dividend and Other Capital Distribution Limitations.** The Office of Thrift Supervision imposes various restrictions or requirements on the ability of savings institutions to make capital distributions, including cash dividends.

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

The Office of Thrift Supervision may disapprove a notice or deny an application for a capital distribution if: (i) the savings institution would be undercapitalized following the capital distribution; (ii) the proposed capital distribution raises safety and soundness concerns; or (iii) the capital

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distribution would violate a prohibition contained in any statute, regulation or agreement.

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

A savings bank that fails the qualified thrift lender test and does not convert to a bank charter generally will be prohibited from: (1) engaging in any new activity not permissible for a national bank, (2) paying dividends not permissible under national bank regulations, and (3) establishing any new branch office in a location not permissible for a national bank in the institution's home state. In addition, if the institution does

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not requalify under the qualified thrift lender test within three years after failing the test, the institution would be prohibited from engaging in any activity not permissible for a national bank and would have to repay any outstanding advances from the Federal Home Loan Bank as promptly as possible.

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

Federal Home Loan Bank System. The Bank is a member of the Federal Home Loan Bank of New York, which is one of twelve regional Federal Home Loan Banks. Each Federal Home Loan Bank serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by financial institutions and proceeds derived from the sale of consolidated

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obligations of the Federal Home Loan Bank System. It makes loans to members pursuant to policies and procedures established by the board of directors of the Federal Home Loan Bank.

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

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

Federal Reserve System. The Federal Reserve System requires all depository institutions to maintain non-interest-bearing reserves at specified levels against their checking accounts and non-personal certificate accounts.

Savings institutions have authority to borrow from the Federal Reserve System "discount window," but Federal Reserve System policy generally requires savings institutions to exhaust all other sources before borrowing from the Federal Reserve System.

The USA Patriot Act. The Bank is subject to Office of Thrift Supervision regulations implementing the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, or the USA Patriot Act. The USA Patriot Act gives the federal government powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. By way of amendments to

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the Bank Secrecy Act, Title III of the USA Patriot Act takes measures intended to encourage information sharing among bank regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative obligations on a broad range of financial institutions, including banks, thrifts, brokers, dealers, credit unions, money transfer agents and parties registered under the Commodity Exchange Act.

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

- o Establishment of anti-money laundering programs that include, at minimum: (i) internal policies, procedures, and controls; (ii) specific designation of an anti-money laundering compliance officer; (iii) ongoing employee training programs; and (iv) an independent audit function to test the anti-money laundering program.
- o Establishment of a program specifying procedures for obtaining

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identifying information from customers seeking to open new accounts, including verifying the identity of customers within a reasonable period of time.

- o Establishment of appropriate, specific, and, where necessary, enhanced due diligence policies, procedures, and controls designed to detect and report money laundering.
- o Prohibitions on establishing, maintaining, administering or managing correspondent accounts for foreign shell banks (foreign banks that do not have a physical presence in any country), and compliance with certain record keeping obligations with respect to correspondent accounts of foreign banks.

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

### Regulation of the Company

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

Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 implemented various legislative reforms addressing, among other matters, corporate governance, auditing and accounting. As directed by Section 302(a) of Sarbanes-Oxley Act and the implementing rules of the Securities and Exchange Commission, the Company's Chief Executive Officer and Chief Financial Officer each are required to certify that the quarterly and annual reports do not contain any untrue statement of a material fact. The rules have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of the Company's internal controls; they have made certain disclosures to the Company's auditors and the audit committee of the Board of Directors about internal controls; and they have included information in the quarterly and annual reports about their evaluation and whether there have been significant changes in the internal controls or in other factors that could significantly affect internal controls. The Company is subject to other additional reporting and audit requirements as a result of the Sarbanes-Oxley Act.

Activities Restrictions. As a savings and loan holding company and as a subsidiary holding company of a mutual holding company, the Company is subject to statutory and regulatory restrictions on its business activities. The non-banking activities of the Company and its non-savings institution subsidiaries are restricted to certain activities specified by Office of Thrift Supervision regulation, which include performing services and holding properties used by a savings institution subsidiary, activities authorized for savings and loan holding companies as of March 5, 1987, and non-banking activities

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permissible for bank holding companies pursuant to the Bank Holding Company Act of 1956 or authorized for financial holding companies pursuant to the Gramm-Leach-Bliley Act. Before engaging in any non-banking activity or acquiring a company engaged in any such activities, the Company must file with the Office of Thrift Supervision either a prior notice or (in the case of non-banking activities permissible for bank holding companies) an application regarding its planned activity or acquisition.

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

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

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

**Acquisition of Control.** Under the federal Change in Bank Control Act, a notice must be submitted to the Office of Thrift Supervision if any person (including a company), or group acting in concert, seeks to acquire "control" of a savings and loan holding company or savings association. An acquisition of "control"



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can occur upon the acquisition of 10% or more of the voting stock of a savings and loan holding company or savings institution or as otherwise defined by the Office of Thrift Supervision. Under the Change in Bank Control Act, the Office of Thrift Supervision has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the anti-trust effects of the acquisition. Any company that so acquires control would then be subject to regulation as a savings and loan holding company.

### Item 1A. Risk Factors

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An increase in interest rates may have an adverse effect on our earnings.

Our earnings largely depend on our net interest income, measured as the difference between:

- o the interest income we earn on our interest-earning assets, such as loans and securities; and
- o the interest expense we pay on our interest-bearing liabilities, such as deposits and amounts we borrow.

Generally, the rates we earn on our assets remain fixed for a contractual period. We, like many community banks have liabilities that generally have shorter contractual maturities than our interest-earning assets or no contractual maturities, such as savings and money market deposits. This imbalance can create significant earnings volatility, because market interest rates change over time. In addition, short-term and long-term interest rates do not necessarily change at the same time or at the same rate.

In a period of rising interest rates, the interest income earned on our assets may not increase as rapidly as the interest paid on our liabilities. We are vulnerable to volatility in our earnings resulting from an increase in interest rates because the majority of our interest-earning assets are relatively long-term, fixed rate assets. In an increasing rate environment, we can expect our cost of funds to increase more rapidly than the yields earned on our loan portfolio and securities portfolio because our primary source of funds is deposits with generally shorter maturities than the maturities on our loans and investment securities. The result may be a narrowing of our net interest spread and a decrease in our earnings.

In a period of falling interest rates, prepayments of loans and mortgage-backed securities generally increase as borrowers refinance their debt in order to reduce their borrowing cost. This causes prepayment risk, because in a falling interest rate environment we cannot reinvest prepayments at rates comparable to the rates earned on the prepaid loans or securities. A falling interest rate environment results in a decrease in rates we pay on deposits and borrowings, but the decrease in the cost of our funds may not be as great as the decrease in the yields on our mortgage-backed securities and loan portfolio. The result may be a narrowing of our net interest spread and decrease in our earnings.

We face further exposure to interest rate risk due to the large portion of our total deposits that are certificates of deposit, particularly "jumbo" certificates of \$100,000 or more. Interest rates and money market conditions significantly influence deposit inflows, but the presence of jumbo certificates of deposit and retention of such deposits upon maturity, make them a more volatile source of funding than core deposits. In order to retain jumbo certificates, we may pay a premium rate, resulting in an increase in our cost of funds. If we are unwilling or unable to pay a premium rate, to the extent that

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such funds do not remain on deposit, borrowings may replace them, which could increase our cost of funds, narrow our net interest spread and decrease our earnings.

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

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

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

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

Due to our minority stock offering, our return on equity compares unfavorably to other companies. This could negatively influence the price of our stock.

The net proceeds from our initial public offering in February 2005 substantially increased our equity capital. We expect to take time to invest this capital prudently. As a result, our return on equity, which is the ratio of earnings divided by average equity capital is lower than that of many similar companies. To the extent that the stock market values a company based in part on its return on equity, our low return on equity relative to our peer group could negatively affect the trading price of our common stock.

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

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

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The Company utilized open market purchases of common stock to fund restricted stock awards; however, funding of stock options granted will come either through open market purchases or from the issuance of authorized but un-issued shares. Existing shareholders will experience a dilution in ownership interest in the event the Company uses newly issued shares rather than open market purchases to fund stock options.

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

Kearny MHC owns a majority of Kearny Financial Corp.'s common stock. The Board of Directors of Kearny MHC is also the Board of Directors of Kearny Financial Corp. and is able to exercise voting control

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over most matters put to a vote of shareholders. For example, Kearny MHC may exercise its voting control to prevent a sale or merger transaction in which stockholders could receive a premium for their shares, to elect directors or to approve employee benefit plans.

Provisions in our charter and by-laws limit the rights of stockholders, may deter potential takeovers and may reduce the trading price of our stock.

Provisions in our charter and by-laws make it difficult and expensive to pursue a change in control or takeover attempt that our Board of Directors opposes. As a result, you may not have an opportunity to participate in such a transaction, and the trading price of our stock may not rise to the level of other institutions that are more vulnerable to hostile takeovers. Such provisions include:

- o the election of directors to staggered three-year terms;
- o provisions restricting the calling of special meetings of stockholders;
- o the absence of cumulative voting by stockholders in elections of directors; and
- o advance notice requirements for stockholder nominations and new business.

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

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

Item 1B. Unresolved Staff Comments

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Not applicable.

### Item 2. Properties

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At June 30, 2006, our net investment in property and equipment totaled \$35.9 million.

### Item 3. Legal Proceedings

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The Bank, from time to time, is a party to routine litigation which arises in the normal course of business, such as claims to enforce liens, condemnation proceedings on properties in which we hold security interests, claims involving the making and servicing of real property loans, and other issues incident to our business. There were no lawsuits pending or known to be contemplated against the Company or the Bank at June 30, 2006 that would be expected to have a material effect on operations or income.

### Item 4. Submission of Matters to a Vote of Security Holders

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None.

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## PART II

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

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Upon completion of the Company's first-step minority stock offering in February 2005, the Company's common stock commenced trading on the Nasdaq National Market under the symbol "KRNY." The table below shows the reported high and low closing prices of the common stock during the periods indicated. The quotations reflect inter-dealer prices, without retail mark-up, mark-down, or commission, and may not represent actual transactions.

	High	Low	Dividends
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2005			
-----			
Quarter ended March 31(1).....	\$11.95	\$11.08	-
Quarter ended June 30.....	11.95	10.10	-
2006			
-----			
Quarter ended September 30.....	\$12.74	\$11.50	\$0.04
Quarter ended December 31.....	12.79	10.97	\$0.05
Quarter ended March 31.....	13.89	12.20	\$0.05
Quarter ended June 30.....	14.98	13.58	\$0.05

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(1) Closing of the minority stock offering February 23, 2005. Trading commenced February 24, 2005.

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

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

As of September 8, 2006, there were approximately 9,019 holders of record of the Company's common stock, including persons who hold stock in "street" name through various brokerage firms.

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Set forth below is information regarding the Company's stock repurchases during the fourth quarter of the fiscal year ended June 30, 2006. The Company's purchases of its common stock to fund restricted stock awards are not considered repurchases for purposes of the following table as such shares remain outstanding and are held by the 2005 Stock Compensation and Incentive Plan.

### ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
Quarter ended June 30, 2006	- 0 -	\$0	- 0 -	
Total	- 0 -	\$0	- 0 -	

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### Item 6. Selected Financial Data

The following financial information and other data in this section is derived from the Company's audited consolidated financial statements and should be read together therewith. The Company acquired Pulaski Bancorp, Inc. in October 2002 and West Essex Bancorp, Inc. in July 2003.

	At June 30,		
	2006	2005	2004

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			(In thousands)	
Balance Sheet Data:				
Assets.....	\$2,007,525	\$2,107,005	\$1,936,518	\$1
Loans receivable, net.....	703,613	558,018	505,794	
Mortgage-backed securities held to maturity.....	689,962	758,121	771,353	
Securities available for sale.....	18,346	33,591	41,564	
Investment securities held to maturity..	209,048	470,098	435,870	
Cash and cash equivalents.....	230,279	139,865	39,488	
Goodwill.....	82,263	82,263	82,263	
Deposits.....	1,443,738	1,528,777	1,537,510	1
Federal Home Loan Bank advances.....	61,105	61,687	94,234	
Total stockholders' equity.....	490,886	505,482	293,505	

	For the Year Ended June 30,			
	----- 2006 -----	----- 2005 -----	----- 2004 -----	-----
	(In thousands, except per share am			
Summary of Operations:				
Interest income.....	\$ 89,323	\$ 82,441	\$ 78,654	\$ 9
Interest expense.....	38,645	30,422	32,100	4
Net interest income.....	50,678	52,019	46,554	5
Provision for loan losses.....	72	68	-	
Net interest income after provision for loan losses.....	50,606	51,951	46,554	5
Non-interest income, excluding gain on sale of available for sale securities	2,302	1,798	1,560	
Non-interest income from gain on sale of available for sale securities...	1,023	7,705	-	
Merger related expenses.....	-	-	592	1
Non-interest expense, excluding merger related expenses.....	42,046	34,862	28,880	2
Income before income taxes.....	11,885	26,592	18,642	
Provisions for income taxes.....	2,277	7,694	5,745	
Net income.....	\$ 9,608	\$ 18,898	\$ 12,897	\$
Net income per share - basic.....	\$ 0.14	\$ 0.33	\$ 0.25	\$
Net income per share - diluted.....	\$ 0.14	\$ 0.33	\$ 0.25	\$
Weighted average number of common shares outstanding - basic.....	70,904	57,963	50,916	5
Weighted average number of common shares outstanding - diluted.....	71,100	57,963	50,916	5
Per Share Data:				
Cash dividends per share (1).....	\$ 0.19	\$ -	\$ -	\$
Dividend payout ratio (2).....	49.30%	0.00%	0.00%	

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	At or For the Year Ended June 30,			
	2006	2005	2004	2003
	----	----	----	----
Performance Ratios:				
Return on average assets (net income divided by average total assets).....	0.47%	0.94%	0.67%	0.21%
Return on average equity (net income divided by average equity).....	1.91	5.40	4.52	1.38
Net interest rate spread.....	2.10	2.51	2.37	2.36
Net interest margin on average interest-earnings assets.....	2.67	2.79	2.59	2.75
Average interest-earning assets to average interest-bearing liabilities.....	127.80	116.93	112.46	116.54
Efficiency ratio (Non-interest expense divided by the sum of net interest income and non-interest income).....	77.96	56.67	61.25	82.68
Efficiency ratio (net of gain on sale of available for sale securities).....	79.36	64.78	61.25	82.68
Non-interest expense to average assets.....	2.04	1.73	1.52	2.26
Asset Quality Ratios:(3)				
Non-performing loans to total loans....	0.13	0.34	0.46	0.57
Non-performing assets to total assets..	0.05	0.10	0.13	0.16
Net charge-offs to average loans outstanding.....	0.01	0.00	0.01	0.00
Allowance for loan losses to total loans.....	0.77	0.96	1.01	1.01
Allowance for loan losses to non-performing loans.....	578.66	281.79	220.96	177.64
Capital Ratios:				
Average equity to average assets (average equity divided by average total assets).....	24.43	17.36	14.73	14.97
Equity to assets at period end.....	24.45	23.99	15.16	14.81
Tangible equity to tangible assets at period end.....	21.19	20.66	11.29	13.31
Number of Offices:				
Offices (including offices acquired in mergers).....	26	25	25	25

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- (1) Cash dividends paid per share represents the aggregate of dividends paid by Kearny Financial Corp., West Essex Bancorp, Inc., and Pulaski Bancorp, Inc. to the minority stockholders of West Essex Bancorp, Inc. and Pulaski Bancorp, Inc. divided by the outstanding shares of Kearny Financial Corp. common stock.
  - (2) Represents cash dividends declared per share divided by net income per common share.
  - (3) Asset quality ratios are period end ratios.

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

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

Overview

Financial Condition and Results of Operations. Kearny Financial Corp.'s results of operations depend primarily on its net interest income. Net interest income is the difference between the interest income we earn on our interest-earning assets and the interest we pay on our interest-bearing liabilities. It is a function of the average balances of loans and investments versus deposits and borrowed funds outstanding in any one period and the yields earned on those loans and investments and the cost of those deposits and borrowed funds.

Our interest-earning assets consist primarily of mortgage-backed securities and investment securities, including available for sale and held to maturity, which comprised 45.7% of total assets at June 30, 2006 while loans receivable, net, comprised 35.0% of total assets. This was a change from 59.9% and 26.5%, respectively, at June 30, 2005. The most significant change in our interest-earning assets between June 30, 2005 and June 30, 2006 was a \$145.6 million, or 26.1%, increase in loans receivable, net. During the year ended June 30, 2006, management stressed growth of the loan portfolio as a key goal. Investment securities held to maturity decreased \$261.1 million and mortgage-backed securities held to maturity decreased \$68.1 million. We continued to invest proceeds from our initial public offering in mortgage loans. Demand for mortgages contributed to the decrease in mortgage-backed securities, as we used principal and interest payments to fund loan originations, supplemented by the proceeds from a restructuring of the investment portfolio in February 2006. Cash flows from mortgage-backed securities repayments also funded deposit outflows. The decrease in investment securities resulted from the restructuring of the investment portfolio.

Our interest-bearing liabilities consist primarily of retail deposits and borrowings from the Federal Home Loan Bank of New York. At June 30, 2006, our total deposits were \$1.44 billion, compared to \$1.53 billion at June 30, 2005, and our Federal Home Loan Bank of New York borrowings were \$61.1 million compared to \$61.7 million a year earlier. The primary factor for the decrease in deposits was a runoff of certificates of deposit and to some degree, core deposits, due to a competitive market for deposits. The challenge for management during the year ended June 30, 2006 was to balance the rate of attrition against a significant increase in the cost of funds. A flat Treasury yield curve throughout the year further exacerbated a difficult operating environment. The nominal decrease in Federal Home Loan Bank advances resulted from a repayment of principal on borrowings featuring a monthly amortization schedule.



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Our net interest income decreased by 2.5%, to \$50.7 million for the year ended June 30, 2006 from \$52.0 million for the year ended June 30, 2005. The net interest rate spread decreased to 2.10% for the year ended June 30, 2006 from 2.51% for 2005 as the average cost of interest-bearing liabilities climbed 69 basis points to 2.60% while the average yield on interest-earning assets improved 28 basis points to 4.70%. Total interest income increased 8.4% due to a 2.2% increase in the average balance of interest-earning assets and 28 basis point increase in the average yield thereof, while total interest expense increased 27.0%, primarily due to a 69 basis point increase in the average cost of interest-bearing liabilities. Net interest income received a boost from the reinvestment of proceeds from the restructuring of the investment portfolio into cash equivalents earning market short-term interest rates.

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Our results of operations also depend on our provision for loan losses, non-interest income and non-interest expense. Non-interest income includes service fees and charges, including income generated by the Bank's retail branch network and operations, and income from bank owned life insurance. Non-interest expense includes salaries and employee benefits, occupancy expenses and other general and administrative expenses. Non-interest expense increased \$7.1 million, or 20.3%, to \$42.0 million for the year ended June 30, 2006, compared to \$34.9 million for the year ended June 30, 2005. The increase was due primarily to increases in salaries and employee benefits, directors' compensation expense, and to a lesser degree, occupancy expenses and miscellaneous expenses. The increase in salaries and benefits and directors' compensation expense resulted primarily from stock compensation plans commencing during the quarter ended December 31, 2005.

Net income for the year ended June 30, 2006 was \$9.6 million, a decrease of \$9.3 million, or 49.2%, from \$18.9 million for the year ended June 30, 2005. The decrease in net income resulted primarily from lower net interest income and higher non-interest expense. There was an increase in non-interest income from service fees and charges and miscellaneous sources and a substantial decrease in the contribution from net gain on sale of securities. In the year ended June 30, 2006, the pre-tax gain on sale of securities contributed \$1.0 million to income, compared to \$7.7 million during the year ended June 30, 2005.

Total assets decreased \$99.5 million, or 4.7%, to \$2.01 billion at June 30, 2006 from \$2.11 billion at June 30, 2005. Cash and cash equivalents increased \$90.4 million year-over-year, due to the reinvestment of proceeds from the restructuring of the investment portfolio into cash equivalents. Cash and cash equivalents provided funding for both loan originations and deposit outflows. A \$15.3 million, or 45.5%, reduction in securities available for sale, to \$18.3 million at June 30, 2006 from \$33.6 million at June 30, 2005, was the result of the sale of Freddie Mac common stock and a closed-end mutual fund. Investment securities held to maturity decreased \$261.1 million, or 55.5%, to \$209.0 million at June 30, 2006 from \$470.1 million at June 30, 2005, due primarily to the restructuring of the portfolio. Mortgage-backed securities held to maturity decreased \$68.1 million, or 9.0%, to \$690.0 million from \$758.1 million year-over-year, utilizing the cash flows from monthly principal and interest payments to fund loan originations and deposit outflows.

Stockholders' equity decreased \$14.6 million, or 2.9%, to \$490.9 million at June 30, 2006, from \$505.5 million at June 30, 2005. The decrease primarily reflects the effect of unearned shares held by the 2005 Stock Compensation and Incentive Plan and unallocated shares held by the employee stock ownership plan totaling \$13.9 million in aggregate. Cash dividends declared of \$4.7 million and a decrease of \$5.6 million in accumulated other comprehensive income resulting from the sale of available for sale securities

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also contributed to the decrease in stockholders' equity, partially offset by net income for the year of \$9.6 million.

Business Strategy. Our current business strategy is to seek to grow and improve our profitability by:

- o increasing the volume of our loan originations and the size of our loan portfolio relative to our securities portfolio;
- o increasing the origination of multi-family and commercial real estate loans, construction loans and commercial business loans;
- o building our core banking business through internal growth and de novo branching, as well as actively considering expansion opportunities such as the acquisition of branches and other financial institutions;
- o developing a sales culture by training and encouraging our branch personnel to promote our existing products and services to our customers; and

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- o maintaining high asset quality.

Our deposits have traditionally exceeded our loan originations, and we have invested these deposits primarily in mortgage-backed securities and investment securities. Following our acquisition of South Bergen Savings Bank in 1999, we began focusing on growing the size of our loan portfolio. Prior to that time, we focused our efforts on obtaining deposits from the communities in which we operated our five branch offices in Bergen and Hudson counties and investing those funds in mortgage-backed and other securities. A primary focus of our current business strategy is to increase our volume of loan originations and the size of our loan portfolio. There can be no assurance, however, that we will be successful in this effort.

In an effort to develop our commercial business, we utilize several experienced business development officers who focus on commercial loan originations, and we expect to offer Internet banking and cash management services to our commercial customers during the quarter ended December 31, 2006. Our residential loan originations have traditionally been largely advertising driven, but we also utilize regional loan originators who specialize in residential mortgage loan originations and work throughout our retail branch network, meeting with prospective loan customers wherever it is most convenient for them.

### Critical Accounting Policies

Our accounting policies are integral to understanding the results reported. We describe them in detail in Note 1 to consolidated financial statements beginning on Page F-8 of this document. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the consolidated statements of financial condition and revenues and expenses for the periods then ended. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant changes relate to the determination of the allowance for loan losses, the assessment of prepayment risks associated with mortgage-backed securities, the evaluation of securities impairment and the impairment testing of goodwill.

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Allowance for Loan Losses. The allowance for loan losses represents our best estimate of losses known and inherent in our loan portfolio that are both probable and reasonable to estimate. In determining the amount of the allowance for loan losses, we consider the losses inherent in our loan portfolio and changes in the nature and volume of our loan activities, along with general economic and real estate market conditions. We use a two-tier approach: (1) identification of impaired loans and establishment of specific loss allowances on such loans; and (2) establishment of general valuation allowances on the remainder of our loan portfolio. We maintain a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Our system takes into consideration, among other things, delinquency status, size of loans, and type of collateral and financial condition of the borrowers. We establish specific loan loss allowances for identified loans based on a review of such information and/or appraisals of the underlying collateral. We base general loan loss allowances upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions and management's judgment.

Although we establish specific and general loan loss allowances in accordance with management's best estimate, actual losses are dependent upon future events and, as such, further provisions for loan losses may be necessary in order to increase the level of the allowance for loan losses. For example, our evaluation of the allowance includes consideration of current economic conditions, and a change in economic conditions could reduce the ability of our borrowers to make timely repayments of their loans. This could result in increased delinquencies and increased non-performing loans, and thus a need to make increased provisions to the allowance for loan losses, which would be a charge to income during the period the provision is made, resulting in a reduction to our earnings. A change in economic conditions could also adversely affect the value of the properties collateralizing our real estate loans, resulting in increased charge-offs against the allowance

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and reduced recoveries, and thus a need to make increased provisions to the allowance for loan losses. Furthermore, a change in the composition of our loan portfolio or growth of our loan portfolio could result in the need for additional provisions.

Prepayment Risks Associated with Mortgage-backed Securities. At June 30, 2006 and June 30, 2005, net premiums of approximately \$2.5 million and \$3.6 million, respectively, were included in the carrying amounts of our mortgage-backed securities. We amortize the premium included in the carrying amount over the average life of the security using the level-yield method. The mortgage-backed securities we hold in our portfolio are subject to prepayment risk because changes in interest rates can affect the expected life of these mortgage-backed securities. We must estimate the level of prepayments in order to estimate the average life of mortgage-backed securities.

We evaluate the estimated average life of mortgage-backed securities on a monthly basis and adjust the amortization speed to reflect any change in the average life. Amortizing the premium faster results in a reduction of the yield on the securities, whereas slowing the amortization increases the yield. A reduction in the yield decreases our interest income on mortgage-backed securities, while an increase in the yield increases our interest income on mortgage-backed securities.

The assessment of the prepayment risks related to mortgage-backed securities is highly dependent upon the prediction of trends in market interest

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rates. A reduction in interest rates generally results in increased prepayments of mortgage-backed securities, as borrowers refinance their debt in order to reduce their borrowing cost. Correspondingly, an increase in interest rates should result in decreased prepayments and fewer re-financings. Because changes in interest rates can affect the average life of mortgage-backed securities, this makes the estimation of the prepayment risk difficult. We address this difficulty by adjusting the amortization speed monthly to reflect the current average life.

**Impairment Testing of Goodwill.** We record goodwill, representing the excess of amounts paid over the fair value of net assets of the institutions acquired in purchase transactions, at its fair value at the date of acquisition. Through June 30, 2002, we amortized goodwill using the straight-line method over 15 years. Effective July 1, 2002, we adopted the Financial Accounting Standards Board's Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." Goodwill is tested and deemed impaired when the carrying value of goodwill exceeds its implied fair value. At June 30, 2006, we reported goodwill of \$82.3 million. The value of the goodwill can change in the future. We expect the value of the goodwill to decrease if there was a significant decrease in the franchise value of Kearny Federal Savings Bank. If an impairment loss is determined in the future, we will reflect the loss as an expense for the period in which the impairment was determined, leading to a reduction of our net income for that period by the amount of the impairment loss.

**Other-than-Temporary Impairment of Securities.** We evaluate on a quarterly basis whether any securities are other-than-temporarily impaired. In making this determination, we consider the extent and duration of the impairment, the nature and financial health of the issuer, and our ability and intent to hold securities for a period sufficient to allow for any anticipated recovery in market value. Other considerations include a review of the credit quality of the issuer and the existence of a guarantee or insurance, if applicable to the security. If a security is determined to be other-than-temporarily impaired, we will record an impairment loss as a charge to income for the period in which the impairment loss was determined to exist, resulting in a reduction to our earnings for that period.

As of June 30, 2006, we concluded that any unrealized losses in the securities available for sale, mortgage-backed securities held to maturity and investment securities held to maturity portfolios were temporary in nature due to market interest rates and not the underlying credit quality of the issuers of the securities. Additionally, we have the intent and ability to hold these investments for the time necessary to

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recover the amortized cost. Future events that would materially change this conclusion and require a charge to operations for an impairment loss include a change in the credit quality of the issuers.

Effective June 30, 2004, we adopted Emerging Issues Task Force ("EITF") Issuance No. 03-1, "The Meaning of Other than Temporary Impairment and Its Application to Certain Investments," which requires quantitative and qualitative disclosures for investment securities that are impaired at the balance sheet date, but for which other-than-temporary impairment has not been recognized. Adoption of EITF 03-01 has not changed our policies for determining whether any securities are other-than-temporarily impaired.

Comparison of Financial Condition at June 30, 2006 and June 30, 2005

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Our total assets decreased by \$99.5 million, or 4.7%, to \$2.01 billion at June 30, 2006 from \$2.11 billion at June 30, 2005, primarily due to decreases in securities available for sale, investment securities held to maturity and mortgage-backed securities held to maturity, partially offset by increases in cash and cash equivalents and loans receivable, net.

Cash and cash equivalents increased \$90.4 million, or 64.6%, to \$230.3 million at June 30, 2006, from \$139.9 million at June 30, 2005. Proceeds from the Company's restructuring of its investment portfolio executed in February 2006 provided the growth in cash and cash equivalents. Management reinvested the proceeds from the restructuring in cash and cash equivalents at market short-term interest rates, with expectations of maintaining liquidity, to the extent funds are not used for loan originations, at an elevated level as long as the Treasury yield curve remains flat.

The carrying value of securities available for sale decreased \$15.3 million, or 45.5%, to \$18.3 million at June 30, 2006, from \$33.6 million at June 30, 2005. As was the case during the year ended June 30, 2005, concern about the future of government-sponsored enterprises triggered the sale during the year ended June 30, 2006 of the Company's remaining shares of Freddie Mac common stock. In June 2005, we sold 130,000 shares, which produced a gain of \$7.6 million, before taxes. In February 2006, we sold 131,088 shares, which resulted in a gain of \$8.8 million, before taxes. We also sold all of our shares of a closed-end mutual fund in August 2005, which resulted in a gain of \$86,000, before taxes. We acquired the Dryden Government Income Fund in the merger with South Bergen Savings Bank in March 1999.

Investment securities held to maturity decreased \$261.1 million, or 55.5%, to \$209.0 million at June 30, 2006, from \$470.1 million at June 30, 2005. The decrease resulted almost exclusively from the sale of the Bank's entire portfolio of government agency notes, totaling \$249.1 million, in February 2006. The transaction resulted in a loss of \$7.8 million, before taxes. The weighted average yield of the portfolio was 3.22%. Management reinvested the proceeds in cash and cash equivalents at market short-term interest rates. The Bank's portfolio of tax-exempt municipal bonds decreased \$4.3 million, or 2.1%, to \$200.3 million at June 30, 2006, from \$204.6 million at June 30, 2005. Cash flow from matured government agency notes and tax-exempt municipal bonds partially funded deposit outflows.

Mortgage-backed securities held to maturity decreased \$68.1 million, or 9.0%, to \$690 million at June 30, 2006, from \$758.1 million at June 30, 2005. Management utilized the cash flows from monthly principal and interest payments and matured mortgage-backed securities to fund loan originations and deposit outflows. In an attempt to provide some protection against interest-rate risk, during the year ended June 30, 2006, management purchased \$111.7 million of mortgage-backed securities with most of the pools containing adjustable rate mortgages. As of June 30, 2006, \$331.4 million, or 48.0% of the mortgage-backed securities are variable rate compared to \$337.2 million, or 44.5% at June 30, 2005.

Loans receivable, net, increased \$145.6 million, or 26.1%, to \$703.6 million at June 30, 2006, from \$558.0 million at June 30, 2005. During the year ended June 30, 2006, management stressed growth of the

loan portfolio as a key goal. One-to-four family real estate mortgages increased \$83.0 million, or 21.7%, to \$465.8 million at June 30, 2006, from \$382.8 million at June 30, 2005. Multi-family and commercial real estate mortgages increased \$10.4 million, or 10.8%, to \$107.1 million at June 30, 2006, from \$96.7 million

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at June 30, 2005. Our strategy particularly emphasizes growth in this segment of the loan portfolio. Commercial business lines of credit increased \$278,000, or 9.6%, to \$3.2 million at June 30, 2006, from \$2.9 million at June 30, 2005. Consumer lending, primarily home equity loans and home equity lines of credit increased \$37.6 million, or 52.1%, to \$109.7 million at June 30, 2006, from \$72.1 million at June 30, 2005. Construction loans increased \$14.0 million, or 172.8%, to \$22.1 million at June 30, 2006, from \$8.1 million at June 30, 2005. To supplement our own loan originations, management entered into agreements to purchase mortgages from several mortgage companies. During the year ended June 30, 2006, we purchased \$24.4 million from these sources.

Premises and equipment increased \$964,000, or 2.8%, to \$35.9 million at June 30, 2006, from \$35.0 million at June 30, 2005. The increase resulted primarily from the cost associated with completing the construction of a de novo branch in Lacey Township, New Jersey, which opened in October 2005. The increase also includes the cost of renovations of retail branches located in Old Tappan and Northvale, New Jersey, which management expects to complete in September and October 2006, respectively.

Bank owned life insurance ("BOLI") increased \$10.6 million, or 265.0%, to \$14.6 million at June 30, 2006, from \$4.0 million at June 30, 2005. During the year, the Company purchased BOLI policies totaling \$10.2 million.

Total deposits decreased by \$85.1 million, or 5.6%, to \$1.44 billion at June 30, 2006, from \$1.53 billion at June 30, 2005. Non-interest-bearing demand deposits increased \$5.0 million, or 8.9%, to \$61.1 million at June 30, 2006, from \$56.1 million at June 30, 2005. Year-over-year, interest-bearing demand accounts increased \$22.8 million, or 23.0%, to \$122.1 million from \$99.3 million. In the quarter ended March 31, 2006, the Bank introduced several products designed to retain and attract core deposits, including Star Banking and a tiered money market account, which contributed to the growth in interest-bearing demand deposits. Savings and club accounts decreased \$72.8 million, or 16.2%, to \$377.4 million at June 30, 2006, from \$450.2 million at June 30, 2005. Fierce competition for core deposits within our marketplace contributed to the decrease in savings and club accounts as well as transfers to our own interest-bearing demand accounts. Certificates of deposit decreased \$40.0 million, or 4.3%, to \$883.1 million at June 30, 2006, from \$923.1 million at June 30, 2005. Management marketed special certificate of deposit maturities, typically with terms of five, nine and 13 months and promotional interest rates, to retain and attract new deposits. The challenge for management during the year ended June 30, 2006 was to balance the rate of attrition for all deposit categories against a significant increase in the cost of funds.

Federal Home Bank of New York advances decreased \$582,000, or 0.9%, to \$61.1 million at June 30, 2006, from \$61.7 million at June 30, 2005. The advances retired during the year were on a monthly repayment schedule. Twice during the year, for short periods, management utilized an overnight line of credit with the Federal Home Loan Bank of New York to meet liquidity needs.

Stockholders' equity decreased \$14.6 million, or 2.9%, to \$490.9 million at June 30, 2006, from \$505.5 million at June 30, 2005. The decrease primarily reflects the effect of unearned shares held by the 2005 Stock Compensation and Incentive Plan and unallocated shares held by the employee stock ownership plan totaling \$13.9 million in aggregate. Cash dividends declared of \$4.7 million and a decrease of \$5.6 million in accumulated other comprehensive income resulting from the sale of available for sale securities also contributed to the decrease in stockholders' equity, partially offset by net income for the year of \$9.6 million. During the year ended June 30, 2006, \$1.5 million in employee stock ownership plan ("ESOP") shares were released. Paid in capital decreased \$18.9 million during the year due to the purchase of the Company's common stock in the open market to fund the restricted stock plan. This reduction of equity was partially

offset by the vesting of \$2.0 million in restricted stock shares, a \$1.2 million adjustment to equity for expensing stock options and \$412,000 attributed to the excess of market over cost of ESOP shares released. Management recorded the purchase of stock to fund the restricted stock plan as a reduction of paid in capital in accordance with SFAS No. 123R. The decrease in accumulated other comprehensive income resulted from a reduction in the carrying value, net of taxes, of the Company's securities available for sale portfolio due to the sales of Freddie Mac common stock and a closed-end mutual fund, nominally offset by an increase in the carrying value, net of taxes, of the securities remaining in the portfolio.

Comparison of Operating Results for the Years Ended June 30, 2006 and June 30, 2005

General. Net income for the year ended June 30, 2006 was \$9.6 million, a decrease of \$9.3 million, or 49.2%, from \$18.9 million for the year ended June 30, 2005. The decrease in net income resulted primarily from lower net interest income and higher non-interest expenses. There was an increase in non-interest income from service fees and charges and miscellaneous sources and a substantial decrease in the contribution from gain on sale of securities. An increase in interest income did not offset an increase in interest expense resulting in lower net interest income. The increase in non-interest expenses was due primarily to increases in salaries and employee benefits, directors' compensation expense, and to a lesser degree, occupancy expenses and miscellaneous expenses.

Net Interest Income. Net interest income decreased by \$1.3 million, or 2.5%, to \$50.7 million for the year ended June 30, 2006, from \$52.0 million for the year ended June 30, 2005. Our net interest rate spread decreased 41 basis points to 2.10% for the year ended June 30, 2006, from 2.51% for 2005. Our net interest margin decreased 12 basis points to 2.67% for the year ended June 30, 2006, compared with 2.79% for the year ended June 30, 2005. Despite a 28 basis point improvement in the average yield on interest-earning assets, increasing from 4.42% for the year ended June 30, 2005 to 4.70% for the year ended June 30, 2006, the net interest rate spread decreased due to a 69 basis point increase in the average cost of interest-bearing liabilities to 2.60% compared to 1.91%, year-over-year. An increase in the average yield on interest-earning assets, a \$36.5 million increase in average interest-earnings assets and \$106.9 million decrease in average interest-bearing liabilities, was more than offset by the increase in the cost of average interest-bearing liabilities resulting in a decrease in the net interest margin, year-over-year. The ratio of average interest-earning assets to average interest-bearing liabilities increased to 127.8% for the year ended June 30, 2006, compared to 116.9% for the year ended June 30, 2005. Average interest-earning assets increased 2.0%, to \$1.90 billion for the year ended June 30, 2006, from \$1.86 billion for the year ended June 30, 2005. Average interest-bearing liabilities decreased 6.7%, to \$1.49 billion for the year ended June 30, 2006, from \$1.59 billion for the year ended June 30, 2005.

Interest Income. Total interest income increased \$6.9 million, or 8.4%, to \$89.3 million for the year ended June 30, 2006, from \$82.4 million for the year ended June 30, 2005. The improvement in interest income resulted from both an increase in the yield on average interest-earning assets as well as an increase in the average balance of interest-earning assets. The average yield on average interest-earning assets increased 28 basis points to 4.70% from 4.42%, while average interest-earning assets increased \$36.5 million, or 2.0%, to \$1.90 billion from \$1.86 billion.

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Interest income on loans receivable increased \$6.0 million, or 20.5%, to \$35.3 million for the year ended June 30, 2006, from \$29.3 million for the year ended June 30, 2005. The increase resulted from an increase in the average balance of loans receivable, net, partially offset by a reduction in the average yield on loans. The average balance of loans receivable, net, increased \$110.5 million, or 21.3%, to \$628.2 million for the year ended June 30, 2006, from \$517.7 million for the year ended June 30, 2005. The average yield on loans decreased four basis points, to 5.62% for the year ended June 30, 2006, compared to 5.66% for 2005. The lower yield reflects generally lower interest rates on originations compared to principal repayments on seasoned higher yielding mortgages; however, the decline in average yields year-over-year began to slow. The average yield for the year ended June 30, 2005 was 5.66% compared to 5.79% for 2004.

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Interest income on mortgage-backed securities held to maturity decreased \$483,000, or 1.4%, to \$33.5 million for the year ended June 30, 2006, compared to \$34.0 million for the year ended June 30, 2005. The decrease in interest income on mortgage-backed securities resulted from a decrease in the average balance outstanding rather than average yield, which was unchanged at 4.59% for the years ended June 30, 2006 and 2005. The average balance of mortgage-backed securities decreased \$11.4 million, or 1.5%, to \$729.0 million for the year ended June 30, 2006, from \$740.4 million for the year ended June 30, 2005. The decrease in the average balance resulted from the utilization of cash flows from monthly principal and interest payments to fund loan originations and deposit outflows rather than reinvestment in the portfolio. Following a decline in average yield between the prior two years, due to principal repayments received on seasoned higher yielding securities reinvested in a lower interest rate environment, the average yield stabilized during the year ended June 30, 2006. The average yield for the year ended June 30, 2005 was 4.59% compared to 4.76% for 2004. Most pools purchased during the year contained adjustable rate mortgages, thus sacrificing higher yields on fixed rate mortgages for interest rate risk protection in the future.

Interest income on investment securities available for sale and held to maturity, both taxable and tax-exempt, decreased \$2.3 million, or 13.9%, to \$14.2 million for the year ended June 30, 2006, from \$16.5 million for the year ended June 30, 2005. The decrease resulted from a decrease of \$95.6 million, or 19.5%, in the average balance of investment securities to \$394.6 million for the year ended June 30, 2006, from \$490.2 million for the year ended June 30, 2005, partially offset by an increase in the average yield year-over-year. The average yield for the year ended June 30, 2006 was 3.60%, compared to 3.37% for the year ended June 30, 2005. The decrease in the average balance resulted almost exclusively from the sale of the Bank's entire portfolio of government agency notes, totaling \$249.1 million, in February 2006. Management attributes the increase in the average yield in part to this sale since the weighted average yield on these notes was 3.22%. Interest income on tax-exempt investment securities increased \$730,000, or 10.6%, to \$7.6 million for the year ended June 30, 2006, from \$6.9 million for the year ended June 30, 2005. The increase resulted from an increase in the average balance partially offset by a decrease in the average yield. The average balance increased by \$21.5 million, or 11.9%, to \$202.0 million for the year ended June 30, 2006, from \$180.5 million for the year ended June 30, 2005, while the average yield decreased to 3.78% for the year ended June 30, 2006, from 3.82% in 2005. The actual balance at June 30, 2006 of \$200.3 million, compared to \$204.6 million at June 30, 2005 reflects management's decision to de-emphasize tax-exempt securities, due to lower pre-tax income and lower interest rates on new issues. Interest income on taxable investment securities decreased \$3.0 million, or 31.3%, to \$6.6 million



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for the year ended June 30, 2006, from \$9.6 million for the year ended June 30, 2005, resulting from a decrease in average balance partially offset by an increase in average yield. The average balance decreased \$117.1 million, or 37.8%, to \$192.6 million for the year ended June 30, 2006, from \$309.7 million for the year ended June 30, 2005. The average yield increased to 3.40% for the year ended June 30, 2006, from 3.11% for 2005. The sale of the entire government agency notes portfolio substantially contributed to both the decrease in average balance and increase in average yield.

Interest income on other interest-earning assets increased \$3.7 million, or 142.3%, to \$6.3 million for the year ended June 30, 2006, from \$2.6 million for the year ended June 30, 2005. The composition of interest income on other interest-earning assets during the year ended June 30, 2006 included interest received from deposits at other banks, specifically the Federal Home Loan Bank of New York and Bank of America, and dividends paid on Federal Home Loan Bank of New York capital stock. The increase in interest income resulted from an increase in average yield and average balance. The average yield increased to 4.28% for the year ended June 30, 2006, from 2.30% for 2005 while the average balance increased \$33.0 million, or 28.7%, to \$147.9 million for the year ended June 30, 2006, from \$114.9 million for the year ended June 30, 2005. Management reinvested the proceeds from the investment portfolio restructuring in cash and cash equivalents to take advantage of market short-term interest rates.

Interest Expense. Total interest expense increased \$8.2 million, or 27.0%, to \$38.6 million for the year ended June 30, 2006, from \$30.4 million for year ended June 30, 2005. The increase resulted from an

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increase in the average cost of interest-bearing liabilities, partially offset by a decrease in the average balance of interest-bearing liabilities. The average cost increased 69 basis points to 2.60% in the year ended June 30, 2006, from 1.91% for 2005. The average balance of interest-bearing liabilities declined \$106.9 million, or 6.7%, to \$1.49 billion during the year ended June 30, 2006, as compared to \$1.59 billion during the year ended June 30, 2005. Management increased rates to match the competition's rate offerings in the face of rising short-term interest rates in an effort to stem the outflow of deposits triggered by the competitive market for deposits.

Interest expense on deposits increased \$8.6 million, or 32.5%, to \$35.1 million for the year ended June 30, 2006, from \$26.5 million for the year ended June 30, 2005. The average cost of interest-bearing deposits increased to 2.47% for the year ended June 30, 2006, from 1.75% in 2005. The average cost of certificates of deposit increased to 3.27% from 2.33%, while the average cost of savings and club accounts increased to 1.18% from 1.02% and the average cost of interest-bearing demand accounts increased to 0.90% from 0.71%. Management found it necessary to market special certificate of deposit maturities with promotional interest rates, typically with terms of five, nine and 13 months, to retain and attract new deposits. The average balance of interest-bearing deposits decreased \$91.3 million, or 6.0%, to \$1.42 billion for the year ended June 30, 2006, from \$1.51 billion for the prior year. Average certificates of deposit increased to \$888.8 million from \$873.9 million, average savings and club accounts decreased to \$429.0 million from \$533.1 million and average interest-bearing demand deposits decreased to \$103.4 million from \$105.5 million. The Bank introduced several products designed to retain and attract core deposits, including Star Banking and a tiered money market account. The challenge for management during the year ended June 30, 2006 was to balance the rate of attrition for all deposit categories against a significant increase in the cost of funds.

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Interest expense on Federal Home Loan Bank advances decreased \$314,000, or 8.1%, to \$3.6 million for the year ended June 30, 2006, from \$3.9 million for the year ended June 30, 2005. The decrease in interest expense resulted from a decrease in the average balance of advances outstanding partially offset by an increase in the average cost of advances. The average balance of advances outstanding decreased \$15.7 million, or 19.4%, to \$65.3 million for the year ended June 30, 2006 compared to \$81.0 million for the year ended June 30, 2005. The average cost of borrowings increased to 5.47% from 4.80%, year-over-year. The decrease in the average balance resulted from short-term advances obtained and subsequently paid off during the year ended June 30, 2005, to fund the purchase of securities. The same situation did not occur during the year ended June 30, 2006. The average cost of borrowed money increased during the year ended June 30, 2006, due to management's utilization of an overnight line of credit with the Federal Home Loan Bank of New York to meet liquidity needs. Overnight borrowings were particularly expensive due to the high cost of short-term interest rates relative to rates on longer-term advances.

Provision for Loan Losses. We charge provisions for loan losses to operations at a level required to reflect credit losses in the loan portfolio that are both probable and reasonable to estimate. Management, in determining the allowance for loan losses, considers the losses inherent in the loan portfolio and changes in the nature and volume of our loan activities, along with the general economic and real estate market conditions. We utilize a two-tier approach: (1) identification of impaired loans and establishment of specific loss allowances on such loans; and (2) establishment of general valuation allowances on the remainder of our loan portfolio. We establish a specific loan loss allowance for an impaired loan based on delinquency status, size of loan, type of collateral and/or appraisal of the underlying collateral and financial condition of the borrower. Management bases general loan loss allowances upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions and management's judgment.

There was a \$72,000 provision for loan losses recorded for the year ended June 30, 2006 compared to a \$68,000 provision for loan losses recorded for the year ended June 30, 2005. During the year ended June 30, 2006, total loans increased to \$708.0 million at June 30, 2006, from \$562.6 million at June 30, 2005.

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Non-performing loans were \$942,000, or 0.13%, of total loans at June 30, 2006, as compared to \$1.9 million, or 0.34%, of total loans at June 30, 2005. The allowance for loan losses as a percentage of total loans outstanding was 0.77% at June 30, 2006, compared to 0.96% at June 30, 2005, reflecting balances of \$5.5 million and \$5.4 million, respectively. The ratio of the allowance for loan losses to non-performing loans increased to 578.7% at June 30, 2006, from 281.8% at June 30, 2005. The increase in the ratio is a result of a \$980,000 decrease in non-performing loans from approximately \$1.9 million at June 30, 2005, to \$942,000 at June 30, 2006.

Management assesses the allowance for loan losses monthly. While management uses available information to recognize losses on loans, additional loan loss provisions in the future may be necessary based on changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses and may require us to recognize additional provisions based on their judgment of information available to them at the time of their examination.

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Non-interest Income. Non-interest income attributed to fees, service charges and miscellaneous income and excluding gains on the sale of securities increased \$504,000, or 28.0%, to \$2.3 million for the year ended June 30, 2006, from \$1.8 million for the year ended June 30, 2005. Fees and service charges increased \$68,000 year-over-year, primarily due to an increase in prepayment charges on loans and a nominal increase in fee income attributed to the Bank's retail branch network, partially offset by lower other loan fees. Miscellaneous income increased \$436,000 primarily due to an increase in the cash surrender value of bank owned life insurance and other fees from operations. At June 30, 2006, we had a \$14.6 million investment in bank owned life insurance, compared to \$4.0 million at June 30, 2005.

Non-interest income attributed to net gain on the sale of securities was \$1.0 million in the year ended June 30, 2006, resulting from the sale of 131,088 shares of Freddie Mac common stock, a closed-end mutual fund and the Bank's entire portfolio of government agency notes. The three transactions produced pre-tax gains of \$8.8 million and \$86,000 and a pre-tax loss of \$7.8 million, respectively. Non-interest income attributed to gains on the sale of securities was \$7.7 million in the year ended June 30, 2005, resulting from the sale of 120,000 shares of Freddie Mac common stock and a trust-preferred security. Concern about the future of government-sponsored enterprises triggered the sale of the Company's Freddie Mac common stock investment. The common stock, trust-preferred security and closed-end mutual fund were part of the Company's available for sale investment portfolio and the government agency notes were in the Bank's held-to-maturity portfolio.

Non-interest Expense. Non-interest expense increased \$7.1 million, or 20.3%, to \$42.0 million for the year ended June 30, 2006, from \$34.9 million for the year ended June 30, 2005. The increase in non-interest expense resulted primarily from increases in salaries and employee benefits, directors' compensation expense, miscellaneous expense, equipment expense and to a lesser degree, advertising expense and net occupancy expense of premises.

Salaries and employee benefits increased \$4.3 million, or 20.7%, to \$25.1 million in the year ended June 30, 2006, from \$20.8 million in the year ended June 30, 2005. The compensation expense component increased \$372,000, or 2.8%, to \$13.4 million for the year ended June 30, 2006, from \$13.1 million for the year ended June 30, 2005. The increase resulted from normal salary increases and hiring of additional employees to staff our newest retail branch opened in Lacy Township, New Jersey during October 2005. Pension plan expense decreased \$699,000 to \$2.6 million for the year ended June 30, 2006, compared to 2005. Pension plan expense in the year ended June 30, 2005 included additional contributions to compensate for lower than expected investment returns on plan assets during prior periods. Benefits expense increased \$905,000 to \$3.8 million, year-over-year, resulting from higher health insurance premiums as well as additional employees enrolled in the benefit plans. Employee stock ownership plan ("ESOP") compensation expense increased \$1.4 million to \$1.9 million, compared to 2005. ESOP compensation expense began

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accruing immediately following the initial public offering completed in February 2005, therefore, there was only four months' expense recorded during the year ended June 30, 2005. Stock compensation plan expense attributed to a stock benefit plan approved at the 2005 Annual Meeting was \$2.3 million. There was no such expense recorded in 2005. Payroll tax expense increased \$82,000 to \$1.1 million compared to the previous year.

Net occupancy expense of premises increased \$119,000, or 3.7%, to \$3.3 million for the year ended June 30, 2006, from \$3.2 million for the year ended

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June 30, 2005. Decreases in rent expense, net, and lower property taxes partially offset increases in repairs and maintenance expense, depreciation expense and utilities expense. During the year ended June 30, 2006, the Bank leased space at two locations vacated by management staff and administrative operations upon their move to the Company's headquarters in late 2004. Another tenant will move into Bank property in November 2006 and additional vacant space is being prepared for lease. The rental income will partially offset the occupancy expense of such premises in the future.

Equipment expense increased \$470,000, or 11.8%, to \$4.4 million for the year ended June 30, 2006, from \$4.0 million during the year ended June 30, 2005. The largest increase was attributed to the data processing expense, which increased \$255,000 to \$2.5 million, year-over-year. A significant part of the increase resulted from additional security enhancements to the Bank's data processing infrastructure.

Advertising expense increased \$289,000, or 24.1%, to \$1.5 million for the year ended June 30, 2006, from \$1.2 million for the year ended June 30, 2005. The increase in advertising expense resulted from a publicity campaign connected to the grand opening of the Lacy Township branch, and media advertising launching our Star Banking product and promoting special certificate of deposit offerings. These were in addition to extensive campaigns to advertise residential and commercial loan products and retail and commercial deposit products.

Directors' compensation expense increased \$1.2 million, or 135.4%, to \$2.1 million for the year ended June 30, 2006, from \$886,000 for the year ended June 30, 2005. Stock compensation plan expense attributed to a stock benefit plan approved at the 2005 Annual Meeting was \$1.1 million. There was no such expense recorded in 2005. Directors' fees remained unchanged at \$676,000 and advisory board fees decreased \$89,000 to \$123,000, year-over-year. Other fees including an incentive bonus plan were \$225,000 for 2006.

Miscellaneous expense increased \$744,000, or 20.1%, to \$4.4 million for the year ended June 30, 2006, from \$3.7 million for the year ended June 30, 2005. Audit and accounting services expense and costs associated with being a public company, including annual meeting expense produced the largest increases in the miscellaneous expense category. Audit and accounting services expense increased \$184,000 to \$535,000, compared to 2005. A significant part of that increase, approximately \$124,000, resulted from professional services rendered to assist management in complying with Sarbanes-Oxley Section 404. The Company recorded expense of approximately \$10,000 in 2005 to begin the compliance effort for Section 404. Annual meeting expense was \$201,000 during the year ended June 30, 2006, which includes a provision for the estimated cost of the 2006 annual meeting. There was no such expense recorded in 2005.

Provision for Income Taxes. The provision for income taxes decreased \$5.4 million, or 70.1%, to \$2.3 million for the year ended June 30, 2006, from \$7.7 million for the year ended June 30, 2005. The decrease in income tax expense resulted from a decrease in pre-tax income of \$14.7 million, or 55.3%, to \$11.9 million in the year ended June 30, 2006, from \$26.6 million for the year ended June 30, 2005. The effective income tax rates were 19.2% for the year ended June 30, 2006, as compared to 28.9% for the year ended June 30, 2005. Due to the Bank's significant investment in tax-exempt municipal bonds, tax-exempt interest reduced the Company's federal income expense by approximately \$2.4 million during the year ended June 30, 2006, compared to a reduction of approximately \$2.2 million in the year ended June 30, 2005.

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Comparison of Operating Results for the Years Ended June 30, 2005 and June 30, 2004

General. Net income for the year ended June 30, 2005 was \$18.9 million, an increase of \$6.0 million, or 46.5%, from \$12.9 million for 2004. The increase in net income resulted from the gain on sale of available for sale securities recorded in 2005. Without the gain on sale, net income for the year ended June 30, 2005 remained virtually unchanged from a year earlier, since an increase in non-interest expense offset a comparable increase in net interest income.

Net Interest Income. Net interest income increased by \$5.4 million, or 11.6%, to \$52.0 million for the year ended June 30, 2005, from \$46.6 million for the year ended June 30, 2004. The net interest rate spread increased to 2.51% for the year ended June 30, 2005, from 2.37% for 2004. The net interest margin increased 20 basis points to 2.79% for the year ended June 30, 2005, compared with 2.59% for the year ended June 30, 2004. The net interest rate spread improved due to a four basis point increase in the average yield on interest-earning assets complemented by a decrease of 10 basis points in the average cost of interest-bearing liabilities. The increase in net interest margin resulted from the improvement in the ratio of average interest-earning assets to average interest-bearing liabilities, 116.93% for the year ended June 30, 2005, compared to 112.46% for the year ended June 30, 2004. Average interest-earning assets increased \$68.8 million, or 3.9%, to \$1.86 billion for the year ended June 30, 2005, from \$1.79 billion for the year ended June 30, 2004. Average interest-bearing liabilities remained virtually unchanged, decreasing by \$2.3 million for the year ended June 30, 2005.

Interest Income. Total interest income increased \$3.7 million, or 4.7%, to \$82.4 million for the year ended June 30, 2005, from \$78.7 million for the year ended June 30, 2004. The improvement in interest income resulted from both the increase in the yield on average interest-earning assets as well as the increase in average interest-earning assets. The average yield on average interest-earning assets increased four basis points to 4.42% from 4.38%, while average interest-earning assets increased \$68.8 million, or 3.9%, to \$1.86 billion from \$1.79 billion.

Interest income on loans receivable increased \$392,000, or 1.4%, to \$29.3 million for the year ended June 30, 2005, from \$28.9 million for the year ended June 30, 2004. The increase resulted from an increase in the average balance of loans receivable, net, partially offset by a reduction in the average yield on loans. The average balance of loans receivable, net, increased \$18.2 million, or 3.6%, to \$517.7 million for the year ended June 30, 2005, from \$499.5 million for the year ended June 30, 2004. The average yield on loans decreased 13 basis points, to 5.66% for the year ended June 30, 2005, compared to 5.79% for 2004. The increased average balance reflects an effort to improve the ratio of loans to deposits. Net loans receivable increased \$52.2 million, or 10.3%, to \$558.0 million at June 30, 2005, from \$505.8 million at June 30, 2004. The lower yield reflects generally lower interest rates on originations and downward rate adjustments on adjustable rate and floating rate loans.

Interest income on mortgage-backed securities held to maturity decreased \$26,000 and was \$34.0 million for the year ended June 30, 2005, virtually unchanged from 2004. Interest income on mortgage-backed securities did not change as an increase in the average balance outstanding was offset by a decrease in the average yield. The average balance of mortgage-backed securities increased \$27.0 million, or 3.8%, to \$740.4 million for the year ended June 30, 2005, from \$713.4 million for the year ended June 30, 2004. At the same time, the average yield decreased 17 basis points to 4.59% for the year ended June 30, 2005, compared to 4.76% for 2004. The increase in average balance resulted from the substitution of mortgage-backed securities for loans earlier in the year, while management launched an advertising campaign designed to increase loan originations. Mortgage-backed securities actually decreased \$13.3 million, or

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1.7%, to \$758.1 million at June 30, 2005, from \$771.4 million at June 30, 2004. The decline in yield resulted from principal repayments received on older higher yielding securities subsequently reinvested in a lower interest rate environment. Additionally, most mortgage-backed securities purchased during the year were adjustable rate, sacrificing

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higher yields on fixed rate mortgages in the short-term for some interest rate risk protection in the future.

Interest income on investment securities available for sale and held to maturity, both taxable and tax-exempt, increased \$2.1 million, or 14.6%, to \$16.5 million for the year ended June 30, 2005, from \$14.4 million for the year ended June 30, 2004. The increase resulted from an increase of \$64.9 million, or 15.3%, in the average balance of investment securities to \$490.2 million for the year ended June 30, 2005, from \$425.3 million for the year ended June 30, 2004. A two basis point reduction in the average yield, declining to 3.37% for the year ended June 30, 2005 from 3.39% for 2004, nominally offset the increase in the average balance. Interest income on tax-exempt investment securities increased \$1.2 million, or 21.1%, to \$6.9 million for the year ended June 30, 2005, from \$5.7 million for the year ended June 30, 2004. The increase resulted from an increase in the average balance partially offset by a decrease in the average yield. The average balance increased by \$38.9 million, or 27.5%, to \$180.5 million for the year ended June 30, 2005, from \$141.6 million for the year ended June 30, 2004, while the average yield decreased by 21 basis points, to 3.82% for the year ended June 30, 2005, from 4.03% in 2004. Interest income on taxable investment securities increased \$908,000, or 10.4%, to \$9.6 million for the year ended June 30, 2005, from \$8.7 million for the year ended June 30, 2004, resulting from increases in both average balance and average yield. The average balance increased \$26.0 million, or 9.2%, to \$309.7 million for the year ended June 30, 2005, from \$283.7 million for the year ended June 30, 2004. The average yield increased four basis points, to 3.11% for the year ended June 30, 2005, from 3.07% for 2004. There has been steady growth in both the tax-exempt and taxable portfolios over the previous three years. Management gradually shifted assets from those vulnerable to high prepayments such as mortgage-backed securities, or with low yields, including cash and cash equivalents and securities purchased under agreements to resell, into higher yielding investments, particularly tax-exempt securities, which were offering higher tax equivalent yields.

Interest income on other interest-earning assets increased \$1.3 million, or 100.0%, to \$2.6 million for the year ended June 30, 2005, from \$1.3 million for the year ended June 30, 2004. There were no securities purchased under agreements to resell during the year ended June 30, 2005, therefore, the composition of interest income on other interest-earning assets for 2005 included only interest received from deposits at other banks, specifically the Federal Home Loan Bank of New York, and dividends paid on Federal Home Loan Bank of New York capital stock. The increase in interest income resulted from an increase in average yield, partially offset by a decrease in the average balance. The average yield increased 1.45%, to 2.30% for the year ended June 30, 2005, from 0.85% for 2004 while the average balance decreased \$41.4 million, or 26.5%, to \$114.9 million for the year ended June 30, 2005, from \$156.3 million for the year ended June 30, 2004. The investment of funds received from the purchase of the Company's common stock, including over-subscriptions held during the subscription period, contributed to the increase in interest income on other interest-earning assets, particularly the ability to invest those funds during a period of rising short-term interest rates.

Interest Expense. Total interest expense decreased \$1.7 million, or

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5.3%, to \$30.4 million for the year ended June 30, 2005, from \$32.1 million for year ended June 30, 2004. The decrease resulted from a decrease in the average cost of interest-bearing liabilities, with virtually no change in the average balance of interest-bearing liabilities. The average cost decreased ten basis points to 1.91% in the year ended June 30, 2005, from 2.01% for 2004. The average balance of interest-bearing liabilities declined slightly to \$1.59 billion during the year ended June 30, 2005, as compared to \$1.60 billion during the year ended June 30, 2004. Average cost decreased due to historically low market interest rates prevailing during the period, though short-term rates started climbing as the Federal Reserve raised the federal funds rate by 25 basis point increments.

Interest expense on deposits decreased \$1.6 million, or 5.7%, to \$26.5 million for the year ended June 30, 2005, from \$28.1 million for the year ended June 30, 2004. Interest expense included \$491,000, paid on funds received during the subscription period of the initial public offering completed in February 2005. The decrease resulted from a decrease in the average cost of interest-bearing deposits and a slight decrease in the

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average balance of interest-bearing deposits. The average cost of interest-bearing deposits decreased ten basis points to 1.75% for the year ended June 30, 2005, from 1.85% in 2004. The average cost of certificates of deposit increased to 2.33% from 2.25%, while the average cost of savings and club accounts decreased to 1.02% from 1.23% and the average cost of interest-bearing demand accounts decreased to 0.71% from 0.80%. Management found it necessary to begin raising certificate of deposit interest rates, reacting to rising short-term interest rates during the second half of the year in order to reverse earlier deposit outflows. The average balance of interest-bearing deposits decreased \$8.9 million to \$1.51 billion for the year ended June 30, 2005, from \$1.52 billion for the prior year. The nominal decrease in the average balance partially resulted from the temporary increase in deposits attributed to funds received during the subscription period of the initial public offering completed in February 2005 substantially offsetting an overall deposit outflow. Average certificates of deposit declined to \$873.9 million from \$963.1 million, average savings and club accounts increased to \$533.1 million from \$448.5 million and average interest-bearing demand deposits decreased to \$105.5 million from \$109.8 million. The increase in average savings and club accounts reflects the aforementioned temporary increase in deposits associated with the initial public offering.

Interest expense on Federal Home Loan Bank advances decreased \$128,000, or 3.2%, to \$3.9 million for the year ended June 30, 2005, from \$4.0 million for the year ended June 30, 2004. The decrease in interest expense resulted from a decrease in the average cost of advances partially offset by an increase in the average balance of advances. The average cost of advances fell 60 basis points to 4.80% for the year ended June 30, 2005, from 5.40% for 2004, while the average balance increased \$6.7 million, or 9.0%, to \$81.0 million for the year ended June 30, 2005, from \$74.3 million for the year ended June 30, 2004. The increase in the average balance resulted from short-term advances obtained earlier in the year to fund the purchase of securities, subsequently paid off with proceeds from the initial stock offering completed in February 2005. The relatively low interest rates associated with those advances contributed to lowering the average cost of borrowed money.

Provision for Loan Losses. Provisions for loan losses are charged to operations at a level required to reflect credit losses in the loan portfolio that are both probable and reasonable to estimate. Management, in determining the allowance for loan losses, considers the losses inherent in the loan

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portfolio and changes in the nature and volume of our loan activities, along with the general economic and real estate market conditions. We utilize a two-tier approach: (1) identification of impaired loans and establishment of specific loss allowances on such loans; and (2) establishment of general valuation allowances on the remainder of our loan portfolio. A specific loan loss allowance is established for an impaired loan based on delinquency status, size of loan, type of collateral and/or appraisal of the underlying collateral and financial condition of the borrower. 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 and management's judgment.

There was a \$68,000 provision for loan losses recorded for the year ended June 30, 2005, but no provision for loan losses in 2004. During the year ended June 30, 2005, total loans increased to \$562.6 million at June 30, 2005, from \$510.2 million at June 30, 2004. Non-performing loans were \$1.9 million, or 0.34%, of total loans at June 30, 2005, as compared to \$2.3 million, or 0.46%, of total loans at June 30, 2004. The allowance for loan losses as a percentage of gross loans outstanding was 0.96% at June 30, 2005, compared to 1.01% at June 30, 2004, reflecting balances of \$5.4 million and \$5.1 million, respectively. The ratio of the allowance for loan losses to non-performing loans increased to 281.79% at June 30, 2005, from 220.96% at June 30, 2004. The increase is a result of a \$406,000 decrease in non-performing loans from \$2.3 million at June 30, 2004, to \$1.9 million at June 30, 2004.

Management assesses the allowance for loan losses monthly. While management uses available information to recognize losses on loans, future loan loss provisions may be necessary based on changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses and may require us to recognize additional provisions based on their judgment of information available to them at the time of their examination. The allowance for loan

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losses as of June 30, 2005 was maintained at a level that represented management's best estimate of losses in the loan portfolio to the extent they were both probable and reasonably estimable.

Non-interest Income. Non-interest income attributed to fees, service charges and miscellaneous income and excluding gains on the sale of securities increased \$238,000, or 14.9%, to \$1.8 million for the year ended June 30, 2005, from \$1.6 million for the year ended June 30, 2004. The increase resulted primarily from an increase in fee income from the Bank's retail branch network, an increase in the cash value of bank owned life insurance and non-recurring loan fee income. At June 30, 2005, we had a \$4.0 million investment in bank owned life insurance, compared to \$3.8 million at June 30, 2004.

Non-interest income attributed to gains on the sale of securities was \$7.7 million in the year ended June 30, 2005, resulting from the sale of 120,000 shares of Freddie Mac common stock and a trust-preferred security with a carrying value of \$1.0 million. There were no sales of securities during 2004. Concern about the future of government-sponsored enterprises triggered the sale of approximately 48% of the Company's Freddie Mac common stock investment. Both the common stock and trust-preferred security were part of the Company's available for sale investment portfolio.

Non-interest Expense. Non-interest expense increased \$5.4 million, or 18.3%, to \$34.9 million for the year ended June 30, 2005, from \$29.5 million for the year ended June 30, 2004. The increase in non-interest expenses resulted



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from increases in salaries and employee benefits, net occupancy expense of premises and equipment, advertising and miscellaneous expenses. These increases were offset by the absence of merger related expenses in 2005 as compared to \$592,000 of such expense during 2004.

Salaries and employee benefits increased \$4.3 million, or 26.1%, to \$20.8 million in the year ended June 30, 2005, from \$16.5 million in the year ended June 30, 2004. The compensation component increased \$1.4 million, or 12.5%, to \$12.6 million for the year ended June 30, 2005, from \$11.2 million for the year ended June 30, 2004. The increase resulted from normal salary increases plus additional employees, including several business development personnel and mortgage solicitors hired during the year. Pension plan expense and employee benefits expense increased \$1.7 million and \$574,000, respectively, for the year ended June 30, 2005 compared to 2004. The increase in pension plan expense resulted from lower than expected investment returns on plan assets and higher contributions due to the incremental effect of normal salary increases. During the period March through June 2005, we recorded \$466,000 in employee stock ownership plan ("ESOP") compensation expense. The ESOP commenced immediately following the initial public offering completed in February 2005, therefore, there was no such expense recorded in 2004.

Net occupancy expense of premises and equipment expense increased \$1.1 million, or 18.3%, to \$7.1 million for the year ended June 30, 2005, from \$6.0 million for the year ended June 30, 2004. Net occupancy expense of premises and equipment expense increased \$640,000 and \$478,000, respectively, for the year ended June 30, 2005 compared to 2004. The increase in net occupancy expense of premises reflects the impact of our new 53,000 square foot administrative headquarters building in Fairfield, New Jersey. Management staff and administrative operations began occupying the building in late September and continued to move in until December 2004. Approximately nine months of operating expenses and six months of depreciation expense is included in the year ended June 30, 2005. The increase in equipment expense resulted from higher depreciation expense and increased costs related to data processing, ATM support and Internet banking, all of which are outsourced.

Advertising expense increased \$315,000, or 36.6%, to \$1.2 million for the year ended June 30, 2005, from \$861,000 for the year ended June 30, 2004. The increase in advertising expense resulted from greater media advertising in an attempt to increase loan originations, publicize the Bank's retail and commercial products and refine the Bank's branding. Also, rather than relying exclusively on the large circulation newspapers, management began focusing specifically on the counties in which we operate, through advertisements in smaller local newspapers.

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All other elements of non-interest expenses increased \$281,000, or 5.4%, to \$5.8 million for the year ended June 30, 2005, from \$5.5 million, net of merger related expenses of \$592,000 for the year ended June 30, 2004. Most of the increase in miscellaneous expenses is due to the increased costs associated with being a public company, such as periodic reporting, retention of a transfer agent and professional fees. Professional fees consisting of legal expense and audit and accounting services expense increased \$43,000 and \$161,000, respectively, for the year ended June 30, 2005, compared to 2004.

Provision for Income Taxes. The provision for income taxes increased \$2.0 million, or 35.1%, to \$7.7 million for the year ended June 30, 2005, from \$5.7 million for the year ended June 30, 2004. The increase in income tax expense resulted from an increase in pre-tax income of \$8.0 million, or 43.0%, to \$26.6 million in the year ended June 30, 2005, from \$18.6 million for the

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year ended June 30, 2004. The effective income tax rates were 28.9% for the year ended June 30, 2005, as compared to 30.8% for the year ended June 30, 2004. Management attributes the lower effective income tax rate to tax management strategies, including investing in bank-qualified tax-exempt municipal bonds and transferring investment securities held to maturity and mortgage-backed securities held to maturity to a New Jersey investment subsidiary, Kearny Federal Investment Corp., a wholly-owned subsidiary of the Bank, which commenced operations in July 2004. Of particular significance, tax-exempt municipal bond interest reduced the Company's federal income expense by approximately \$2.2 million.

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Average Balance Sheet. The following table sets forth certain information relating to Kearny Financial Corp. at and for the periods indicated. We derived the average yields and costs by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods presented with daily balances used to derive average balances with the exception of the year ended June 30, 2004. Management does not believe that the use of weekly or monthly balances for the year ended June 30, 2004 caused any material differences in the information presented.

	At June 30,		For the Year Ended J				
	2006		2006		2005		
	Actual Balance	Actual Yield/ Cost	Average Balance	Average Interest	Average Yield/ Cost	Average Balance	Average Interest
(Dollars in thousands)							
Interest-earning assets:							
Loans receivable, net(1).....	\$ 703,613	5.68%	\$ 628,245	\$35,338	5.62%	\$ 517,746	\$29,31
Mortgage-backed securities held to maturity.....	689,962	4.85	728,960	33,471	4.59	740,417	33,95
Investment securities:(2)							
Tax-exempt.....	200,312	3.78	202,042	7,634	3.78	180,513	6,90
Taxable.....	27,082	5.72	192,561	6,554	3.40	309,740	9,63
Securities purchased under agreements to resell.....	-	0.00	-	-	0.00	-	
Other interest- earning assets(3).....	213,122	5.13	147,949	6,326	4.28	114,916	2,64
<b>Total interest- earning assets.....</b>	<b>1,834,091</b>	<b>5.10</b>	<b>1,899,757</b>	<b>89,323</b>	<b>4.70</b>	<b>1,863,332</b>	<b>82,44</b>
Non-interest-earning assets.....	173,434		161,423			151,055	
<b>Total assets.....</b>	<b>\$2,007,525</b>		<b>\$2,061,180</b>			<b>\$2,014,387</b>	
Interest-bearing liabilities:							
Interest-bearing							

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demand.....	\$ 122,129	1.56	\$ 103,397	931	0.90	\$ 105,503	75
Savings and club.....	377,431	1.15	429,019	5,064	1.18	533,131	5,42
Certificates of deposit.....	883,098	3.83	888,809	29,074	3.27	873,907	20,35
Federal Home Loan Bank advances.....	61,105	5.46	65,333	3,576	5.47	80,990	3,89
	-----		-----	-----		-----	-----
Total interest- bearing liabilities..	1,443,763	3.01	1,486,558	38,645	2.60	1,593,531	30,42
				-----			-----
Non-interest-bearing liabilities.....	72,876		71,089			71,119	
	-----		-----			-----	
Total liabilities.....	1,516,639		1,557,647			1,664,650	
Stockholders' equity.....	490,886		503,533			349,737	
	-----		-----			-----	
Total liabilities and stockholders' equity..	\$2,007,525		\$2,061,180			\$2,014,387	
	=====		=====			=====	
Net interest income.....				\$50,678			\$52,01
				=====			=====
Interest rate spread(4)..		2.09%			2.10%		
		====			====		
Net yield on interest- earning assets(5).....					2.67%		
					====		
Ratio of average interest-earning assets to average interest- bearing liabilities.....	1.27x		1.28x			1.17x	
	=====		=====			=====	

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- (1) Non-accruing loans have been included in loans receivable, and the effect of such inclusion was not material.
  - (2) Includes both available for sale and held to maturity securities.
  - (3) Includes interest-bearing deposits at other banks, federal funds purchased and Federal Home Loan Bank of New York capital stock.
  - (4) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.
  - (5) Net yield on interest-earning assets represents net interest income as a percentage of average interest-earning assets.

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

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	Year Ended June 30,		
	2006 vs. 2005		
	Increase (Decrease) Due to		
	Volume	Rate	Net
(In thou)			
Interest and dividend income:			
Loans receivable.....	\$ 6,235	\$ (208)	\$ 6,027
Mortgage-backed securities held to maturity.....	(483)	-	(483)
Investment securities:			
Tax-exempt.....	804	(74)	730
Taxable.....	(3,911)	833	(3,078)
Securities purchased under agreements to resell.....	-	-	-
Other interest-earning assets.....	923	2,763	3,686
	-----	-----	-----
Total interest-earning assets.....	\$ 3,568	\$ 3,314	\$ 6,882
	=====	=====	=====
Interest expense:			
Interest-bearing demand.....	\$ (15)	\$ 194	\$ 179
Savings and club.....	(1,145)	787	(358)
Certificates of deposit.....	353	8,363	8,716
Advances from Federal Home Loan Bank.....	(813)	499	(314)
	-----	-----	-----
Total interest-bearing liabilities.....	\$ (1,620)	\$ 9,843	\$ 8,223
	=====	=====	=====
Change in net interest income.....	\$ 5,188	\$ (6,529)	\$ (1,341)
	=====	=====	=====

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Liquidity and Commitments

Our liquidity, represented by cash and cash equivalents, is a product of our operating, investing and financing activities. Our primary sources of funds are deposits, amortization, prepayments and maturities of mortgage-backed securities and outstanding loans, maturities of investment securities and funds provided from operations. In addition, we invest excess funds in short-term interest-earning assets such as overnight deposits or U.S. agency securities, which provide liquidity to meet lending requirements. While scheduled payments from the amortization of loans and mortgage-backed securities and maturing investment securities and short-term investments are relatively predictable sources of funds, general interest rates, economic conditions and competition greatly influence deposit flows and prepayments on loans and mortgage-backed securities.

The Bank is required to have enough investments that qualify as liquid assets in order to maintain sufficient liquidity to ensure a safe operation. Liquidity may increase or decrease depending upon the availability of funds and comparative yields on investments in relation to the return on loans. We attempt

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to maintain adequate but not excessive liquidity, and liquidity management is both a daily and long-term function of business management.

We review cash flow projections regularly and update them in order to maintain liquid assets at levels believed to meet the requirements of normal operations, including loan commitments and potential deposit outflows from maturing certificates of deposit and savings withdrawals. At June 30, 2006, the Bank had outstanding commitments to originate loans of \$44.4 million, construction loans in process of \$11.4 million and unused lines of credit of \$25.5 million.

Certificates of deposit increased during the quarter ended June 30, 2005, due to a promotional short-term rate offered by the Bank. Deposits, primarily certificates of deposit, decreased in the quarters ended September 30, 2005 and December 31, 2005 as the Bank intentionally slowed increases in the rates it pays on deposits relative to the pace of rising market interest rates. Certificates of deposit continued to decrease, as well as core deposits, during the quarter ended March 31, 2006. Management's goal to slow the increase in the cost of funds was not sustainable. In the quarter ended March 31, 2006, the Bank introduced several deposit products designed to build core deposits and adjusted interest rates on certificates of deposit to stabilize their rate of attrition. During the quarter ended June 30, 2006, management introduced promotional rates for terms of five, nine and 13 months to retain and attract new certificates of deposit. Certificates of deposit scheduled to mature in one year or less at June 30, 2006, totaled \$658.2 million.

While deposits are the Bank's primary source of funds, the Bank also generates cash through borrowings from the Federal Home Loan Bank of New York (the "FHLB"). At June 30, 2006, advances from the FHLB amounted to \$61.1 million. The Bank has the capacity to borrow additional funds from the FHLB, through an overnight line of credit or by taking additional long-term or short-term advances. Because of continued strong loan demand and continued deposit outflows, the Bank began utilizing the FHLB overnight line of credit during the quarter ended March 31, 2006. Management used proceeds from the restructuring of the securities portfolio in February 2006 to repay the borrowed money. No further borrowing occurred during the year ended June 30, 2006, due to adequate liquidity.

As noted above, loan prepayments are greatly influenced by general interest rates. At June 30, 2006, 79.6% of our loan portfolio consisted of fixed rate loans with maturities of greater than one year. If a rising interest rate environment were to occur, we would expect that the rate of prepayments on fixed rate loans would decrease, thus decreasing the amount of funds coming from prepayments and reducing our liquidity.

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The following table discloses our contractual obligations and commitments as of June 30, 2006.

	Total	Less Than 1 Year	1-3 Years	4-5 Years
	-----	-----	-----	-----
	(In thousands)			
Operating lease obligations.....	\$ 1,728	\$ 271	\$ 443	\$ 3
Certificates of deposit.....	883,098	658,218	200,090	24,7
Federal Home Loan Bank advances.....	61,105	5,618	45,487	10,0

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	----- \$945,931 =====	----- \$664,107 =====	----- \$246,020 =====	----- \$35,000 =====
Total.....				
	Total Amounts Committed	Less Than 1 Year	1-3 Years	4-5 Years
	-----	-----	-----	-----
			(In thousands)	
Undisbursed funds from approved lines of credit (1).....	\$25,556	\$ 534	\$ -	\$ -
Construction loans in process.....	11,368	8,395	2,973	-
Other commitments to extend credit(1).....	44,424	44,424	-	-
	-----	-----	-----	-----
Total.....	\$81,348	\$53,353	\$2,973	\$ -
	=====	=====	=====	=====

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(1) Represents amounts committed to customers.

Our material capital expenditure plans relate to renovations and significant improvements to six branch offices, which includes the replacement of one office location with a new building. We expect to complete such renovations, improvements and construction by the end of calendar year 2007, and we anticipate approximately \$3.6 million in funds will be required for the plans related to these six offices. Furthermore, in December of 2004, we acquired a 3.7 acre parcel of land in West Caldwell, New Jersey. We intend to construct a branch office at this location and subdivide and lease to third parties the portion of land not used for the branch building. Engineering studies continue at this location, while we attempt to develop a plan acceptable to the municipality.

The general business purpose of these expenditures is to maintain and improve Kearny Federal Savings Bank's facilities. We anticipate that cash flows from our normal operations will be a sufficient source of funds for these expenditure plans.

Off-Balance Sheet Arrangements

We are a party to financial instruments with off-balance-sheet risk in the normal course of our business of investing in loans and securities as well as in the normal course of maintaining and improving Kearny Federal Savings Bank's facilities. These financial instruments include significant purchase commitments, such as commitments related to capital expenditure plans and commitments to purchase investment securities or mortgage-backed securities, and commitments to extend credit to meet the financing needs of our customers. At June 30, 2006, we had no significant off-balance sheet commitments to purchase securities. Our significant purchase commitments as of June 30, 2006 related to capital expenditure plans consisted of anticipated post-June 30, 2006 expenditures of approximately \$281,000 connection with the completion of renovations of existing branches in Old Tappan and Northvale, New Jersey.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Our exposure to credit loss in the event of

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nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. We use the same credit policies in making

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commitments and conditional obligations as we do for on-balance-sheet instruments. At June 30, 2006, the total approved loan origination commitments outstanding amounted to \$44.4 million and commitments to purchase participation interests in loans totaled \$0. At the same date, unused lines of credit were \$25.5 million and construction loans in process were \$11.4 million. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. For additional information regarding our outstanding lending commitments at June 30, 2006, see Note 16 to consolidated financial statements contained in this Annual Report on Form 10-K.

### Capital

Consistent with its goals to operate a sound and profitable financial organization, Kearny Federal Savings Bank actively seeks to maintain a well capitalized institution in accordance with regulatory standards. As of June 30, 2006, Kearny Federal Savings Bank exceeded all capital requirements of the Office of Thrift Supervision. Kearny Federal Savings Bank's regulatory capital ratios at June 30, 2006 were as follows: core capital 19.41%; Tier I risk-based capital 48.19%; and total risk-based capital 48.90%. The regulatory capital requirements to be considered well capitalized are 5.0%, 6.0% and 10.0%, respectively. For additional information regarding regulatory capital at June 30, 2006, see Note 14 to consolidated financial statements contained in this Annual Report on Form 10-K.

### Impact of Inflation

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

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

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

### Recent Accounting Pronouncements

Management believes that there were no significant recent accounting pronouncements requiring disclosure at June 30, 2006.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk  
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Management of Interest Rate Risk and Market Risk

Qualitative Analysis. Because the majority of our assets and liabilities are sensitive to changes in interest rates, a significant form of market risk for us is interest rate risk, or changes in interest rates. Notwithstanding the unpredictability of future interest rates, management expects that changes in interest rates may have a significant, adverse impact on our net interest income.

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:

- o the interest income we earn on our interest-earning assets, such as loans and securities; and
- o the interest expense we pay on our interest-bearing liabilities, such as deposits and amounts we borrow.

The rates we earn on our assets are generally fixed for a contractual period of time. We, like many savings institutions, have liabilities that generally have shorter contractual maturities than our assets, such as certificates of deposit, or have no stated maturity, such as savings and money market deposits. This imbalance can create significant earnings volatility because market interest rates change over time. In a period of rising interest rates, the interest income earned on our assets, which consist primarily of long-term, fixed-rate securities, may not increase as rapidly as the interest paid on our liabilities.

We are vulnerable to volatility in our earnings as a result of an increase in interest rates because the majority of our interest-earning assets consist of long-term, fixed rate assets. At June 30, 2006, 82.1% of our loans with contractual maturities of greater than one year had fixed rates of interest, and 74.4% of our total loans had contractual maturities of ten or more years. At June 30, 2006, we held \$690.0 million of mortgage-backed securities, representing 34.4% of our assets. We invest generally in fixed-rate securities and 97.0% of our mortgage-backed securities at June 30, 2006 had contractual maturities of greater than ten years. In an increasing rate environment, our cost of funds is expected to increase more rapidly than the interest earned on our loan portfolio and securities portfolio because our primary source of funds is deposits with generally shorter maturities than the maturities on our loans and investment securities. Having interest-bearing liabilities that reprice more frequently than interest-earning assets will be detrimental during periods of rising interest rates and could cause our net interest rate spread to shrink because the increase in the rates we would earn on our securities and loan portfolios may be less than the increase in the rates we would pay on deposits and borrowings.

In a period of falling interest rates, prepayments of loans and mortgage-backed securities generally will increase as borrowers refinance their debt in order to reduce their borrowing cost. This causes reinvestment risk, because in a falling rate environment we are generally not able to reinvest prepayments at rates that are comparable to the rates we earned on the prepaid loans or securities. A falling rate environment would result in a decrease in



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rates we pay on deposits and borrowings, but the decrease in the cost of our funds may not be as great as the decrease in the yields on our mortgage-backed securities and loan portfolios. This could cause a narrowing of our net interest rate spread and could cause a decrease in our earnings.

The Board of Directors has established an Interest Rate Risk Management Committee, comprised of Directors Regan, Aanensen, Mazza and Parow, which is responsible for monitoring interest rate risk. Our Chief Financial Officer also participates in this committee as a management liaison. The committee meets quarterly to address management of our assets and liabilities, including review of our short term liquidity position; loan and deposit pricing and production volumes and alternative funding sources; current

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investments; average lives, durations and repricing frequencies of loans and securities; and a variety of other asset and liability management topics. The results of the committee's quarterly review are reported to the full Board, which makes adjustments to our interest rate risk policy and strategies as it considers necessary and appropriate.

Quantitative Analysis. The following table presents Kearny Federal Savings Bank's net portfolio value as of June 30, 2006. The Office of Thrift Supervision, based on information provided by Kearny Federal Savings Bank, calculated the net portfolio values shown in this table.

At June 30, 2006					
Changes in Rates (1)	Net Portfolio Value		Net Portfolio Value as % of Present Value of Assets		
	\$ Amount	\$ Change	% Change	Net Portfolio Value Ratio	Basis Point Change
	(Dollars in thousands)				
+300 bp	274,160	-135,558	-33%	15.39%	-581 bp
+200 bp	318,540	-91,178	-22%	17.40%	-380 bp
+100 bp	364,082	-45,637	-11%	19.35%	-185 bp
0 bp	409,718			21.20%	
-100 bp	451,685	41,966	+10%	22.80%	+160 bp
-200 bp	482,117	72,398	+18%	23.88%	+268 bp

(1) The -300bp scenario is not shown due to the low prevailing interest rate environment.

This analysis also indicated that as of June 30, 2006 an immediate and permanent 2.00% increase in interest rates would cause an approximately 6.41% decrease in our net interest income.

Future interest rates or their effect on net portfolio value or net interest income are not predictable. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, prepayments, and deposit run-offs, and should not be relied upon as indicative of actual results. Certain shortcomings are inherent in this type of computation. Although certain assets and liabilities may have similar maturity or periods of repricing, they may react at different times and in different degrees to changes in market interest rates. The interest rate on certain types of assets and liabilities, such as demand deposits and savings accounts, may fluctuate in advance of changes in market

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interest rates, while rates on other types of assets and liabilities may lag behind changes in market interest rates. Certain assets, such as adjustable rate mortgages, generally have features which restrict changes in interest rates on a short-term basis and over the life of the asset. In the event of a change in interest rates, prepayments and early withdrawal levels could deviate significantly from those assumed in making calculations set forth above. Additionally, an increased credit risk may result as the ability of many borrowers to service their debt may decrease in the event of an interest rate increase.

Notwithstanding the discussion above, the quantitative interest rate analysis presented above indicates that a rapid increase in interest rates would adversely affect our net interest margin and earnings.

### Item 8. Financial Statements and Supplementary Data

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The Company's financial statements are contained in this Annual Report on Form 10-K immediately following Item 15.

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### Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure

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There were no disagreements or reportable events as described in Item 304 of Regulation S-K in connection with the merger of the Company's former independent auditors, Radics & Co., LLC, into the Company's current independent auditors, Beard Miller Company LLP.

### Item 9A. Controls and Procedures

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#### (a) Disclosure Controls and Procedures

Based on their evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")), the Company's principal executive officer and principal financial officer have concluded that as of the end of the period covered by this Annual Report on Form 10-K such disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to the Company's management, including the principal executive and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

#### (b) Internal Control over Financial Reporting

1. Management's Annual Report on Internal Control Over Financial Reporting.

Management's report on the Company's internal control over financial reporting appears in the Company's financial statements that are contained in this Annual Report on Form 10-K immediately following Item 15. Such report is incorporated herein by reference.

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### 2. Attestation Report of Independent Public Accounting Firm.

The attestation report of Beard Miller Company LLP on management's assessment of the Company's internal control over financial reporting appears in the Company's financial statements that are contained in this Annual Report on Form 10-K immediately following Item 15. Such report is incorporated herein by reference.

### 3. Changes in Internal Control Over Financial Reporting.

During the last quarter of the year under report, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

### Item 9B. Other Information

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None.

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## PART III

### Item 10. Directors and Executive Officers of the Registrant

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The information that appears under the headings "Section 16(a) Beneficial Ownership Reporting Compliance" and "Information Regarding Directors and Executive Officers" in the Registrant's definitive proxy statement for the Registrant's 2006 Annual Meeting of Stockholders (the "Proxy Statement") is incorporated herein by reference.

The Company has adopted a code of ethics that applies to its principal executive officer, principal financial officer and principal accounting officer. A copy of the code of ethics is available without charge upon request to the Corporate Secretary, Kearny Financial Corp., 120 Passaic Avenue, Fairfield, New Jersey 07004.

### Item 11. Executive Compensation

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The information that appears under the headings "Board of Directors and Executive Officer Compensation" and "Compensation Committee Report on Executive Compensation" in the Proxy Statement is incorporated herein by reference.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and

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#### Related Stockholder Matters

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- (a) Security Ownership of Certain Beneficial Owners. Information required by this item is incorporated herein by reference to the section captioned "Voting Securities and Principal Holders Thereof" in the Proxy Statement.
- (b) Security Ownership of Management. Information required by this item is incorporated herein by reference to the section captioned "Information Regarding Directors and Executive Officers" in the Proxy Statement.

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- (c) Changes in Control. Management of the Company knows of no arrangements, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change in control of the registrant.
- (d) Securities Authorized for Issuance Under Equity Compensation Plans. Set forth below is information as of June 30, 2006 with respect to compensation plans under which equity securities of the Registrant are authorized for issuance.

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Equity Compensation Plan Information

	(A)	(B)	(C)
	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-average Exercise Price of Outstanding Options, Warrants and Rights	Number Remaini Future Equit Plans (E Reflect
	-----	-----	-----
Equity compensation plans approved by shareholders:			
2005 Stock Compensation and Incentive Plan (1).....	3,374,240	\$ 12.34	
Equity compensation plans not approved by stockholders:			
None.....	-	-	
	-----	-----	-----
Total.....	3,374,240	\$ 12.34	
	=====	=====	=====

(1) In addition to 3,374,240 options outstanding under this plan as of June 30, 2006, restricted stock awards of 1,337,696 shares were outstanding under this plan as of June 30, 2006. Such awards are earned at the rate of 20% one year after the date of the grant and 20% annually thereafter. As of June 30, 2006, there were 189,897 shares remaining available for restricted share awards under this plan, and these shares are included under column (C) as securities remaining available for future issuance under this plan along with 87,959 options remaining available for award.

Item 13. Certain Relationships and Related Transactions

The information that appears under the subheading "Certain Relationships and Related Transactions" under the heading "Information Regarding Directors and Executive Officers" in the Proxy Statement is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

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The information relating to this item is incorporated herein by reference to the information contained under the section captioned "Information Regarding Independent Auditor" in the Proxy Statement.

### PART IV

#### Item 15. Exhibits and Financial Statement Schedules

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(1) The following financial statements and the independent auditors' report appear in this Annual Report on Form 10-K immediately after this Item 15:

Report of Independent Registered Public Accounting Firm  
Consolidated Statements of Financial Condition as of  
June 30, 2006 and 2005  
Consolidated Statements of Income For the Years Ended  
June 30, 2006, 2005 and 2004  
Consolidated Statements of Changes in Stockholders' Equity  
for the Years Ended June 30, 2006, 2005 and 2004  
Consolidated Statements of Cash Flows for the Years Ended  
June 30, 2006, 2005 and 2004  
Notes to Consolidated Financial Statements

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(2) All schedules are omitted because they are not required or applicable, or the required information is shown in the consolidated financial statements or the notes thereto.

(3) The following exhibits are filed as part of this report:

3.1	Charter of Kearny Financial Corp.*
3.2	Bylaws of Kearny Financial Corp.*
4	Stock Certificate of Kearny Financial Corp*
10.1	Employment Agreement with John N. Hopkins**
10.2	Employment Agreement with Allan Beardslee**
10.3	Employment Agreement with Albert E. Gossweiler**
10.4	Employment Agreement with Sharon Jones**
10.5	Employment Agreement with William C. Ledgerwood**
10.6	Employment Agreement with Erika Sacher Parisi**
10.7	Employment Agreement with Patrick M. Joyce**
10.8	Employment Agreement with Craig Montanaro**
10.9	Directors Consultation and Retirement Plan**
10.10	Benefit Equalization Plan**
10.11	Benefit Equalization Plan for Employee Stock Ownership Plan**
10.12	Stock Option Plan ***
10.13	Restricted Stock Plan ***
10.14	Kearny Federal Savings Bank Director Life Insurance Agreement****
10.15	Kearny Federal Savings Bank Executive Life Insurance Agreement****
11	Statement regarding computation of earnings per share
21	Subsidiaries of the Registrant (see "Item 1. Business - Subsidiary Act
23	Consent of Beard Miller Company LLP
31	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 200
32	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 200

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- \* Incorporated by reference to the exhibits to the Registrant's Registration Statement (File No. 333-118815).
- \*\* Incorporated by reference to the exhibit to the Registrant's Form 8-K filed on (File No. 000-51093).
- \*\*\* Incorporated by reference to the appendices to the Registrant's definitive proxy 2005 Annual Meeting filed on September 30, 2005 (File No. 000-51093).
- \*\*\*\* Incorporated by reference to the exhibits to the Registrant's Form 8-K filed on (File No. 000-51093).
- + Management or compensatory plan required to be filed as an exhibit.

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September 1, 2006

Beard Miller Company LLP  
55 US Highway 46 East  
PO Box 676  
Pine Brook, NJ 07058-0676

### Management Report on Internal Control over Financial Reporting

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The management of Kearny Financial Corp. and Subsidiaries (collectively the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control system is a process designed to provide reasonable assurance to the management and board of directors regarding the preparation and fair presentation of published consolidated financial statements.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on our consolidated financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to consolidated financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management assessed the effectiveness of internal control over financial reporting as of June 30, 2006. In making this assessment, we used the criteria set forth by The Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework. Based on our assessment, we believe that, as of June 30, 2006, the Company's internal control over financial reporting is effective based on those criteria.

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Page 2  
Beard Miller Company LLP  
Management Report  
September 1, 2006

The Company's independent registered public accounting firm that audited the consolidated financial statements has issued an audit report on our assessment of, and the effective operation of, the Company's internal control over financial reporting as of June 30, 2006.

/s/John N. Hopkins  
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John N. Hopkins  
President and Chief Executive Officer

/s/Albert E. Gossweiler  
-----

Albert E. Gossweiler  
Senior Vice President and Chief Financial Officer

[BMC LOGO]

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders  
Kearny Financial Corp.

We have audited management's assessment, included in the accompanying Management Report on Internal Control Over Financial Reporting, that Kearny Financial Corp. (the "Company") and Subsidiaries maintained effective internal control over financial reporting as of June 30, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Management of the Company is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

To the Board of Directors and Stockholders 2.  
Kearny Financial Corp.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Kearny Financial Corp. and Subsidiaries maintained effective internal control over financial reporting as of June 30, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Kearny Financial Corp. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of June 30, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial condition of the Company as of June 30, 2006 and 2005, and the related consolidated statements of income, changes in stockholders' equity, and cash flows of the Company for each of the years in the three-year period ended June 30, 2006, and our report dated September 1, 2006, expressed an unqualified opinion.

/s/Beard Miller Company, LLP

Beard Miller Company, LLP  
Pine Brook, New Jersey  
September 1, 2006

### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors  
Kearny Financial Corp.  
Kearny, New Jersey

We have audited the accompanying consolidated statements of financial



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condition of Kearny Financial Corp. (the "Company") and Subsidiaries as of June 30, 2006 and 2005, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended June 30, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to in the second preceding paragraph present fairly, in all material respects, the consolidated financial position of Kearny Financial Corp. and Subsidiaries as of June 30, 2006 and 2005, and the consolidated results of their operations and cash flows for each of the years in the three-year period ended June 30, 2006, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Kearny Financial Corp.'s internal control over financial reporting as of June 30, 2006, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated September 1, 2006 expressed an unqualified opinion on management's assessment of internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ Beard Miller Company LLP

Beard Miller Company LLP  
Pine Brook, New Jersey  
September 1, 2006

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES  
-----  
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

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## ASSETS

Cash and amounts due from depository institutions  
Interest-bearing deposits in other banks

### Cash and Cash Equivalents

Securities available for sale (amortized cost 2006 \$18,550; 2005 \$25,153)  
Securities held to maturity (estimated fair value 2006 \$204,447; 2005 \$469,221)  
Loans receivable, including net deferred loan costs 2006 \$1,087; 2005 \$815  
Less allowance for loan losses

### Net Loans Receivable

Mortgage-backed securities held to maturity (estimated fair value 2006 \$670,329;  
2005 \$762,730)  
Premises and equipment  
Federal Home Loan Bank of New York ("FHLB") stock  
Interest receivable  
Goodwill  
Bank owned life insurance  
Other assets

### Total Assets

## LIABILITIES AND STOCKHOLDERS' EQUITY

### LIABILITIES

Deposits:  
Non-interest bearing  
Interest-bearing

### Total Deposits

Advances from FHLB  
Advance payments by borrowers for taxes  
Other liabilities

### Total Liabilities

### STOCKHOLDERS' EQUITY

Preferred stock, \$0.10 par value; 25,000,000 shares authorized; none issued and outstanding  
Common stock, \$0.10 par value; 75,000,000 shares authorized; 2006 72,737,500 shares and  
2005 72,737,500 shares issued and outstanding  
Paid-in capital  
Retained earnings  
Unearned Employee Stock Ownership Plan shares  
Accumulated other comprehensive income (loss)

### Total Stockholders' Equity

### Total Liabilities and Stockholders' Equity

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See notes to consolidated financial statements.

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## KEARNY FINANCIAL CORP. AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF INCOME

	Years Ended June 30,		
	2006	2005	2004
	(In Thousands, Except Per Share Data)		
<hr/>			
INTEREST INCOME			
Loans	\$35,338	\$29,311	\$28,919
Mortgage-backed securities	33,471	33,954	33,980
Securities:			
Taxable	6,554	9,632	8,724
Tax-exempt	7,634	6,904	5,702
Other interest-earning assets	6,326	2,640	1,329
	<hr/>	<hr/>	<hr/>
Total Interest Income	89,323	82,441	78,654
	<hr/>	<hr/>	<hr/>
INTEREST EXPENSE			
Deposits	35,069	26,532	28,082
Borrowings	3,576	3,890	4,018
	<hr/>	<hr/>	<hr/>
Total Interest Expense	38,645	30,422	32,100
	<hr/>	<hr/>	<hr/>
Net Interest Income	50,678	52,019	46,554
	<hr/>	<hr/>	<hr/>
PROVISION FOR LOAN LOSSES	72	68	--
	<hr/>	<hr/>	<hr/>
Net Interest Income after Provision for Loan Losses	50,606	51,951	46,554
	<hr/>	<hr/>	<hr/>
NON-INTEREST INCOME			
Fees and service charges	1,016	948	824
Gain on sale of securities	1,023	7,705	--
Miscellaneous	1,286	850	736
	<hr/>	<hr/>	<hr/>
Total Non-Interest Income	3,325	9,503	1,560
	<hr/>	<hr/>	<hr/>
NON-INTEREST EXPENSES			
Salaries and employee benefits	25,145	20,790	16,522
Net occupancy expense of premises	3,282	3,163	2,523
Equipment	4,423	3,953	3,470
Advertising	1,465	1,176	861
Federal insurance premium	548	554	587
Amortization of intangible assets	636	636	636

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Directors' compensation	2,099	886	827
Merger related expenses	--	--	592
Miscellaneous	4,448	3,704	3,454
	-----	-----	-----
Total Non-Interest Expenses	42,046	34,862	29,472
	-----	-----	-----
Income before Income Taxes	11,885	26,592	18,642
INCOME TAXES	2,277	7,694	5,745
	-----	-----	-----
Net Income	\$ 9,608	\$18,898	\$12,897
	=====	=====	=====
NET INCOME PER COMMON SHARE			
Basic	\$ 0.14	\$ 0.33	\$ 0.25
	=====	=====	=====
Diluted	\$ 0.14	\$ 0.33	\$ 0.25
	=====	=====	=====
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING			
Basic	70,904	57,963	50,916
	=====	=====	=====
Diluted	71,100	57,963	50,916
	=====	=====	=====

See notes to consolidated financial statements.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
Years Ended June 30, 2006, 2005, and 2004

	Common Stock		Paid-In	Retained	Unearned	Unearned
	Shares	Amount	Capital	Earnings	ESOP Shares	Incentiv Plan Shar
	-----	-----	-----	-----	-----	-----
	(In Thousands)					
BALANCE - JUNE 30, 2003	12	\$ 1	\$19,066	\$273,970	\$ (663)	\$ (19
Comprehensive income:						
Net income	-	-	-	12,897	-	-
Unrealized gain on securities available for sale, net of deferred income tax expense of \$1,296	-	-	-	-	-	-

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Total Comprehensive Income						
Acquisition of West Essex Bancorp, Inc.	(2)	-	(18,567)	(3,908)	663	19
BALANCE - JUNE 30, 2004	10	1	499	282,959	-	
Comprehensive income:						
Net income	-	-	-	18,898	-	
Realized gain on securities available for sale, net of income tax of \$2,697	-	-	-	-	-	
Unrealized gain on securities available for sale, net of deferred income tax expense of \$240	-	-	-	-	-	
Total Comprehensive Income						
Initial capitalization from establishment of mutual holding company	(10)	(1)	1	-	-	
Proceeds from common stock offering	72,738	7,274	207,293	-	-	

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
Years Ended June 30, 2006, 2005, and 2004

	Common Stock		Paid-In	Retained	Unearned	Unearned
	Shares	Amount	Capital	Earnings	ESOP Shares	Incentiv Plan Shar
	-----	-----	-----	-----	-----	-----
	(In Thousands)					
Unearned ESOP shares (1,746 shares)	-	\$ -	\$ -	\$ -	\$(17,457)	\$ -
ESOP shares committed to be released (48 shares)	-	-	45	-	485	-
BALANCE - JUNE 30, 2005	72,738	7,274	207,838	301,857	(16,972)	-

Comprehensive income:

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Net income	-	-	-	9,608	-	-
Realized gain on securities available for sale, net of income tax of \$3,095	-	-	-	-	-	-
Unrealized gain on securities available for sale, net of deferred income tax expense of \$71	-	-	-	-	-	-
Total Comprehensive Income						
Refund of common stock offering expense	-	-	3	-	-	-
ESOP shares committed to be released (144 shares)	-	-	412	-	1,455	-
Stock option transactions	-	-	1,211	-	-	-
Treasury stock purchases (178)	(178)	-	-	-	-	-
Treasury stock reissued to restricted stock plan	178	-	(2,268)	-	-	-
Restricted stock plan shares purchased (1,194 shares)	-	-	(16,673)	-	-	-
Restricted stock plan shares earned (164 shares)	-	-	2,011	-	-	-
Cash dividends declared (\$0.24/share)	-	-	-	(4,737)	-	-
	-----	-----	-----	-----	-----	-----
BALANCE - JUNE 30, 2006	72,738	\$7,274	\$192,534	\$306,728	\$(15,517)	\$
	=====	=====	=====	=====	=====	=====

See notes to consolidated financial statements.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended June 30	
	2006	2005
	(In Thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 9,608	\$ 18,898
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	1,898	1,549
Net amortization of premiums, discounts and loan fees and costs	1,033	1,035
Deferred income taxes	(9)	343
Amortization of intangible assets	636	636
Provision for loan losses	72	68
Realized gains on sale of securities available for sale	(8,844)	(7,705)

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Realized loss on sale of securities held to maturity	7,821	-
(Increase) in cash surrender value of bank owned life insurance	(439)	(145)
ESOP stock option plan and restricted stock plan expenses	5,089	530
Realized loss on sale of real estate owned	35	-
(Increase) decrease in interest receivable	1,594	(569)
(Increase) decrease in other assets	(2,964)	4,006
Increase (decrease) in interest payable	53	(57)
Increase (decrease) in other liabilities	(446)	1,045
	-----	-----
Net Cash Provided by Operating Activities	15,137	19,634
	-----	-----
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of securities available for sale	(298)	(202)
Proceeds from sale of securities available for sale	15,750	8,866
Proceeds from sale of securities held to maturity	241,206	-
Purchases of securities held to maturity	(4,000)	(54,387)
Proceeds from calls and maturities of securities held to maturity	11,199	15,387
Proceeds from repayments of securities held to maturity	4,836	4,797
Purchase of loans	(24,434)	(1,515)
Net (increase) decrease in loans receivable	(121,373)	(50,913)
Proceeds from sale of real estate owned	65	-
Purchases of mortgage-backed securities held to maturity	(111,670)	(163,607)
Principal repayments on mortgage-backed securities held to maturity	178,918	175,911
Additions to premises and equipment	(2,862)	(9,877)
Purchase of FHLB stock	(3,322)	-
Redemption of FHLB stock	9,277	31
Purchase of bank owned life insurance	(10,208)	-
	-----	-----
Net Cash Provided by (Used in) Investing Activities	183,084	(75,509)
	-----	-----

See notes to consolidated financial statements

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### KEARNY FINANCIAL CORP. AND SUBSIDIARIES

#### CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years E	
	2006	-
	-----	-----
	(In	)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net decrease in deposits	\$ (85,097)	\$
Repayment of FHLB advances	(582)	
Net change in short-term borrowings from FHLB	-	
Increase in advance payments by borrowers for taxes	605	
Proceeds from issuance of common stock of Kearny Financial Corp.	-	
Refund of common stock offering expense	3	
Dividends paid to minority stockholders of Kearny Financial Corp.	(3,795)	
Purchase of common stock of Kearny Financial Corp. for treasury	(2,268)	

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Purchase of common stock of Kearny Financial Corp. for restricted stock plan	(16,673)	
Net Cash Provided by (Used in) Financing Activities	(107,807)	
Net Increase (Decrease) in Cash and Cash Equivalents	90,414	
CASH AND CASH EQUIVALENTS - BEGINNING	139,865	
CASH AND CASH EQUIVALENTS - ENDING	\$ 230,279	\$
SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION Cash paid during the year for:		
Income taxes, net of refunds	\$ 6,154	\$
Interest	\$ 38,592	\$
SUPPLEMENTAL DISCLOSURES OF NON-CASH TRANSACTIONS		
Cash dividend declared	\$ 942	\$
Minority interest in consolidated subsidiaries	\$ -	\$
Goodwill - West Essex acquisition	\$ -	\$
Deposit for acquisition of West Essex Bancorp, Inc.	\$ -	\$

See notes to consolidated financial statements

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### KEARNY FINANCIAL CORP. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

##### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

###### Basis of Consolidated Financial Statement Presentation

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries, Kearny Federal Savings Bank (the "Bank") and Kearny Financial Securities, Inc., and the Bank's wholly-owned subsidiaries, KFS Financial Services, Inc. and Kearny Federal Investment Corp., and have been prepared in conformity with accounting principles generally accepted in the United States of America. All significant intercompany accounts and transactions have been eliminated in consolidation.



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In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the consolidated statements of financial condition and revenues and expenses for the periods then ended. Actual results could differ significantly from those estimates. A material estimate that is particularly susceptible to significant change relates to the determination of the allowance for loan losses. Management believes that the allowance for loan losses represents its best estimate of losses known and inherent in the loan portfolio that are both probable and reasonable to estimate. While management uses available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in economic conditions in the market area.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the recognition of additions to the allowance based on their judgments about information available to them at the time of their examination.

### Business of the Company and Subsidiaries

The Company's primary business is the ownership and operation of the Bank. The Bank is principally engaged in the business of attracting deposits from the general public at its 26 locations in New Jersey and using these deposits, together with other funds, to invest in securities and to make loans collateralized by residential and commercial real estate and, to a lesser extent, consumer loans. The Company's other subsidiary, Kearny Financial Securities, Inc., was organized in April 2005 under Delaware law as a Delaware Investment Company primarily to hold investment and mortgage-backed securities. The Bank's subsidiary, Kearny Federal Investment Corp. was organized in July 2004 under New Jersey law as a New Jersey Investment Company primarily to hold investment and mortgage-backed securities.

### Cash and Cash Equivalents

Cash and cash equivalents include cash and amounts due from depository institutions and interest-bearing deposits in other banks, all with original maturities of three months or less.

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### KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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#### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### Securities

Investments in debt securities that we have the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost. Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized holding gains and losses included in earnings. Debt and equity

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securities not classified as trading securities or as held-to-maturity securities are classified as available for sale securities and reported at fair value, with unrealized holding gains or losses, net of deferred income taxes, reported in the accumulated other comprehensive income component of stockholders' equity.

Individual securities are considered impaired when fair value is less than amortized cost. Management evaluates on a monthly basis whether any securities are other-than-temporarily impaired. In making this determination, we consider the extent and duration for the impairment, the nature and financial health of the issuer, other factors relevant to specific securities, and our ability and intent to hold securities for a period of time sufficient to allow for any anticipated recovery in market value. If a security is determined to be other-than-temporarily impaired, an impairment loss is charged to operations.

Premiums and discounts on all securities are amortized/accreted to maturity by use of the level-yield method. Gain or loss on sales of securities is based on the specific identification method.

### Concentration of Risk

Financial instruments which potentially subject the Company and its subsidiaries to concentrations of credit risk consist of cash and cash equivalents, investment and mortgage-backed securities and loans. Cash and cash equivalents include amounts placed with highly rated financial institutions. Investment securities include securities backed by the U.S. Government and other highly rated instruments. The Bank's lending activity is primarily concentrated in loans collateralized by real estate in the State of New Jersey. As a result, credit risk is broadly dependent on the real estate market and general economic conditions in the state.

### Loans Receivable

Loans receivable are stated at unpaid principal balances plus net deferred loan origination costs and discounts less the allowance for loan losses. Loan origination fees and certain direct loan origination costs are deferred and amortized, using the level-yield method, as an adjustment of yield over the contractual lives of the related loans. Unearned discounts are accreted by use of the level-yield method over the contractual lives of the related loans.

Recognition of interest by the accrual method is generally discontinued when interest or principal payments are ninety days or more in arrears on a contractual basis, or when other factors indicate that the collection of such amounts is doubtful. At the time a loan is placed on nonaccrual status, an allowance for uncollected interest is recorded in the current period for previously accrued and uncollected interest. Interest on such loans, if appropriate, is recognized as income when payments are received. A loan is returned to accrual status when interest or principal payments are no longer ninety days or more in arrears on a contractual basis and factors indicating doubtful collectibility no longer exist.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Allowance for Loan Losses

An allowance for loan losses is maintained at a level that represents management's best estimate of losses known and inherent in the loan portfolio that are both probable and reasonable to estimate. The allowance is decreased by loan charge-offs, increased by subsequent recoveries of loans previously charged off, and then adjusted, via either a charge or credit to operations, to an amount determined by management to be necessary. Loans or portions thereof, are charged off when, after collection efforts are exhausted, they are determined to be uncollectible. Management of the Bank, in determining the allowance for loan losses, considers the losses inherent in its loan portfolio and changes in the nature and volume inherent in its loan activities, along with the general economic and real estate market conditions. The Bank utilizes a two tier approach: (1) identification of impaired loans and establishment of specific loss allowances on such loans; and (2) establishment of general valuation allowances on the remainder of its loan portfolio. The Bank maintains a loan review system which allows for a periodic review of its loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified loans based on a review of such information and/or appraisals of the underlying collateral. General loan losses are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions and management's judgment. Although management believes that specific and general loan losses are established in accordance with management's best estimate, actual losses are dependent upon future events and, as such, further additions to the level of loan loss allowances may be necessary.

A loan evaluated for impairment is deemed to be impaired when, based on current information and events, it is probable that the Bank 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. The Bank does not aggregate such loans for evaluation purposes. Payments received on impaired loans are applied first to interest receivable and then to principal.

#### Premises and Equipment

Land is carried at cost. Buildings and improvements, furnishings and equipment and leasehold improvements are carried at cost, less accumulated depreciation and amortization computed on the straight-line method over the following estimated useful lives:

	Years
	-----
Building and improvements	10 - 50
Furnishings and equipment	4 - 20
Leasehold improvements	Shorter of useful lives or lease term

Construction in progress primarily represents facilities under construction for future use in our business and includes all costs to acquire land and construct buildings, as well as capitalized interest during the construction period. Interest is capitalized at the Bank's average cost of

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interest-bearing liabilities.

Significant renewals and betterments are charged to the property and equipment account. Maintenance and repairs are charged to operations in the year incurred. Rental income is netted against occupancy costs in the consolidated statements of income.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Federal Home Loan Bank Stock

Federal law requires a member institution of the Federal Home Loan Bank system to hold restricted stock of its district Federal Home Loan Bank according to a predetermined formula. The restricted stock is carried at cost.

#### Goodwill and Other Intangible Assets

Goodwill and other intangible assets principally represent the excess cost over the fair value of the net assets of the institutions acquired in purchase transactions. Goodwill is evaluated annually by reporting unit and an impairment loss recorded if indicated. The impairment test is performed in two phases. The first step of the goodwill impairment test compares the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired; however, if the carrying amount of the reporting unit exceeds its fair value, an additional procedure must be performed. That additional procedure compares the implied fair value of the reporting unit's goodwill (as defined in SFAS No. 142), with the carrying amount of that goodwill. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. Fair value is determined by a combination of the Comparable Transaction and Discounted Cash Flow approaches. No impairment charges were required to be recorded in the years ended June 30, 2006, 2005 or 2004. If an impairment loss is determined to exist in the future, such loss will be reflected as an expense in the consolidated statements of income in the period in which the impairment loss is determined. Separate intangible assets, including core deposit intangibles that are not deemed to have indefinite lives, continue to be amortized over their useful lives, which is estimated to be ten years.

#### Bank Owned Life Insurance

Bank owned life insurance is accounted for using the cash surrender value method and is recorded at its realizable value. The change in the net asset value is recorded as a component of non-interest income.

#### Income Taxes

The Company and its subsidiaries file consolidated federal income tax returns. Income taxes are allocated based on the contribution of income to

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the consolidated income tax returns. Separate state income tax returns are filed.

Federal and state income taxes have been provided on the basis of the reported income. The amounts reflected on our tax returns differ from these provisions due principally to temporary differences in the reporting of certain items for financial reporting and income tax reporting purposes. Deferred income taxes are recorded to recognize such temporary differences.

### Interest Rate Risk

The Bank is principally engaged in the business of attracting deposits from the general public and using these deposits, together with other funds, to purchase securities and to make loans secured by real estate. The potential for interest-rate risk exists as a result of the generally shorter duration of interest-sensitive liabilities compared to the generally longer duration of interest-sensitive assets. In a rising rate environment, liabilities will reprice faster than assets, thereby reducing net interest income. For this reason, management regularly monitors the maturity structure of the Bank's assets and liabilities in order to measure its level of interest-rate risk and to plan for future volatility.

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### KEARNY FINANCIAL CORP. AND SUBSIDIARIES

#### ----- NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### Net Income per Common Share

Basic EPS is based on the weighted average number of common shares actually outstanding adjusted for Employee Stock Ownership Plan ("ESOP") shares not yet committed to be released and unvested restricted stock awards. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as unvested restricted stock awards and outstanding stock options, were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. Diluted EPS is calculated by adjusting the weighted average number of shares of common stock outstanding to include the effect of contracts or securities exercisable or which could be converted into common stock, if dilutive, using the treasury stock method. Shares issued and reacquired during any period are weighted for the portion of the period they were outstanding.

The 10,000 shares issued to Kearny MHC in connection with the Company's reorganization in 2001 were "replaced" with 50,916,250 shares, or 70% of the shares issued in the Company's initial public offering. This transaction is analogous to a stock split or significant stock dividend, therefore, net income per common share for those shares have been retroactively restated for all periods presented.

##### Reclassification

Certain amounts as of and for the years ended June 30, 2005 and 2004 have been reclassified to conform to the current year's presentation.

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### NOTE 2 - BUSINESS COMBINATIONS

On September 11, 2002, the Company and the Bank entered into a merger agreement with West Essex Bancorp, Inc. (West Essex), West Essex Savings Bank (WESB) and its 100% owned subsidiaries. On July 1, 2003, the Company purchased West Essex's common stock held by public stockholders for \$35.10 per share, in cash. (The purchase price was transferred to a third party escrow agent as of June 30, 2003.) The purchase of minority interest shares was recorded as the acquisition of the noncontrolling interests of a subsidiary utilizing the purchase method of accounting and the immediately following merger of the Company and West Essex, and the Bank and WESB, were recorded as a combination of entities under common control. The amount paid to minority shareholders of West Essex in excess of their interest in West Essex amounted to \$50,517,000, which was recorded as goodwill. Merger related expenses, which included legal, professional and filing fees and other expenses, were \$592,000 for the year ended June 30, 2004.

### NOTE 3 - STOCK OFFERING

On June 7, 2004, the Board of Directors of the Company and the Bank adopted a plan of stock issuance pursuant to which the Company subsequently sold common stock representing a minority ownership of the estimated pro forma market value of the Company to eligible depositors of the Bank. On February 23, 2005, the Company completed the minority stock offering in which it sold 21,821,250 shares, valued at \$10.00 per share, representing 30% of its outstanding common stock. Kearny MHC (the "MHC") owns the remaining 70% of the outstanding common stock, or 50,916,250 shares. The MHC is a federally-chartered mutual holding company organized on March 30, 2001, and is subject to regulation by the Office of Thrift Supervision. So long as the MHC is in existence, it will continue to own a majority of the outstanding common stock of the Company. The Office of Thrift Supervision also regulates the Company and the Bank.

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### KEARNY FINANCIAL CORP. AND SUBSIDIARIES

### ----- NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 3 - STOCK OFFERING (CONTINUED)

Following the sale of common stock, all depositors who had membership or liquidation rights with respect to the Bank as of the effective date of the transaction continue to have such rights solely with respect to the MHC as long as they continue to hold deposit accounts with the Bank. In addition, all persons who become depositors of the Bank subsequent to the date of the transaction have such membership and liquidation rights with respect to the holding company. Borrowers of the Bank as of the date of the transaction have the same membership rights in the holding company that they had in the Bank immediately prior to the date of the transaction as long as their borrowings remain outstanding.

The minority stock offering resulted in net proceeds of \$214.6 million, after expenses of \$3.6 million. The Company used 50% of the net proceeds to make a capital contribution to the Bank. The Company also provided a term loan to the Bank's Employee Stock Ownership Plan (the "ESOP") to enable it to purchase

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1,745,700 shares of the Company's common stock for the plan.

On November 9, 2005, the Company announced that it received regulatory approval to begin the purchase of up to 1,425,655 shares or approximately 2% of the outstanding shares of its common stock in open market transactions for use in funding the Company's 2005 Stock Compensation and Incentive Plan previously approved by stockholders. During the year ended June 30, 2006, the Company purchased 1,371,341 shares at a total cost of \$18,941,000, or approximately \$13.81 per share.

On July 18, 2006, the Company announced that the Board of Directors authorized a stock repurchase plan to acquire up to 1,091,063 shares, or 5% of the Company's outstanding common stock held by persons other than Kearny MHC. This stock repurchase plan commences after the Company completes its purchase of shares in the open market to fund the Company's 2005 Stock Compensation and Incentive Plan.

During the year ended June 30, 2006, the federally chartered mutual holding company of the Company, Kearny MHC, waived its right, upon non-objection from the Office of Thrift Supervision, to receive cash dividends of \$9,674,000 paid during the year.

### NOTE 4 - SECURITIES AVAILABLE FOR SALE

	June 30, 2006		
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
	-----	-----	-----
	(In Thousands)		
Mutual funds	\$ 7,654	\$ -	\$ 230
Trust preferred securities due after ten years	10,896	134	108
	-----	-----	-----
	\$18,550	\$ 134	\$ 338
	=====	=====	=====

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### KEARNY FINANCIAL CORP. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 4 - SECURITIES AVAILABLE FOR SALE

	June 30, 2005		
	Amortized	Gross Unrealized	Gross Unrealized
	-----	-----	-----

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	Cost -----	Gains -----	Losses -----
(In Thousands)			
Common stock	\$ 128	\$8,423	\$ -
Mutual funds	14,134	161	155
Trust preferred securities due after ten years	10,891	200	191
	-----	-----	-----
	\$25,153	\$8,784	\$346
	=====	=====	=====

During the years ended June 30, 2006 and 2005, proceeds from sales of securities available for sale totaled \$15,750,000 and \$8,866,000 and resulted in gross gains of \$8,844,000 and \$7,705,000, respectively. There were no sales of securities available for sale during the year ended June 30, 2004. At June 30, 2006, securities available for sale with a carrying value of \$9,859,000 are callable within one year.

The age of unrealized losses and fair value of related securities available for sale at June 30, 2006 and 2005 were as follows:

	Less than 12 Months -----		12 Months or More -----	
	Fair Value -----	Unrealized Losses -----	Fair Value -----	Unrealized Losses -----
(In Thousands)				
June 30, 2006:				
Mutual funds	\$ -	\$ -	\$ 7,424	\$230
Trust preferred securities	-	-	4,341	108
	-----	-----	-----	-----
Total	\$ -	\$ -	\$11,765	\$338
	=====	=====	=====	=====
June 30, 2005:				
Mutual funds	\$ -	\$ -	\$ 7,201	\$155
Trust preferred securities	-	-	5,210	191
	-----	-----	-----	-----
Total	\$ -	\$ -	\$12,411	\$346
	=====	=====	=====	=====

As of June 30, 2006 and 2005, management has concluded that the unrealized losses are temporary in nature since they are primarily related to market interest rates and not related to the underlying credit quality of the issuer of the securities. Additionally, we have the intent and ability to hold these investments for a time necessary to recover the amortized cost. As of June 30, 2006, there was one mutual fund and two trust preferred securities in unrealized loss positions compared to one and three, respectively, in unrealized loss positions as of June 30, 2005.



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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 5 - SECURITIES HELD TO MATURITY

	June 30, 2006			
	Carrying Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In Thousands)			
Government agencies:				
After five years but within ten years	\$ 963	\$ 38	\$ 1	\$ 1,000
After ten years	7,773	14	1	7,786
	-----	-----	-----	-----
	8,736	52	2	8,786
	-----	-----	-----	-----
Obligations of states and political subdivisions:				
Within one year	4,339	5	21	4,323
After one year but within five years	17,194	76	430	16,840
After five years but within ten years	120,775	672	3,043	118,404
After ten years	58,004	56	1,966	56,094
	-----	-----	-----	-----
	200,312	809	5,460	195,661
	-----	-----	-----	-----
	\$209,048	\$ 861	\$ 5,462	\$204,447
	=====	=====	=====	=====
	June 30, 2005			
Government agencies:				
Within one year	\$ 17,000	\$ -	\$ 152	\$ 16,848
After one year but within five years	235,019	4	4,065	230,958
After five years but within ten years	494	81	-	575
After ten years	12,956	-	112	12,844
	-----	-----	-----	-----
	265,469	85	4,329	261,225
	-----	-----	-----	-----
Obligations of states and political subdivisions:				
Within one year	4,202	11	3	4,210
After one year but within five years	16,139	216	78	16,277
After five years but within ten years	99,841	2,453	261	102,033
After ten years	84,447	1,327	298	85,476
	-----	-----	-----	-----
	204,629	4,007	640	207,996
	-----	-----	-----	-----

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\$470,098      \$ 4,092      \$ 4,969      \$469,221  
 =====      =====      =====      =====

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 - SECURITIES HELD TO MATURITY (CONTINUED)

During the year ended June 30, 2006, securities held to maturity with a total aggregate carrying value of \$249,027,000 were sold for total proceeds of \$241,206,000 and resulted in gross losses of \$7,821,000. The Company sold its entire portfolio of government agency notes to restructure the securities portfolio by reinvesting the proceeds at current market interest rates to improve the Company's net interest margin. There were no sales of securities held to maturity during the years ended June 30, 2005 and 2004. During the years ended June 30, 2006, 2005 and 2004, proceeds from calls of securities totaled \$-0-, \$10,000,000, and \$103,749,000, respectively, resulting in no gains or losses. At June 30, 2006, securities held to maturity with a carrying value of \$3,467,000 are callable within one year.

At June 30, 2006 and 2005, securities held to maturity with carrying value of approximately \$294,000 and \$293,000, respectively, was pledged to secure public funds on deposit.

At June 30, 2006 and 2005, all obligations of states and political subdivisions were guaranteed by insurance policies issued by various insurance companies.

The age of unrealized losses and fair value of related securities held to maturity at June 30, 2006 and 2005 were as follows:

	Less than 12 Months		12 Months or More		
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	
	-----	-----	-----	-----	
	(In Thousands)				
June 30, 2006:					
Government agencies	\$ -	\$ -	\$ 809	\$ 2	\$
Obligations of states					
and					
political subdivisions	89,281	2,747	49,700	2,713	
	-----	-----	-----	-----	
Total	\$ 89,281	\$ 2,747	\$ 50,509	\$ 2,715	\$
	=====	=====	=====	=====	
June 30, 2005:					
Government agencies	\$ 754	\$ 6	\$254,116	\$ 4,323	\$
Obligations of states					

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and political subdivisions	19,469	221	32,923	419
	-----	-----	-----	-----
Total	\$ 20,223	\$ 227	\$287,039	\$ 4,742
	=====	=====	=====	=====

As of June 30, 2006 and 2005, management has concluded that the unrealized losses are temporary in nature since they are primarily related to market interest rates and not related to the underlying credit quality of the issuers of the securities. Additionally, we have the intent and ability to hold these investments for the time necessary to recover the amortized cost. As of June 30, 2006, there were two Government agencies and 304 obligations of states and political subdivisions in unrealized loss positions compared to 37 and 113, respectively, in unrealized loss positions as of June 30, 2005.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 - LOANS RECEIVABLE

	June 30,	
	2006	2005
	-----	-----
	(In Thousands)	
Real estate mortgage	\$ 572,933	\$ 479,451
	-----	-----
Commercial business	3,208	2,930
	-----	-----
Consumer:		
Home equity loans	93,639	54,199
Home equity lines of credit	12,988	14,850
Passbook or certificate	2,884	2,831
Other	247	264
	-----	-----
	109,758	72,144
	-----	-----
Construction	22,078	8,094
	-----	-----
Total Loans	707,977	562,619
Unamortized premium (discounts) on purchased loans	73	(65)
Deferred loan costs and fees, net	1,014	880
	-----	-----

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\$ 709,064    \$ 563,434  
 =====    =====

At June 30, 2006 and 2005, real estate mortgage loans included \$465,822,000 and \$382,766,000, respectively, of loans secured by one-to-four-family residential properties.

The Bank has granted loans to officers and directors of the Company and its Subsidiaries and to their associates. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than normal risk of collectibility. As of June 30, 2006 and 2005 such loans totaled approximately \$3,732,000 and \$3,188,000, respectively. During the year ended June 30, 2006, new loans to related parties totaled \$775,000 and repayments totaled approximately \$231,000.

The activity in the allowance for loan losses is as follows:

	Years Ended June 30,		
	2006	2005	2004
	-----	-----	-----
	(In Thousands)		
Balance - beginning	\$ 5,416	\$ 5,144	\$ 5,180
Provisions charged to operations	72	68	-
Loans charged off	(42)	(9)	(36)
Loans recovered	5	213	-
	-----	-----	-----
Balance - ending	\$ 5,451	\$ 5,416	\$ 5,144
	=====	=====	=====

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 - LOANS RECEIVABLE (CONTINUED)

At June 30, 2006 and 2005, nonaccrual loans for which the accrual of interest had been discontinued totaled approximately \$942,000 and \$1,922,000, respectively. Had these loans been performing in accordance with their original terms, the interest income recognized for the years ended June 30, 2006, 2005 and 2004, would have been \$81,000, \$162,000, and \$177,000, respectively. Interest income recognized on such loans was \$9,000, \$69,000, and \$118,000, respectively.

There were no impaired loans at the end of June 30, 2006 and 2005. \$-0-, \$88,000, and \$-0- was received and recognized for impaired loans during the years ended June 30, 2006, 2005 and 2004, respectively. The average balance of impaired loans impaired during the years ended June 30, 2006, 2005 and 2004 approximated \$-0-, \$235,000, and \$243,000, respectively.

NOTE 7 - MORTGAGE-BACKED SECURITIES HELD TO MATURITY

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June 30, 2006				
Carrying Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	
(In Thousands)				
Government National Mortgage Association	\$ 42,323	\$ 717	\$ 394	\$ 42,646
Federal Home Loan Mortgage Corporation	264,747	301	9,012	256,036
Federal National Mortgage Association	382,892	253	11,498	371,647
	-----	-----	-----	-----
	\$689,962	\$ 1,271	\$ 20,904	\$670,329
	=====	=====	=====	=====
June 30, 2005				
Government National Mortgage Association	\$ 63,399	\$ 1,767	\$ 196	\$ 64,970
Federal Home Loan Mortgage Corporation	305,059	2,465	1,712	305,812
Federal National Mortgage Association	389,663	3,985	1,700	391,948
	-----	-----	-----	-----
	\$758,121	\$ 8,217	\$ 3,608	\$762,730
	=====	=====	=====	=====

Net premiums of approximately \$2,538,000 and \$3,613,000 at June 30, 2006 and 2005, respectively, are included in the carrying amounts of mortgage-backed securities held to maturity.

There were no sales of mortgage-backed securities held to maturity during the years ended June 30, 2006, 2005 and 2004. At June 30, 2006 and 2005, mortgage-backed securities with carrying value of approximately \$283,000 and \$426,000, respectively, was pledged to secure public funds on deposit.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 - MORTGAGE-BACKED SECURITIES HELD TO MATURITY (CONTINUED)

The age of unrealized losses and fair value of related mortgage-backed securities held to maturity at June 30, 2006 and 2005 were as follows:

Less than 12 Months		12 Months or More		Total
Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
(In Thousands)				
-----	-----	-----	-----	-----
-----	-----	-----	-----	-----

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June 30, 2006	\$314,766 =====	\$8,352 =====	\$279,931 =====	\$12,552 =====	\$594,697 =====
June 30, 2005	\$143,550 =====	\$ 986 =====	\$230,786 =====	\$ 2,622 =====	\$374,336 =====

As of June 30, 2006 and 2005, management has concluded that the unrealized losses are temporary in nature since they are primarily related to market interest rates and not related to the underlying credit quality of the issuers of the securities. Additionally, we have the intent and ability to hold these investments for the time necessary to recover the amortized cost. As of June 30, 2006, there were 320 mortgage-backed securities in unrealized loss positions compared to 117 in unrealized loss positions as of June 30, 2005.

NOTE 8 - PREMISES AND EQUIPMENT

	June 30,	
	2006	
	(In Thousands)	
Land	\$ 8,968	\$
Buildings and improvements	29,760	
Leasehold improvements	505	
Furnishings and equipment	10,242	
Construction in progress	-	
	-----	
	49,475	
Less accumulated depreciation and amortization	13,534	
	-----	
	\$35,941	\$
	=====	=

NOTE 9 - INTEREST RECEIVABLE

	June 30,	
	2006	
	(In Thousands)	
Loans	\$3,038	\$
Mortgage-backed securities	3,267	
Investments	2,531	
	-----	
	\$8,836	\$
	=====	=

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 - GOODWILL AND OTHER INTANGIBLE ASSETS

	Goodwill ----- (In Thousands)	Core Dep Intangib -----
Balance at June 30, 2003	\$31,746	\$2,83
Amortization	-	(63
West Essex Savings Bank acquisition (see Note 2)	50,517	-----
Balance at June 30, 2004	82,263	2,20
Amortization	-	(63
Balance at June 30, 2005	82,263	1,56
Amortization	-	(63
Balance at June 30, 2006	\$82,263 =====	\$ 92 =====

The gross carrying amount of core deposit intangibles was \$5,987,000 at both June 30, 2006 and 2005, while accumulated amortization totaled \$5,059,000 and \$4,423,000 at June 30, 2006 and 2005, respectively. Amortization is expected to total \$636,000 in the year ending June 30, 2007, \$241,000 in the year ending June 30, 2008, and \$43,000 in the year ending June 30, 2009.

NOTE 11 - DEPOSITS

	June 30,			
	2006		2005	
	Amount -----	Weighted Average Interest Rate -----	Amount -----	Wei Ave Int R -----
(Dollars In Thousands)				
Non-interest bearing demand	\$ 61,080	-	\$ 56,142	
Interest-bearing demand	122,129	1.56	99,308	0
Savings and club	377,431	1.15	450,211	1

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Certificates of deposit	883,098	3.83	923,116
	-----		-----
	\$1,443,738	2.78 %	\$1,528,777
	=====		=====

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 - DEPOSITS (CONTINUED)

Certificates of deposit with balances of \$100,000 or more at June 30, 2006 and 2005, totaled approximately \$205,955,000 and \$209,552,000, respectively. Deposits in excess of \$100,000 are not insured by the Federal Deposit Insurance Corporation.

A summary of certificates of deposit by maturity follows:

	June 30,	
	2006	2005
	-----	
	(In Thousands)	
One year or less	\$658,218	\$701,710
After one to two years	179,609	148,557
After two to three years	20,481	43,275
After three to four years	17,875	9,367
After four to five years	6,826	20,019
After five years	89	188
	-----	-----
	\$883,098	\$923,116
	=====	=====

Interest expense on deposits consists of the following:

	Years Ended June 30,		
	2006	2005	2004
	-----		
	(In Thousands)		
Demand	\$ 931	\$ 752	\$ 882
Savings and clubs	5,065	5,422	5,508
Certificates of deposits	29,073	20,358	21,692
	-----	-----	-----



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\$35,069  
=====

\$26,532  
=====

\$28,082  
=====

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES  
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 - ADVANCES FROM FHLB

Fixed rate advances from the Federal Home Loan Bank ("FHLB") of New York mature as follows:

	June 30,		Weighted Average Interest Rate	Wei Ave Int R
	2006	2005		
	Amount	Amount		
	(Dollars In Thousands)			
Twelve months ending June 30:				
2006	\$ -	\$ 582	- %	6
2007	5,618	5,618	5.91 %	5
2008	37,487	37,487	5.41 %	5
2009	8,000	8,000	5.47 %	5
2010	-	-	- %	-
2011	10,000	10,000	5.40 %	5
	-----	-----		
	\$61,105	\$61,687	5.46 %	5
	=====	=====		

At June 30, 2006, of the \$55,487,000 in advances due after one year, \$42,000,000 are callable, all of which are callable within one year.

FHLB advances at June 30, 2006 and 2005 are collateralized by the FHLB capital stock owned by the Bank, investment securities held to maturity and mortgage-backed securities held to maturity with fair values totaling approximately \$97,249,000 and \$106,716,000 and carrying values totaling approximately \$103,748,000 and \$100,806,000, respectively.

NOTE 13 - BENEFIT PLANS

Employee Stock Ownership Plan

Effective upon completion of the Company's initial public offering in February 2005, the Bank established an Employee Stock Ownership Plan

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("ESOP") for all eligible employees who complete a twelve-month period of employment with the Bank, have attained the age of 21 and complete at least 1,000 hours of service in a plan year. The ESOP used \$17,457,000 in proceeds from a term loan obtained from the Company to purchase 1,745,700 shares of Company common stock. The term loan principal is payable over 144 equal installments through March 31, 2017. The interest rate on the term loan is 5.50%. Each year, the Bank intends to make discretionary contributions to the ESOP, which will be equal to principal and interest payments required on the term loan. The Bank may further pay down the loan with dividends paid, if any, on the Company common stock owned by the ESOP.

Shares purchased with the loan proceeds provide collateral for the term loan and are held in a suspense account for future allocations among participants. Contributions to the ESOP and shares released from the suspense account are to be allocated among the participants on the basis of compensation, as described by the Plan, in the year of allocation.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 13 - BENEFIT PLANS

#### Employee Stock Ownership Plan (Continued)

The ESOP is accounted for in accordance with Statement of Position 93-6, "Accounting for Employee Stock Ownership Plans," which was issued by the American Institute of Certified Public Accountants. Accordingly, ESOP shares pledged as collateral were initially recorded as unearned ESOP shares in the consolidated statements of financial condition. Thereafter, on a monthly basis, 12,123 shares are committed to be released, compensation expense is recorded equal to the number of shares committed to be released times the monthly average market price of the shares, and the committed shares become outstanding for basic net income per common share computations. ESOP compensation expense was approximately \$1,867,000 and \$530,000 for the years ended June 30, 2006 and 2005, respectively.

At June 30, 2006 and 2005, the ESOP shares were as follows:

	June 30,	
	2006	2005
Allocated shares	110,202	-
Shares committed to be released	83,766	48,492
Unearned shares	1,551,732	1,697,208
	-----	-----
Total ESOP Shares	1,745,700	1,745,700
	-----	-----
Fair value of unearned shares	\$22,965,634	\$20,027,054
	-----	-----

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### Employee Stock Ownership Plan Benefit Equalization Plan ("BEP")

The Bank has a non-qualified plan to compensate senior officers of the bank who participate in the Bank's ESOP for certain benefits lost under such plan by reason of benefit limitations imposed by the Internal Revenue Code. The plan expense for the year ended June 30, 2006 was approximately \$76,000. The liability totaled approximately \$25,000 at June 30, 2006.

### Thrift Plan

The Bank sponsors the Employees' Savings and Profit Sharing Plan and Trust (the "Plan"), pursuant to Section 401(k) of the Internal Revenue Code, for all eligible employees. Employees may elect to save up to 20% of their compensation. The Bank will contribute a matching contribution up to 3% of the employee annual compensation. The Plan expense amounted to approximately \$330,000, \$281,000, and \$264,000, for the years ended June 30, 2006, 2005 and 2004, respectively.

### Retirement Plan

The Bank has a non-contributory multiple-employer pension plan covering all eligible employees. Significant actuarial assumptions include the projected unit credit cost valuation method and an annual investment rate of 7.75%, 8.25%, and 8.25%, for the years ended June 30, 2006, 2005 and 2004, respectively. At the date of latest plan review, the net assets available for plan benefits exceeded the actuarial present value of accumulated plan benefits. Data for the actuarial present value of accumulated vested and non-vested benefits is not determinable for this multiple-employer retirement plan. During the years ended June 30, 2006, 2005 and 2004, total pension plan expense and contributions to the plan were approximately \$2,172,000, \$2,538,000, and \$1,193,000, respectively.

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## KEARNY FINANCIAL CORP. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 13 - BENEFIT PLANS (CONTINUED)

##### Benefit Equalization Plan ("BEP")

The Bank has an unfunded non-qualified plan to compensate senior officers of the Bank who participate in the Bank's qualified benefit plans for certain benefits lost under such plans by reason of benefit limitations imposed by Sections 415 and 401 of the Internal Revenue Code. There were approximately \$59,000 in contributions made to and benefits paid under the BEP during each of the years ended June 30, 2006, 2005 and 2004.

The following table sets forth the BEP's funded status and components of net periodic pension cost:

June 30,	
2006	2005
-----	-----

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(In Thousands)

Change in benefit obligation:		
Benefit obligation - beginning	\$ 1,949	\$ 1,831
Service cost	59	42
Interest cost	176	135
Actuarial loss	421	-
Benefit payments	(59)	(59)
Increase due to the decrease in the discount rate	342	-
	-----	-----
Benefit obligation - ending	\$ 2,888	\$ 1,949
	=====	=====
Change in plan assets:		
Fair value of assets - beginning	\$ -	\$ -
Settlements	59	59
Contributions	(59)	(59)
	-----	-----
Fair value of assets - ending	\$ -	\$ -
	=====	=====
Reconciliation of funded status:		
Accumulated benefit obligation	\$ (1,850)	\$ (1,209)
	=====	=====
Projected benefit obligation	\$ (2,888)	\$ (1,949)
Fair value of assets	-	-
	-----	-----
Funded status	(2,888)	(1,949)
Unrecognized prior service cost	(47)	(58)
Unrecognized net actuarial loss	1,493	913
	-----	-----
Accrued pension cost included in other liabilities	\$ (1,442)	\$ (1,094)
	=====	=====
Value assumptions:		
Discount rate	6.25%	7.50%
Salary increase rate	5.50%	5.50%

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13 - BENEFIT PLANS (CONTINUED)

Benefit Equalization Plan ("BEP") (Continued)

Years Ended June 30,  
-----

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	2006	2005	2004
	----	----	----
	(In Thousands)		
Net periodic pension expense:			
Service cost	\$ 59	\$ 42	\$ 24
Interest cost	176	135	98
Amortization of unrecognized past service costs	(12)	8	8
Amortization of unrecognized net actuarial loss	182	122	77
	----	----	----
	\$405	\$307	\$207
	====	====	====
Valuation assumptions:			
Discount rate	6.25%	7.50%	7.50%
Salary increase rate	5.50%	5.50%	5.50%

It is estimated that contributions of approximately \$81,000 will be made during the year ending June 30, 2007.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

2007	\$ 81,000
2008	105,000
2009	117,000
2010	123,000
2011-2015	972,000

Postretirement Welfare Plan

The Bank has a postretirement group term life insurance plan covering all eligible employees. The benefits are based on age and years of service. The plan is unfunded. During the years ended June 30, 2006, 2005 and 2004, contributions and benefits paid totaled \$5,000, \$7,000, and \$6,000, respectively. The valuation measurement date has been changed from July 1 to April 1 effective April 1, 2006.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13 - BENEFIT PLANS (CONTINUED)

Postretirement Welfare Plan (Continued)

The following table sets forth the accrued accumulated postretirement benefit obligation and the net periodic postretirement benefit cost:

	June 30,	
	-----	-----
	2006	2005
	----	----

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(In Thousands)

Change in benefit obligation:		
Benefit obligation - beginning	\$ 451	\$ 409
Service cost	25	20
Interest cost	25	27
Actuarial (gain) loss	(32)	2
Premiums/claims paid	(5)	(7)
	-----	-----
Benefit obligation - ending	\$ 464	\$ 451
	=====	=====
Change in plan assets:		
Fair value of assets - beginning	\$ -	\$ -
Premiums/claims paid	5	7
Contributions	(5)	(7)
	-----	-----
Fair value of assets - ending	\$ -	\$ -
	=====	=====
Reconciliation of funded status:		
Accumulated benefit obligation	\$ (464)	\$ (451)
Fair value of assets	-	-
	-----	-----
Funded status	(464)	(451)
Unrecognized net actuarial gain	(38)	(7)
Unrecognized prior service cost	54	63
	-----	-----
Accrued postretirement benefit cost included in other liabilities	\$ (448)	\$ (395)
	=====	=====
Value assumptions:		
Discount rate	6.25%	5.63%
Salary increase rate	3.25%	3.00%

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13 - BENEFIT PLANS (CONTINUED)

Postretirement Welfare Plan (Continued)

Years Ended June 30,

-----  
2006      2005      2004  
-----

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(In Thousands)

Net periodic postretirement benefit cost:			
Service cost	\$25	\$20	\$18
Interest cost	25	27	22
Amortization of unrecognized past service liability	10	11	9
	---	---	---
	\$60	\$58	\$49
	===	===	===
Valuation assumptions:			
Discount rate	5.63%	6.63%	5.75%
Salary increase rate	3.00%	4.00%	3.25%

It is estimated that contributions of approximately \$8,000 will be made during the year ending June 30, 2007.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

2007	\$ 8,000
2008	10,000
2009	14,000
2010	16,000
2011	19,000
2012-2016	109,000

### Directors' Consultation and Retirement Plan ("DCRP")

The Bank has an unfunded retirement plan for non-employee directors. The benefits are payable based on term of service as a director. During each of the years ended June 30, 2006, 2005 and 2004, contributions and benefits paid totaled \$89,000. The valuation measurement date has been changed from July 1 to April 1 effective April 1, 2006.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 13 - BENEFIT PLANS (CONTINUED)

#### Directors' Consultation and Retirement Plan ("DCRP") (Continued)

The following table sets forth the DCRP's funded status and components of net periodic cost:

	June 30,	
	-----	-----
	2006	2005
	-----	-----
	(In Thousands)	

Change in benefit obligation:

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Projected benefit obligation - beginning	\$ 2,149	\$ 1,561
Service cost	128	86
Interest cost	116	99
Actuarial (gain) loss	(51)	157
Annuity payments	(89)	(89)
Plan amendments	-	335
	-----	-----
Projected benefit obligation - ending	\$ 2,253	\$ 2,149
	=====	=====
Change in plan assets:		
Fair value of assets - beginning	\$ -	\$ -
Settlements	89	89
Contributions	(89)	(89)
	-----	-----
Fair value of assets - ending	\$ -	\$ -
	=====	=====
Reconciliation of funded status:		
Accumulated benefit obligation	\$ (1,965)	\$ (1,879)
	=====	=====
Projected benefit obligation	\$ (2,253)	\$ (2,149)
Fair value of assets	-	-
	-----	-----
Funded status	(2,253)	(2,149)
Unrecognized transition obligation	132	175
Unrealized net actuarial loss	98	150
Unrecognized prior service cost	583	643
	-----	-----
Accrued cost included in other liabilities	\$ (1,440)	\$ (1,181)
	=====	=====
Value assumptions:		
Discount rate	6.25%	5.63%
Fee increase rate	3.25%	3.00%

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13 - BENEFIT PLANS (CONTINUED)

Directors' Consultation and Retirement Plan ("DCRP") (Continued)

Years Ended June 30,		
2006	2005	2004
----	----	----



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(In Thousands)

Net periodic plan cost:			
Service cost	\$128	\$ 86	\$ 78
Interest cost	116	99	83
Amortization of unrecognized transition obligation	44	44	44
Amortization of unrecognized past service liability	61	33	33
	-----	-----	-----
	\$349	\$262	\$238
	=====	=====	=====
Valuation assumptions:			
Discount rate	5.63%	6.63%	5.75%
Fee increase rate	3.00%	4.00%	3.25%

It is estimated that contributions of approximately \$172,000 will be made during the year ending June 30, 2007.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

2007	\$ 172,000
2008	183,000
2009	194,000
2010	204,000
2011	212,000
2012-2016	1,071,000

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13 - BENEFIT PLANS (CONTINUED)

Stock Compensation Plans

The Company has two stock-related compensation plans: stock options and restricted stock awards. At the annual meeting held on October 24, 2005, stockholders of the Company approved the Kearny Financial Corp. 2005 Stock Compensation and Incentive Plan. The plan authorizes the award of up to 3,564,137 shares as stock options and 1,425,655 shares as restricted stock awards. On October 24, 2005, non-employee directors received in aggregate 1,069,240 options and 427,696 shares of restricted stock. On December 5, 2005, certain officers of the Company and Bank received in aggregate 2,305,000 options and 910,000 shares of restricted stock. The Company adopted SFAS No. 123R upon approval of the Plan, and began to expense the fair value of all options over their vesting periods and began to expense the fair value of all share-based compensation granted over the requisite service periods.

SFAS No. 123R also requires the Company to realize as a financing cash flow rather than an operating cash flow, as previously required, the benefits of realized tax deductions in excess of previously recognized tax benefits on compensation expense (which was \$-0- for the twelve months ended June 30,

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2006). In accordance with Staff Accounting Bulletin ("SAB") No. 107, the Company classified share-based compensation for employees within salaries and employee benefits to correspond with the same line item as the cash compensation paid to employees. The Company classified share-based compensation for non-employee directors within directors' compensation to correspond with the same line item as the cash compensation paid to non-employee directors.

Employee options and non-employee director options generally vest over a five-year service period. Management recognizes compensation expense for all option grants over the awards' respective requisite service periods. Management estimated the fair values relating to all of fiscal 2006 option grants using the Black-Scholes option-pricing model. Since there is no historical information on the volatility of our stock, management based expectations about future volatility on the average volatilities of similar entities for an appropriate period following their initial public offering. Thus, calculations to determine the stock volatility of mutual holding companies converted since 1995, and a subset of the first group, all mutual holding companies that converted after 2000, were used to derive the one and three-year Beta for purposes of identifying a reasonable volatility factor. Management estimated the expected life of the options assuming that they must be no less than the vesting period, five years, and no greater than their contractual life, ten years, in conjunction with an evaluation of the grantees ages and lengths of service. The 10-year Treasury yield in effect at the time of the grant provides the risk-free rate for periods within the contractual life of the option. Management recognizes compensation expense for the fair values of these awards, which have graded vesting, on a straight-line basis over the requisite service period of the awards.

Management used the following assumptions to estimate the fair values of options granted:

	Year Ended June 30, 2006 ----
Weighted average risk-free interest rate	4.53%
Expected dividend yield	1.62%
Weighted average volatility factor of the expected market price of the Company's common stock	18.00%
Weighted average expected life of the options	6.50 years

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13 - BENEFIT PLANS (CONTINUED)

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### Stock Compensation Plans (Continued)

Restricted shares generally vest in full after five years. The product of the number of shares granted and the grant date market price of the Company's common stock determine the fair value of restricted shares under the Company's restricted stock plans. Management recognizes compensation expense for the fair value of restricted shares on a straight-line basis over the requisite service period of five years.

During the year ended June 30, 2006, the Company recorded \$3.2 million of share-based compensation expense, comprised of stock option expense of \$1.2 million and restricted stock expense of \$2.0 million.

The following is a summary of the Company's stock option activity and related information for its option plans for the year ended June 30, 2006:

	Options -----	Weighted Average Exercise Price -----	Weighted Average Remaining Contractual Term ----	
		(In Thousands)		
Outstanding at June 30, 2005	-	-		
Granted	3,374	\$12.34		
Exercised	-	-		
Forfeited	-	-		
	-----			
Outstanding at June 30, 2006	3,374	\$12.34	9.4 years	
	=====			
Exercisable at June 30, 2006	-	-	N/A	

The weighted average fair value of stock options granted during the year ended June 30, 2006 was \$2.95.

The following is a summary of the status of the Company's non-vested options as of June 30, 2006 and changes during the year ended June 30, 2006:

	Options -----	Weighted Average Grant Date Fair Value -----
		(In Thousands)
Non-vested at June 30, 2005	-	\$ -
Granted	3,374	2.95
Exercised	-	-
Forfeited	-	-
	-----	-----
Non-vested at June 30, 2006	3,374	\$2.95
	=====	=====

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13 - BENEFIT PLANS (CONTINUED)

Stock Compensation Plans (Continued)

Expected future compensation expense relating to the 3.4 million non-vested options outstanding as of June 30, 2006 is \$8.7 million over a weighted average period of 4.4 years.

Upon exercise of vested options, management expects to draw on treasury stock as the source of the shares. In July 2006, the Company announced a stock repurchase plan to acquire up to 1,091,063 shares during the next twelve months for general corporate purposes.

The following is a summary of the status of the Company's restricted shares as of 2006 and changes during the year ended June 30, 2006:

	Restricted Shares	Weighted Average Grant Date Fair Value
	-----	-----
	(In Thousands)	
Non-vested at June 30, 2005	-	\$ -
Granted	1,338	12.34
Exercised	-	-
Forfeited	-	-
	-----	-----
Non-vested at June 30, 2006	1,338	\$12.34
	=====	=====

Expected future compensation expense relating to the 1.3 million restricted shares at June 30, 2006 is \$14.5 million over a weighted average period of 4.4 years.

NOTE 14 - STOCKHOLDERS' EQUITY AND REGULATORY CAPITAL

The Office of Thrift Supervision (the "OTS") imposes various restrictions or requirements on the ability of savings institutions to make capital distributions, including cash dividends. A savings institution that is a subsidiary of a savings and loan holding company, such as the Bank, must file an application or a notice with the OTS at least thirty days before making a capital distribution. A savings institution must file an application for prior approval of a capital distribution if: (i) it is not eligible for expedited treatment under the applications processing rules of the OTS; (ii) the total amount of all capital distributions, including the proposed capital distribution, for the applicable calendar year would exceed an amount equal to the savings institution's net income for that year to date plus the

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institution's retained net income for the preceding two years; (iii) it would not adequately be capitalized after the capital distribution; or (iv) the distribution would violate an agreement with the OTS or applicable regulations.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 14 - STOCKHOLDERS' EQUITY AND REGULATORY CAPITAL (CONTINUED)

The Bank is subject to various regulatory capital requirements administered by Federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weighting, and other factors.

The OTS may disapprove a notice or deny an application for a capital distribution if: (i) the savings institution would be undercapitalized following the capital distribution; (ii) the proposed capital distribution raises safety and soundness concerns; or (iii) the capital distribution would violate a prohibition contained in any statute, regulation or agreement. The capital distributions by Kearny Financial Corp., as a savings and loan holding company, will not be subject to the OTS capital distribution rules.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to adjusted total assets (as defined). The following tables present a reconciliation of capital per accounting principles generally accepted in the United States of America ("GAAP") and regulatory capital and information as to the Bank's capital levels at the dates presented:

	June 30,	
	2006	2005
	(In Thousands)	
GAAP capital:		
Consolidated capital	\$490,886	\$505,482
Less: Unconsolidated capital of the Company	(38,948)	(109,653)
	451,938	395,829
Bank capital		
Less: Unrealized (gain) loss on securities	133	(5,485)
Goodwill	(82,263)	(82,263)
Intangible assets	(928)	(1,564)
	451,938	395,829

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Core and tangible capital	368,880	306,517
Add: General valuation allowance	5,451	5,416
Unrealized gain on equity securities	-	3,467
	-----	-----
Total Regulatory Capital	\$374,331	\$315,400
	=====	=====

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14 - STOCKHOLDERS' EQUITY AND REGULATORY CAPITAL (CONTINUED)

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
	-----	-----	-----	-----
	(Dollars in Thousands)			
As of June 30, 2006:				
Total capital (to risk-weighted assets)	\$374,331	48.90%	\$=>61,235	=>8.00%
Tier 1 capital (to risk-weighted assets)	368,880	48.19	=> -	=> -
Core (Tier 1) capital (to adjusted total assets)	368,880	19.41	=>57,001	=>3.00
Tangible capital (to adjusted total assets)	368,880	19.41	=>28,501	=>1.50
As of June 30, 2005:				
Total capital (to risk-weighted assets)	\$315,400	45.19%	\$=>55,833	=>8.00%
Tier 1 capital (to risk-weighted assets)	306,517	43.92	=> -	=> -
Core (Tier 1) capital (to adjusted total assets)	306,517	15.94	=>57,672	=>3.00
Tangible capital (to adjusted total assets)	306,517	15.94	=>28,836	=>1.50

On February 6, 2006, the most recent notification from the OTS, the Bank was categorized as well capitalized as of December 31, 2005, under the regulatory framework for prompt corrective action. There are no conditions existing or events which have occurred since notification that management believes have changed the Bank's category.

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NOTE 15 - INCOME TAXES

The Bank qualifies as a savings institution under the provisions of the Internal Revenue Code (the "IRC"). Retained earnings at June 30, 2006, includes approximately \$30.5 million of bad debt allowance, pursuant to the IRC, for which income taxes have not been provided. If such amount is used for purposes other than to absorb bad debts, including distributions in liquidation, it will be subject to income tax at the then current rate.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15 - INCOME TAXES (CONTINUED)

The components of income taxes are as follows:

	Years En
	-----
	2006
	-----
Current tax expense:	
Federal income	\$1,312
State income	974
	-----
	2,286
	-----
Deferred tax (benefit):	
Federal income	(7)
State income	(2)
	-----
	(9)
	-----
	\$2,277
	=====

The following table presents a reconciliation between the reported income taxes and the income taxes which would be computed by applying the normal federal income tax rate of 35% to income before income taxes:

	Years En
	-----
	2006

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	-----	(In
Federal income tax expense	\$4,160	
Increases (reductions) in income taxes resulting from:		
Tax exempt interest	(2,392)	
New Jersey state tax, net of federal income tax effect	632	
Nondeductible merger expenses	-	
Other items, net	(123)	
	-----	
Total income tax expense	\$2,277	
	=====	
Effective income tax rate	19.16%	
	=====	

The effective income tax rate represents total income tax expense divided by income before income taxes.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15 - INCOME TAXES (CONTINUED)

The tax effects of existing temporary differences that give rise to deferred income tax assets and liabilities are as follows:

	June 30,	
	2006	2005
	----- (In Thousands) -----	
Deferred income tax assets:		
Allowance for loan losses	\$2,227	\$2,212
Goodwill	-	453
Benefit plans	1,449	1,184
Compensation	1,355	167
Other	71	61
	-----	-----
	5,102	4,077
	-----	-----
Deferred income tax liabilities:		
Unrealized gain on securities available for sale	71	2,953
Depreciation	1,164	541



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Goodwill	392	-
Other	90	89
	-----	-----
	1,717	3,583
	-----	-----
Net deferred income tax assets	\$3,385	\$ 494
	=====	=====

NOTE 16 - COMMITMENTS

The Bank has non-cancelable operating leases for branch offices. The following is a schedule by years of future minimum rental payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of June 30, 2006:

Year Ended June 30:	
2007	\$ 271,000
2008	240,000
2009	203,000
2010	188,000
2011	185,000
Thereafter	641,000
	-----
Total Minimum Payments Required	\$1,728,000
	=====

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16 - COMMITMENTS (CONTINUED)

The following schedule shows the composition of total rental expense for all operating leases:

	June 30,		
	-----	-----	-----
	2006	2005	2004
	-----	-----	-----
	(In Thousands)		
Minimum rentals	\$353,000	\$372,000	\$371,000
Rental income	(40,000)	(45,000)	(28,000)
	-----	-----	-----
	\$313,000	\$327,000	\$343,000
	=====	=====	=====

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. The Bank's exposure

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to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The outstanding loan commitments are as follows:

	June 30,	
	2006	2005
	(In Thousands)	
Mortgage loans	\$37,698	\$30,594
Home equity loans	2,819	3,089
Construction loans	3,907	2,300
Construction loans in process	11,368	6,489
Undisbursed funds from approved lines of credit	25,556	27,707
	-----	-----
	\$81,348	\$70,179
	=====	=====

At June 30, 2006, the outstanding mortgage loan commitments include \$32,052,000 for fixed rate loans with interest rates ranging from 4.625% to 6.80% and \$5,646,000 for adjustable rate loans with initial rates ranging from 4.125% to 6.60%. Home equity loan commitments include \$2,369,000 for fixed rate loans with interest rates ranging from 5.625% to 6.50% and \$450,000 for adjustable rate loans with an initial rate of 7.00%. Construction loan commitments are for loans with interest rates 1.00% above the prime rate published in the Wall Street Journal. Undisbursed funds from approved lines of credit are adjustable rate loans with interest rates ranging from 1.00% below to 2.00% above the prime rate published in the Wall Street Journal.

At June 30, 2005, the outstanding mortgage loan commitments include \$23,673,000 for fixed rate loans with interest rates ranging from 4.50% to 6.75% and \$6,921,000 for adjustable rate loans with an initial rates ranging from 4.00% to 6.13%. Home equity loan commitments include \$2,979,000 of fixed rate loans with interest rates ranging from 4.38% to 7.00% and \$110,000 for adjustable rate loans with an initial rate of 5.50%. Construction loan commitments are for loans with interest rates ranging from 1.00% to 1.50% above the prime rate published in the Wall Street Journal. Undisbursed funds from approved lines of credit are adjustable rate loans with interest rates ranging from 1.00% below to 2.00% above the prime rate published in the Wall Street Journal.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16 - COMMITMENTS (CONTINUED)

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may

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require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank upon extension of credit is based on management's credit evaluation of the counterparty.

The Bank has established an overnight line of credit and companion (DRA) commitment, each in the amount of \$100,000,000, with the Federal Home Loan Bank of New York, which expire on July 31, 2006. As of June 30, 2006, no funds were drawn against these credit lines.

At June 30, 2006, the Bank has commitments for building improvements in the amount of \$281,000. In addition, the Bank also has, in the normal course of business, commitments for servicers and supplies. Management does not anticipate losses on any of these transactions.

The Company and subsidiaries are also party to litigation which arises primarily in the ordinary course of business. In the opinion of management, the ultimate disposition of such litigation should not have a material adverse effect on the consolidated financial position of the Company.

### NOTE 17 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

#### Cash and Cash Equivalents, Interest Receivable and Interest Payable

The carrying amounts for cash and cash equivalents, interest receivable and interest payable approximate fair value because they mature in three months or less.

#### Securities Available for Sale, Securities Held to Maturity and Mortgage-Backed Securities Held to Maturity

The fair values for securities available for sale, investment securities held to maturity and mortgage-backed securities held to maturity are based on quoted market prices when available. If quoted market prices are not available, fair value is estimated using quoted market prices for similar securities.

#### Loans Receivable

The fair value of loans receivable is estimated by discounting the future cash flows, using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, of such loans.

#### Deposits

The fair value of demand, savings and club accounts is equal to the amount payable on demand at the reporting date. The fair value of certificates of deposit is estimated using rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by deposit liabilities compared to the cost of borrowing funds in the market.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 17 - FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

### Advances from FHLB

Fair value is estimated using rates currently offered for advances of similar remaining maturities.

### Commitments

The fair value of commitments to fund credit lines and originate or participate in loans is estimated using fees currently charged to enter into similar agreements taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed rate loans commitments, fair value also considers the difference between current levels of interest and the committed rates. The carrying value, represented by the net deferred fee arising from the unrecognized commitment, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, are not considered material for disclosure. The contractual amounts of unfunded commitments are presented in Note 16.

The carrying amounts and estimated fair values of financial instruments are as follows:

	June 30,		
	2006		
	Carrying Amount	Estimated Fair Value	Carrying Amount
	(In Thousands)		
<b>Financial assets:</b>			
Cash and cash equivalents	\$ 230,279	\$ 230,279	\$ 139,865
Securities available for sale	18,346	18,346	33,591
Securities held to maturity	209,048	204,447	470,098
Loans receivable	703,613	664,672	558,018
Mortgage-backed securities held to maturity	689,962	670,329	758,121
Interest receivable	8,836	8,836	10,430
<b>Financial liabilities:</b>			
Deposits (A)	1,443,738	1,439,141	1,528,777
Advances from FHLB	61,105	61,073	61,687
Interest payable on advances	445	445	392

(A) Includes accrued interest payable on deposits

Limitations

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Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. Because no market value exists for a significant portion of the financial instrument, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instrument and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17 - FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Limitations (Continued)

The fair value estimates are based on existing on-and-off balance sheet financial instruments without attempting the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial assets and liabilities include premises and equipment, and advances from borrowers for taxes and insurance. In addition, the ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

Finally, reasonable comparability between financial institutions may not be likely due to the wide range of permitted valuation techniques and numerous estimates which must be made given the absence of active secondary markets for many of the financial instruments. This lack of uniform valuation methodologies introduces a greater degree of subjectivity to these estimated fair values.

NOTE 18 - PARENT ONLY FINANCIAL INFORMATION

Kearny Financial Corp. operates its wholly owned subsidiaries, Kearny Financial Securities, Inc. and Kearny Federal Savings Bank and its wholly-owned subsidiaries. The consolidated earnings of the subsidiaries are recognized by the Company using equity method of accounting. Accordingly, the consolidated earnings of the subsidiaries are recorded as increase in the Company's investment in the subsidiaries. The following are the condensed financial statements for Kearny Financial Corp. (Parent Company only) as June 30, 2006 and 2005, and for each of the years in the three-year period ended June 30, 2006.

CONDENSED STATEMENTS OF FINANCIAL CONDITION

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	June 30,	
	----- 2006	2005 -----
	(In Thousands)	
ASSETS		
Cash and amounts due from depository institutions	\$ 22,535	\$ 92,305
ESOP loan receivable	15,796	17,198
Accrued interest receivable	72	79
Investment in subsidiaries	451,945	395,831
Due from subsidiaries	2,241	-
Other assets	225	241
	-----	-----
	\$492,814	\$505,654
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Due to subsidiaries	\$ -	\$ 105
Other liabilities	1,928	67
Stockholders' equity	490,886	505,482
	-----	-----
	\$492,814	\$505,654
	=====	=====

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18 - PARENT ONLY FINANCIAL INFORMATION (CONTINUED)

CONDENSED STATEMENTS OF INCOME

	Years Ended
	----- 2006 -----
	(In Thou
Net interest income	\$ 2,702
Gain on sale of securities available for sale	-
Loss on sale of real estate owned	(35)
Equity in undistributed earnings of subsidiaries	8,639
	-----
	11,306
	-----
Directors' compensation	188

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Merger expense	-
Other expenses	844
	-----
	1,032
	-----
Income before Income Taxes	10,274
Income tax expense (benefit)	666
	-----
Net income	\$ 9,608
	=====

CONDENSED STATEMENTS OF CASH FLOWS

	Years Ended
	-----
	2006
	-----
	(In Thou
CASH FLOWS FROM OPERATING ACTIVITIES	
Net income	\$ 9,608
Adjustments to reconcile net income to net cash provided by (used in) operating activities:	
Equity in undistributed earnings of the subsidiaries	(8,639)
Amortization of premiums	-
Realized gain on sale of securities available for sale	-
Realized loss on sale of real estate owned	35
(Increase) decrease in accrued interest receivable	7
(Increase) in intercompany accounts	(9)
(Increase) decrease in other assets	(84)
Increase (decrease) in other liabilities	919
	-----
Net Cash Provided by (Used in) Operating Activities	1,837
	-----

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18 - PARENT ONLY FINANCIAL INFORMATION (CONTINUED)

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## CONDENSED STATEMENTS OF CASH FLOWS (CONTINUED)

	Years Ended	
	2006	
	(In Thou	(In Thou
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sale of securities available for sale	\$ -	\$ -
Proceeds from sale of real estate owned	65	
Loan to ESOP	-	
Repayment of loan to ESOP	1,402	
Cash dividends paid on unallocated ESOP shares used to repay loan receivable from Bank	(326)	
Capital contributions to subsidiaries	(50,015)	
	(48,874)	(
Net Cash Used in Investing Activities		
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from issuance of common stock of Kearny Financial Corp.	-	
Refund of common stock offering expense	3	
Purchase of common stock of Kearny Financial Corp. for treasury	(2,268)	
Purchase of common stock of Kearny Financial Corp. for restricted stock plan	(16,673)	
Dividends paid to minority stockholders of Kearny Financial Corp.	(3,795)	
	(22,733)	(
Net Cash Provided by (Used in) Financing Activities		
Net Increase (Decrease) in Cash and Cash Equivalents	(69,770)	
CASH AND CASH EQUIVALENTS - BEGINNING	92,305	
	22,535	22,535
CASH AND CASH EQUIVALENTS - ENDING	\$ 22,535	\$ 22,535
<b>SUPPLEMENTARY DISCLOSURE OF NONCASH TRANSACTIONS</b>		
Cash dividend declared	\$ 942	\$ 942
	-	-
Minority interest in consolidated subsidiaries	\$ -	\$ -
	-	-
Goodwill - West Essex acquisition	\$ -	\$ -
	-	-
Deposit for acquisition of West Essex	\$ -	\$ -
	-	-



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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19 - EARNINGS PER SHARE

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations:

	Year Ende
	-----
	Income
	(Numerator) (De
	-----
	(In Thousands, Exce
Net income	\$9,608 =====
Basic earnings per share, income available to common stockholders	\$9,608
Effect of dilutive securities:	
Stock options	-
Restricted stock awards	-
	-----
	\$9,608 =====
	Year Ende
	-----
Net income	\$18,898 =====
Basic earnings per share, income available to common stockholders	\$18,898
Effect of dilutive securities:	
Stock options	-
Restricted stock awards	-
	-----
	\$18,898 =====

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	Year Ende
Net income	\$12,897 =====
Basic earnings per share, income available to common stockholders	\$12,897
Effect of dilutive securities:	
Stock options	-
Restricted stock awards	-
	-----
	\$12,897 =====

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 20 - QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following is a condensed summary of quarterly results of operations for the years ended June 30, 2006 and 2005:

	Year Ended June 30, 2006			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	-----	-----	-----	-----
	(In Thousands, Except Per Share Data)			
Interest income	\$ 21,971	\$ 21,995	\$ 22,456	\$ 22,901
Interest expense	9,158	9,507	9,764	10,216
	-----	-----	-----	-----
Net Interest Income	12,813	12,488	12,692	12,685
Provision for loan losses	75	64	106	(173)
	-----	-----	-----	-----
Net Interest Income after Provision for Loan Losses	12,738	12,424	12,586	12,858

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Noninterest income	593	617	1,529	586
Noninterest expenses	9,378	10,138	11,419	11,111
	-----	-----	-----	-----
Income before Income Taxes	3,953	2,903	2,696	2,333
Income taxes	989	577	250	461
	-----	-----	-----	-----
Net Income	\$ 2,964	\$ 2,326	\$ 2,446	\$ 1,872
	=====	=====	=====	=====
Net income per common share:				
Basic	\$ 0.04	\$ 0.03	\$ 0.03	\$ 0.03
	=====	=====	=====	=====
Diluted	\$ 0.04	\$ 0.03	\$ 0.03	\$ 0.03
	=====	=====	=====	=====
Dividends declared per common share	\$ 0.09	\$ 0.05	\$ 0.05	\$ 0.05
	=====	=====	=====	=====

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KEARNY FINANCIAL CORP. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 20 - QUARTERLY RESULTS OF OPERATIONS (UNAUDITED) (CONTINUED)

	Year Ended June 30, 2005			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	-----	-----	-----	-----
	(In Thousands, Except Per Share Data)			
Interest income	\$ 19,907	\$ 19,832	\$ 21,078	\$ 21,624
Interest expense	7,103	7,174	7,764	8,381
	-----	-----	-----	-----
Net Interest Income	12,804	12,658	13,314	13,243
Provision for loan losses	151	(34)	(110)	61
	-----	-----	-----	-----
Net Interest Income after Provision for Loan Losses	12,653	12,692	13,424	13,182
Noninterest income	494	410	492	8,107
Noninterest expenses	7,789	8,767	8,811	9,495
	-----	-----	-----	-----

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Income before Income Taxes	5,358	4,335	5,105	11,794
Income taxes	1,562	1,143	1,279	3,710
	-----	-----	-----	-----
Net Income	\$ 3,796	\$ 3,192	\$ 3,826	\$ 8,084
	=====	=====	=====	=====
Net income per common share:				
Basic	\$ 0.07	\$ 0.06	\$ 0.06	\$ 0.11
	=====	=====	=====	=====
Diluted	\$ 0.07	\$ 0.06	\$ 0.06	\$ 0.11
	=====	=====	=====	=====

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

KEARNY FINANCIAL CORP.

Dated: September 5, 2006

By: /s/John N. Hopkins

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John N. Hopkins  
President and Chief Executive Officer  
(Duly Authorized Officer)

Pursuant to the requirement of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on September 5, 2006 on behalf of the Registrant and in the capacities indicated.

By: /s/John N. Hopkins

-----  
John N. Hopkins  
President and Chief Executive Officer  
(Principal Executive Officer)

By: /s/Albert E. Gossweiler

-----  
Albert E. Gossweiler  
Senior Vice President and  
Financial Officer  
(Principal Financial Officer)

By: /s/William C. Ledgerwood

-----  
William C. Ledgerwood  
Senior Vice President and Treasurer,  
Chief Accounting Officer  
(Principal Accounting Officer)

By: /s/Theodore J. Aanensen

-----  
Theodore J. Aanensen  
Director

By: /s/John J. Mazur, Jr.

By: /s/Joseph P. Mazza

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John J. Mazur Jr.  
Chairman

Joseph P. Mazza  
Director

By: /s/Matthew T. McClane  
-----  
Matthew T. McClane  
Director

By: /s/John F. McGovern  
-----  
John F. McGovern  
Director

By: /s/Leopold W. Montanaro  
-----  
Leopold W. Montanaro  
Director

By: /s/John F. Regan  
-----  
John F. Regan  
Director

By: /s/Henry S. Parow  
-----  
Henry S. Parow  
Director