

PROVIDENT FINANCIAL HOLDINGS INC  
Form 10-Q  
November 09, 2015  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
For the quarterly period ended September 30, 2015  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number  
000-28304

PROVIDENT FINANCIAL HOLDINGS, INC.  
(Exact name of registrant as specified in its charter)  
Delaware  
(State or other jurisdiction of  
incorporation or organization)

33-0704889  
(I.R.S. Employer  
Identification  
No.)

3756 Central Avenue, Riverside, California 92506  
(Address of principal executive offices and zip code)

(951) 686-6060  
(Registrant's telephone number, including area code)

\_\_\_\_\_  
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

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

Yes      No    ü .

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Title of class:	As of November 2, 2015
Common stock, \$ 0.01 par value, per share	8,432,678 shares

---

PROVIDENT FINANCIAL HOLDINGS, INC.

Table of Contents

PART 1 - FINANCIAL INFORMATION

ITEM 1 - Financial Statements. The Unaudited Interim Condensed Consolidated Financial Statements of Provident Financial Holdings, Inc. filed as a part of the report are as follows:

	Page
Condensed Consolidated Statements of Financial Condition as of September 30, 2015 and June 30, 2015	<u>1</u>
Condensed Consolidated Statements of Operations for the Quarters Ended September 30, 2015 and 2014	<u>2</u>
Condensed Consolidated Statements of Comprehensive Income for the Quarters Ended September 30, 2015 and 2014	<u>3</u>
Condensed Consolidated Statements of Stockholders' Equity for the Quarters Ended September 30, 2015 and 2014	<u>4</u>
Condensed Consolidated Statements of Cash Flows for the Three Months Ended September 30, 2015 and 2014	<u>5</u>
Notes to Unaudited Interim Condensed Consolidated Financial Statements	<u>6</u>

ITEM 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations:

General	<u>42</u>
Safe-Harbor Statement	<u>43</u>
Critical Accounting Policies	<u>44</u>
Executive Summary and Operating Strategy	<u>46</u>
Off-Balance Sheet Financing Arrangements and Contractual Obligations	<u>47</u>
Comparison of Financial Condition at September 30, 2015 and June 30, 2015	<u>47</u>
Comparison of Operating Results for the Quarters Ended September 30, 2015 and 2014	<u>49</u>
Asset Quality	<u>54</u>
Loan Volume Activities	<u>63</u>
Liquidity and Capital Resources	<u>64</u>
Supplemental Information	<u>66</u>

ITEM 3 - Quantitative and Qualitative Disclosures about Market Risk 67

ITEM 4 - Controls and Procedures 68

PART II - OTHER INFORMATION

ITEM 1 - Legal Proceedings 69

ITEM 1A - Risk Factors 69

ITEM 2 - Unregistered Sales of Equity Securities and Use of Proceeds 69

ITEM 3 - Defaults Upon Senior Securities 70

ITEM 4 - Mine Safety Disclosures 70

ITEM 5 - Other Information 70

ITEM 6 - Exhibits 70

SIGNATURES 73



PROVIDENT FINANCIAL HOLDINGS, INC.  
Condensed Consolidated Statements of Financial Condition  
In Thousands, Except Share Information

	(Unaudited)	
	September 30, 2015	June 30, 2015
<b>Assets</b>		
Cash and cash equivalents	\$ 156,146	\$ 81,403
Investment securities – held to maturity, at cost	800	800
Investment securities – available for sale, at fair value	13,461	14,161
Loans held for investment, net of allowance for loan losses of \$9,034 and \$8,724, respectively; includes \$4,036 and \$4,518 at fair value, respectively	805,686	814,234
Loans held for sale, at fair value	163,644	224,715
Accrued interest receivable	2,640	2,839
Real estate owned, net	3,674	2,398
Federal Home Loan Bank (“FHLB”) – San Francisco stock	8,094	8,094
Premises and equipment, net	5,259	5,417
Prepaid expenses and other assets	17,833	20,494
<b>Total assets</b>	<b>\$ 1,177,237</b>	<b>\$ 1,174,555</b>
<b>Liabilities and Stockholders’ Equity</b>		
<b>Liabilities:</b>		
Non interest-bearing deposits	\$ 68,101	\$ 67,538
Interest-bearing deposits	856,765	856,548
Total deposits	924,866	924,086
<b>Borrowings</b>	<b>91,351</b>	<b>91,367</b>
Accounts payable, accrued interest and other liabilities	21,766	17,965
Total liabilities	1,037,983	1,033,418
<b>Commitments and Contingencies</b>		
<b>Stockholders’ equity:</b>		
Preferred stock, \$.01 par value (2,000,000 shares authorized; none issued and outstanding)	—	—
Common stock, \$.01 par value (40,000,000 shares authorized; 17,779,865 and 17,766,865 shares issued; 8,429,678 and 8,634,607 shares outstanding, respectively)	178	177
Additional paid-in capital	89,278	88,893
Retained earnings	189,617	188,206
Treasury stock at cost (9,350,187 and 9,132,258 shares, respectively)	(140,119)	(136,470)
Accumulated other comprehensive income, net of tax	300	331
<b>Total stockholders’ equity</b>	<b>139,254</b>	<b>141,137</b>

Total liabilities and stockholders' equity	\$1,177,237	\$1,174,555
--	-------------	-------------

The accompanying notes are an integral part of these condensed consolidated financial statements.

1

---

PROVIDENT FINANCIAL HOLDINGS, INC.  
Condensed Consolidated Statements of Operations  
(Unaudited)  
In Thousands, Except Per Share Information

	Quarter Ended September 30,	
	2015	2014
Interest income:		
Loans receivable, net	\$9,490	\$9,195
Investment securities	67	76
FHLB – San Francisco stock	200	144
Interest-earning deposits	100	94
Total interest income	9,857	9,509
Interest expense:		
Checking and money market deposits	117	104
Savings deposits	168	157
Time deposits	858	976
Borrowings	648	335
Total interest expense	1,791	1,572
Net interest income	8,066	7,937
Recovery from the allowance for loan losses	(38)	(818)
Net interest income, after recovery from the allowance for loan losses	8,104	8,755
Non-interest income:		
Loan servicing and other fees	111	268
Gain on sale of loans, net	8,924	7,652
Deposit account fees	610	626
Gain (loss) on sale and operations of real estate owned acquired in the settlement of loans, net	229	(19)
Card and processing fees	362	356
Other	213	227
Total non-interest income	10,449	9,110
Non-interest expense:		
Salaries and employee benefits	10,792	9,581
Premises and occupancy	1,108	1,348
Equipment	379	472
Professional expenses	500	464
Sales and marketing expenses	262	331
Deposit insurance premiums and regulatory assessments	262	273
Other	1,057	1,270
Total non-interest expense	14,360	13,739
Income before income taxes	4,193	4,126
Provision for income taxes	1,750	1,736
Net income	\$2,443	\$2,390

Edgar Filing: PROVIDENT FINANCIAL HOLDINGS INC - Form 10-Q

Basic earnings per share	\$0.29	\$0.26
Diluted earnings per share	\$0.28	\$0.25
Cash dividends per share	\$0.12	\$0.11

The accompanying notes are an integral part of these condensed consolidated financial statements.

2

---



PROVIDENT FINANCIAL HOLDINGS, INC.  
 Condensed Consolidated Statements of Comprehensive Income  
 (Unaudited)  
 In Thousands

	For the Quarters Ended September 30,	
	2015	2014
Net income	\$2,443	\$2,390
Change in unrealized holding loss on securities available for sale	(53	)(16 )
Reclassification of (gains) losses to net income	—	—
Other comprehensive loss, before income taxes	(53	)(16 )
Income tax benefit	(22	)(7 )
Other comprehensive loss	(31	)(9 )
Total comprehensive income	\$2,412	\$2,381

The accompanying notes are an integral part of these condensed consolidated financial statements.

PROVIDENT FINANCIAL HOLDINGS, INC.  
Condensed Consolidated Statements of Stockholders' Equity  
(Unaudited)  
In Thousands, Except Share Information

For the Quarters Ended September 30, 2015 and 2014:

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss), Total Net of Tax	
	Shares	Amount					
Balance at June 30, 2015	8,634,607	\$ 177	\$ 88,893	\$ 188,206	\$(136,470)	\$ 331	\$ 141,137
Net income				2,443			2,443
Other comprehensive loss						(31)	(31)
Purchase of treasury stock <sup>(1)</sup>	(220,429)				(3,649)		(3,649)
Exercise of stock options	13,000	1	95				96
Distribution of restricted stock	2,500						—
Amortization of restricted stock			161				161
Stock options expense			128				128
Tax effect from stock based compensation			1				1
Cash dividends <sup>(2)</sup>				(1,032)			(1,032)
Balance at September 30, 2015	8,429,678	\$ 178	\$ 89,278	\$ 189,617	\$(140,119)	\$ 300	\$ 139,254

<sup>(1)</sup> Includes the repurchase of 4,500 shares from a cashless stock option exercise.

<sup>(2)</sup> Cash dividends of \$0.12 per share were paid in the quarter ended September 30, 2015.

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss), Total Net of Tax	
	Shares	Amount					
Balance at June 30, 2014	9,312,269	\$ 177	\$ 88,259	\$ 182,458	\$(125,418)	\$ 386	\$ 145,862
Net income				2,390			2,390
Other comprehensive loss						(9)	(9)
Purchase of treasury stock	(162,204)				(2,398)		(2,398)
Exercise of stock options	2,000	—	14				14
Amortization of restricted stock			59				59
Awards of restricted stock			(1,641)		1,641		—
Stock options expense			84				84
Tax effect from stock based compensation			(16)				(16)
Cash dividends <sup>(1)</sup>				(1,023)			(1,023)
Balance at September 30, 2014	9,152,065	\$ 177	\$ 86,759	\$ 183,825	\$(126,175)	\$ 377	\$ 144,963

<sup>(1)</sup> Cash dividends of \$0.11 per share were paid in the quarter ended September 30, 2014.

The accompanying notes are an integral part of these condensed consolidated financial statements.

4

---

PROVIDENT FINANCIAL HOLDINGS, INC.  
Condensed Consolidated Statements of Cash Flows  
(Unaudited - In Thousands)

	Three Months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net income	\$2,443	\$2,390
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Depreciation and amortization	307	611
Recovery from the allowance for loan losses	(38)	(818)
Unrealized gain on real estate owned	(161)	(17)
Gain on sale of loans, net	(8,924)	(7,652)
(Gain) loss on sale of real estate owned, net	(30)	9
Stock-based compensation	289	143
(Benefit) provision for deferred income taxes	(632)	176
Tax effect from stock based compensation	(1)	16
Increase (decrease) in accounts payable and other liabilities	1,617	(366)
Decrease in prepaid expenses and other assets	1,711	1,852
Loans originated for sale	(540,289)	(513,770)
Proceeds from sale of loans	613,940	498,413
Net cash provided by (used for) operating activities	70,232	(19,013)
Cash flows from investing activities:		
Decrease (increase) in loans held for investment, net	7,289	(16,774)
Principal payments from investment securities available for sale	650	780
Purchase of investment securities available for sale	—	(250)
Proceeds from sale of real estate owned	463	502
Purchase of premises and equipment	(71)	(168)
Net cash provided by (used for) investing activities	8,331	(15,910)
Cash flows from financing activities:		
Increase in deposits, net	780	4,562
Repayments of long-term borrowings	(16)	(15)
Exercise of stock options	96	14
Tax effect from stock based compensation	1	(16)
Cash dividends	(1,032)	(1,023)
Treasury stock purchases	(3,649)	(2,398)
Net cash (used for) provided by financing activities	(3,820)	1,124
Net increase (decrease) in cash and cash equivalents	74,743	(33,799)
Cash and cash equivalents at beginning of period	81,403	118,937
Cash and cash equivalents at end of period	\$156,146	\$85,138
Supplemental information:		
Cash paid for interest	\$1,788	\$1,562
Cash paid for income taxes	\$—	\$—
Transfer of loans held for sale to held for investment	\$1,552	\$678
Real estate acquired in the settlement of loans	\$1,006	\$927

The accompanying notes are an integral part of these condensed consolidated financial statements.

5

---

PROVIDENT FINANCIAL HOLDINGS, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2015

Note 1: Basis of Presentation

The unaudited interim condensed consolidated financial statements included herein reflect all adjustments which are, in the opinion of management, necessary to present a fair statement of the results of operations for the interim periods presented. All such adjustments are of a normal, recurring nature. The condensed consolidated statement of financial condition at June 30, 2015 is derived from the audited consolidated financial statements of Provident Financial Holdings, Inc. and its wholly-owned subsidiary, Provident Savings Bank, F.S.B. (the "Bank") (collectively, the "Corporation"). Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been omitted pursuant to the rules and regulations of the United States Securities and Exchange Commission ("SEC") with respect to interim financial reporting. It is recommended that these unaudited interim condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto included in the Corporation's Annual Report on Form 10-K for the year ended June 30, 2015. The results of operations for the quarter ended September 30, 2015 are not necessarily indicative of results that may be expected for the entire fiscal year ending June 30, 2016.

Note 2: Accounting Standard Updates ("ASU")

ASU 2014-04:

In January 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-04, "Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." The amendments in this ASU are intended to reduce diversity in practice by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate property recognized. Holding foreclosed real estate property presents different operational and economic risk to creditors compared with holding an impaired loan. Therefore, consistency in the timing of loan derecognition and presentation of foreclosed real estate properties is of qualitative significance to users of the creditor's financial statements. Additionally, the disclosure of the amount of foreclosed residential real estate properties and of the recorded investment in consumer mortgage loans secured by residential real estate properties that are in the process of foreclosure is expected to provide decision-useful information to many users of the creditor's financial statements. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Corporation's adoption of this ASU did not have a material impact on its consolidated financial statements.

ASU 2014-14:

In August 2014, the FASB issued ASU 2014-14, "Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure." Current GAAP provides classification and measurement guidance for situations in which a creditor obtains a debtor's assets in satisfaction of a receivable, including receipt of assets through foreclosure, but does not provide specific guidance on how to classify and measure foreclosed loans that are government guaranteed. Current GAAP also does not provide guidance on how to determine the unit of account; that is, whether a single asset should be recognized or whether two separate assets should be recognized (real estate and a guarantee receivable). In practice, most creditors derecognize the loan and recognize a single asset. Some creditors recognize a nonfinancial asset (other real estate owned), while

others recognize a financial asset (typically, a guarantee receivable). Regardless of the classification of the asset (or assets), measurement of the asset (or total measurement of the assets) in practice generally represents the amount recoverable under the guarantee. The amendments in this ASU should reduce variations in practice by providing guidance on how to classify and measure certain government-guaranteed mortgage loans upon foreclosure. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Corporation's adoption of this ASU did not have a material impact on its consolidated financial statements.

ASU 2015-05:

In April 2015, the FASB issued ASU 2015-05, "Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40)." The amendments in this ASU provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The guidance will not change GAAP

for a customer's accounting for service contracts. In addition, the guidance in this ASU supersedes paragraph 350-40-25-16. Consequently, all software licenses within the scope of Subtopic 350-40 will be accounted for consistent with other licenses of intangible assets. For public entities, the FASB decided that the amendments will be effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015 and early adoption is permitted. The Corporation's adoption of this ASU is not expected have a material impact on its consolidated financial statements.

ASU 2015-10:

In June 2015, the FASB issued ASU 2015-10, "Technical Corrections and Improvements." The amendments in this ASU cover a wide range of topics in the Codification. The reason for each amendment is provided before each amendment for clarity and ease of understanding. The amendments generally related to: (1) amendments related to differences between original guidance and the codification, (2) guidance clarification and reference corrections, (3) simplification and (4) minor improvements. These amendments improve the guidance and are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. Transition guidance varies based on the amendments in this ASU. The amendments in this ASU that require transition guidance are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. All other amendments will be effective upon the issuance of this ASU. The Corporation's adoption of this ASU is not expected have a material impact on its consolidated financial statements.

ASU 2015-12:

In July 2015, the FASB issued ASU 2015-12, "Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965): (Part I) Fully Benefit-Responsive Investment Contracts, (Part II) Plan Investment Disclosures, (Part III) Measurement Date Practical Expedient (consensuses of the FASB Emerging Issues Task Force)." The amendments of this ASU (i) require fully benefit-responsive investment contracts to be measured, presented and disclosed only at contract value, not fair value; (ii) simplify the investment disclosure requirements; and (iii) provide a measurement date practical expedient for employee benefit plans. This ASU is effective for fiscal years beginning after December 15, 2015, earlier adoption is permitted. The Corporation's adoption of this ASU is not expected have a material impact on its consolidated financial statements.

Note 3: Earnings Per Share

Basic earnings per share ("EPS") excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that would then share in the earnings of the entity.

As of September 30, 2015 and 2014, there were outstanding options to purchase 1.0 million shares and 1.1 million shares of the Corporation's common stock, respectively, of which 236,500 shares and 271,500 shares, respectively, were excluded from the diluted EPS computation as their effect was anti-dilutive. As of September 30, 2015 and 2014, there were outstanding restricted stock awards of 197,500 shares and 266,500 shares, respectively, all of which have dilutive effects.



The following table provides the basic and diluted EPS computations for the quarters ended September 30, 2015 and 2014, respectively.

(In Thousands, Except Earnings Per Share)	For the Quarters Ended	
	September 30, 2015	2014
Numerator:		
Net income – numerator for basic earnings per share and diluted earnings per share - available to common stockholders	\$2,443	\$2,390
Denominator:		
Denominator for basic earnings per share:		
Weighted-average shares	8,566	9,253
Effect of dilutive shares:		
Stock options	111	173
Restricted stock	67	42
Denominator for diluted earnings per share:		
Adjusted weighted-average shares and assumed conversions	8,744	9,468
Basic earnings per share	\$0.29	\$0.26
Diluted earnings per share	\$0.28	\$0.25

## Note 4: Operating Segment Reports

The Corporation operates in two business segments: community banking through the Bank and mortgage banking through Provident Bank Mortgage (“PBM”), a division of the Bank.

The following tables set forth condensed consolidated statements of operations and total assets for the Corporation’s operating segments for the quarters ended September 30, 2015 and 2014, respectively.

(In Thousands)	For the Quarter Ended September 30, 2015		
	Provident Bank	Provident Bank Mortgage	Consolidated Totals
Net interest income	\$6,903	\$1,163	\$8,066
Provision (recovery) for loan losses	12	(50)	(38)
Net interest income, after provision (recovery) for loan losses	6,891	1,213	8,104
Non-interest income:			
Loan servicing and other fees <sup>(1)</sup>	144	(33)	) 111
Gain on sale of loans, net <sup>(2)</sup>	1	8,923	8,924
Deposit account fees	610	—	610
Gain on sale and operations of real estate owned acquired in the settlement of loans, net	224	5	229
Card and processing fees	362	—	362
Other	213	—	213
Total non-interest income	1,554	8,895	10,449
Non-interest expense:			
Salaries and employee benefits	4,553	6,239	10,792
Premises and occupancy	696	412	1,108
Operating and administrative expenses	989	1,471	2,460
Total non-interest expense	6,238	8,122	14,360
Income before income taxes	2,207	1,986	4,193
Provision for income taxes	915	835	1,750
Net income	\$1,292	\$1,151	\$2,443
Total assets, end of period	\$1,013,345	\$163,892	\$1,177,237

(1) Includes an inter-company charge of \$65 credited to PBM by the Bank during the period to compensate PBM for originating loans held for investment.

(2) Includes an inter-company charge of \$108 credited to PBM by the Bank during the period to compensate PBM for servicing fees on loans sold on a servicing retained basis.

(In Thousands)	For the Quarter Ended September 30, 2014		
	Provident Bank	Provident Bank Mortgage	Consolidated Totals
Net interest income	\$6,895	\$1,042	\$7,937
(Recovery) provision for loan losses	(890)	)72	(818 )
Net interest income after (recovery) provision for loan losses	7,785	970	8,755
Non-interest income:			
Loan servicing and other fees <sup>(1)</sup>	8	260	268
Gain on sale of loans, net <sup>(2)</sup>	71	7,581	7,652
Deposit account fees	626	—	626
Loss on sale and operations of real estate owned acquired in the settlement of loans, net	(19)	)—	(19 )
Card and processing fees	356	—	356
Other	227	—	227
Total non-interest income	1,269	7,841	9,110
Non-interest expense:			
Salaries and employee benefits	4,267	5,314	9,581
Premises and occupancy	872	476	1,348
Operating and administrative expenses	1,156	1,654	2,810
Total non-interest expense	6,295	7,444	13,739
Income before income taxes	2,759	1,367	4,126
Provision for income taxes	1,167	569	1,736
Net income	\$1,592	\$798	\$2,390
Total assets, end of period	\$925,881	\$180,973	\$1,106,854

(1) Includes an inter-company charge of \$158 credited to PBM by the Bank during the period to compensate PBM for originating loans held for investment.

(2) Includes an inter-company charge of \$14 credited to PBM by the Bank during the period to compensate PBM for servicing fees on loans sold on a servicing retained basis.

## Note 5: Investment Securities

The amortized cost and estimated fair value of investment securities as of September 30, 2015 and June 30, 2015 were as follows:

September 30, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value	Carrying Value
(In Thousands)					
Held to maturity:					
Certificates of deposit	\$ 800	\$—	\$—	\$ 800	\$ 800
Total investment securities - held to maturity	\$ 800	\$—	\$—	\$ 800	\$ 800
Available for sale:					
U.S. government agency MBS <sup>(1)</sup>	\$ 7,305	\$ 268	\$—	\$ 7,573	\$ 7,573
U.S. government sponsored enterprise MBS	4,765	281	—	5,046	5,046
Private issue CMO <sup>(2)</sup>	683	8	—	691	691
Common stock - community development financial institution	250	—	(99	) 151	151
Total investment securities - available for sale	\$ 13,003	\$ 557	\$ (99	) \$ 13,461	\$ 13,461
Total investment securities	\$ 13,803	\$ 557	\$ (99	) \$ 14,261	\$ 14,261

<sup>(1)</sup> Mortgage-Backed Securities (“MBS”).

<sup>(2)</sup> Collateralized Mortgage Obligations (“CMO”).

June 30, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value	Carrying Value
(In Thousands)					
Held to maturity:					
Certificates of deposit	\$ 800	\$—	\$—	\$ 800	\$ 800
Total investment securities - held to maturity	\$ 800	\$—	\$—	\$ 800	\$ 800
Available for sale:					
U.S. government agency MBS	\$ 7,613	\$ 293	\$—	\$ 7,906	\$ 7,906
U.S. government sponsored enterprise MBS	5,083	304	—	5,387	5,387
Private issue CMO	708	9	—	717	717
Common stock - community development financial institution	250	—	(99	) 151	151
Total investment securities - available for sale	\$ 13,654	\$ 606	\$ (99	) \$ 14,161	\$ 14,161
Total investment securities	\$ 14,454	\$ 606	\$ (99	) \$ 14,961	\$ 14,961

In the first quarters of fiscal 2016 and 2015, the Corporation received MBS principal payments of \$650,000 and \$780,000, respectively, and did not purchase or sell investment securities, except the purchase in the first quarter of

fiscal 2015 of \$250,000 in the common stock of a community development financial institution to help fulfill the Bank's Community Reinvestment Act obligation.

The Corporation held investments with unrealized loss position at September 30, 2015 and June 2015 of \$99,000 at both dates.

As of September 30, 2015 (In Thousands)	Unrealized Holding Losses		Unrealized Holding Losses		Unrealized Holding Losses	
	Less Than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stock <sup>(1)</sup>	\$ 151	\$ 99	\$ —	\$ —	\$ 151	\$ 99
Total	\$ 151	\$ 99	\$ —	\$ —	\$ 151	\$ 99

  

As of June 30, 2015 (In Thousands)	Unrealized Holding Losses		Unrealized Holding Losses		Unrealized Holding Losses	
	Less Than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Common stock <sup>(1)</sup>	\$ 151	\$ 99	\$ —	\$ —	\$ 151	\$ 99
Total	\$ 151	\$ 99	\$ —	\$ —	\$ 151	\$ 99

<sup>(1)</sup> Common stock of a community development financial institution.

The Corporation evaluates individual investment securities quarterly for other-than-temporary declines in market value. As of September 30, 2015, the unrealized holding loss was less than 12 months on the common stock, primarily the result of the dilutive nature of the institution's recent merger with another community development financial institution. Based on the nature of the investment, management concluded that such unrealized loss was not other than temporary as of September 30, 2015. The Corporation intends and has the ability to hold the common stock and will not likely be required to sell before realizing a full recovery. The Corporation does not believe that there are any other-than-temporary impairments at September 30, 2015 and 2014; therefore, no impairment losses have been recorded for the quarters ended September 30, 2015 and 2014.

Contractual maturities of investment securities as of September 30, 2015 and June 30, 2015 were as follows:

(In Thousands)	September 30, 2015		June 30, 2015	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
<b>Held to maturity:</b>				
Due in one year or less	\$ 800	\$ 800	\$ 800	\$ 800
Due after one through five years	—	—	—	—
Due after five through ten years	—	—	—	—
Due after ten years	—	—	—	—
Total investment securities - held to maturity	\$ 800	\$ 800	\$ 800	\$ 800
<b>Available for sale:</b>				
Due in one year or less	\$ —	\$ —	\$ —	\$ —
Due after one through five years	—	—	—	—
Due after five through ten years	—	—	—	—
Due after ten years	12,753	13,310	13,404	14,010

Edgar Filing: PROVIDENT FINANCIAL HOLDINGS INC - Form 10-Q

No stated maturity (common stock)	250	151	250	151
Total investment securities - available for sale	\$13,003	\$13,461	\$13,654	\$14,161
Total investment securities	\$13,803	\$14,261	\$14,454	\$14,961

12

---

## Note 6: Loans Held for Investment

Loans held for investment consisted of the following:

(In Thousands)	September 30, 2015	June 30, 2015
Mortgage loans:		
Single-family	\$356,963	\$365,961
Multi-family	355,442	347,020
Commercial real estate	94,580	100,897
Construction	6,185	8,191
Other	72	—
Commercial business loans	399	666
Consumer loans	243	244
Total loans held for investment, gross	813,884	822,979
Undisbursed loan funds	(2,691	)(3,360
Advance payments of escrows	193	199
Deferred loan costs, net	3,334	3,140
Allowance for loan losses	(9,034	)(8,724
Total loans held for investment, net	\$805,686	\$814,234

As of September 30, 2015, the Corporation had \$13.6 million in mortgage loans that are subject to negative amortization, consisting of \$10.2 million in multi-family loans, \$3.2 million in single-family loans and \$213,000 in commercial real estate loans. This compares to \$14.1 million of negative amortization mortgage loans at June 30, 2015, consisting of \$10.7 million in multi-family loans, \$3.2 million in single-family loans and \$227,000 in commercial real estate loans. During the first quarters of fiscal 2016 and 2015, no loan interest income was added to the negative amortization loan balance. Negative amortization involves a greater risk to the Corporation because the loan principal balance may increase by a range of 110% to 115% of the original loan amount during the period of negative amortization and because the loan payment may increase beyond the means of the borrower when loan principal amortization is required. Also, the Corporation has originated interest-only ARM loans, which typically have a fixed interest rate for the first two to five years coupled with an interest only payment, followed by a periodic adjustable rate and a fully amortizing loan payment. As of September 30, 2015 and June 30, 2015, the interest-only ARM loans were \$131.4 million and \$152.6 million, or 16.1% and 18.6% of loans held for investment, respectively. As of September 30, 2015, the Corporation had \$4.0 million of single-family loans, 12 loans, held for investment which were originated for sale but were subsequently transferred to held for investment and are carried at fair value. This compares to \$4.5 million of single-family loans, 13 loans, held for investment at June 30, 2015 which were originated for sale but were subsequently transferred to held for investment and are carried at fair value.

The following table sets forth information at September 30, 2015 regarding the dollar amount of loans held for investment that are contractually repricing during the periods indicated, segregated between adjustable rate loans and fixed rate loans. Fixed-rate loans comprised 3% of loans held for investment at September 30, 2015, as compared to 4% at June 30, 2015. Adjustable rate loans having no stated repricing dates that reprice when the index they are tied to reprices (e.g. prime rate index) and checking account overdrafts are reported as repricing within one year. The table does not include any estimate of prepayments which may cause the Corporation's actual repricing experience to differ materially from that shown.



(In Thousands)	Adjustable Rate				Fixed Rate	Total
	Within One Year	After One Year Through 3 Years	After 3 Years Through 5 Years	After 5 Years Through 10 Years		
Mortgage loans:						
Single-family	\$287,251	\$5,167	\$48,876	\$1,984	\$13,685	\$356,963
Multi-family	66,947	98,626	178,461	8,332	3,076	355,442
Commercial real estate	13,634	29,099	46,411	—	5,436	94,580
Construction	720	—	375	—	5,090	6,185
Other	—	—	—	—	72	72
Commercial business loans	138	—	—	—	261	399
Consumer loans	236	—	—	—	7	243
Total loans held for investment, gross	\$368,926	\$132,892	\$274,123	\$10,316	\$27,627	\$813,884

The Corporation has developed an internal loan grading system to evaluate and quantify the Bank's loans held for investment portfolio with respect to quality and risk. Management continually evaluates the credit quality of the Corporation's loan portfolio and conducts a quarterly review of the adequacy of the allowance for loan losses using quantitative and qualitative methods. The Corporation has adopted an internal risk rating policy in which each loan is rated for credit quality with a rating of pass, special mention, substandard, doubtful or loss. The two primary components that are used during the loan review process to determine the proper allowance levels are individually evaluated allowances and collectively evaluated allowances. Quantitative loan loss factors are developed by determining the historical loss experience, expected future cash flows, discount rates and collateral fair values, among others. Qualitative loan loss factors are developed by assessing general economic indicators such as gross domestic product, retail sales, unemployment rates, employment growth, California home sales and median California home prices. The Corporation assigns individual factors for the quantitative and qualitative methods for each loan category and each internal risk rating.

The Corporation categorizes all of the loans held for investment into risk categories based on relevant information about the ability of the borrower to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. A description of the general characteristics of the risk grades is as follows:

Pass - These loans range from minimal credit risk to average however still acceptable credit risk. The likelihood of loss is considered remote.

Special mention - A Special Mention asset has potential weaknesses that may be temporary or, if left uncorrected, may result in a loss. While concerns exist, the bank is currently protected and loss is considered unlikely and not imminent.

Substandard - A substandard loan is inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral pledged, if any. Loans so classified must have a well-defined weakness, or weaknesses, that may jeopardize the liquidation of the debt. A substandard loan is characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful - A doubtful loan has all of the weaknesses inherent in one classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of the currently existing facts, conditions and values, highly questionable and improbable.

Loss - A loss loan is considered uncollectible and of such little value that continuance as an asset of the institution is not warranted.



The following tables summarize gross loans held for investment by loan types and risk category at the dates indicated:  
September 30, 2015

(In Thousands)	Single-family	Multi-family	Commercial Real Estate	Construction	Other Mortgage	Commercial Business	Consumer	Total
Pass	\$337,156	\$ 350,923	\$92,628	\$6,185	\$72	\$292	\$243	\$787,499
Special Mention	7,187	408	—	—	—	—	—	7,595
Substandard	12,620	4,111	1,952	—	—	107	—	18,790
Total loans held for investment, gross	\$356,963	\$ 355,442	\$94,580	\$6,185	\$72	\$399	\$243	\$813,884

June 30, 2015

(In Thousands)	Single-family	Multi-family	Commercial Real Estate	Construction	Commercial Business	Consumer	Total
Pass	\$347,301	\$ 339,093	\$98,254	\$8,191	\$557	\$244	\$793,640
Special Mention	7,766	413	—	—	—	—	8,179
Substandard	10,894	7,514	2,643	—	109	—	21,160
Total loans held for investment, gross	\$365,961	\$ 347,020	\$100,897	\$8,191	\$666	\$244	\$822,979

The allowance for loan losses is maintained at a level sufficient to provide for estimated losses based on evaluating known and inherent risks in the loans held for investment and upon management's continuing analysis of the factors underlying the quality of the loans held for investment. These factors include changes in the size and composition of the loans held for investment, actual loan loss experience, current economic conditions, detailed analysis of individual loans for which full collectability may not be assured, and determination of the realizable value of the collateral securing the loans. The provision (recovery) for (from) the allowance for loan losses is charged (credited) against operations on a quarterly basis, as necessary, to maintain the allowance at appropriate levels. Although management believes it uses the best information available to make such determinations, there can be no assurance that regulators, in reviewing the Corporation's loans held for investment, will not request a significant increase in its allowance for loan losses. Future adjustments to the allowance for loan losses may be necessary and results of operations could be significantly and adversely affected as a result of economic, operating, regulatory, and other conditions beyond the Corporation's control.

Non-performing loans are charged-off to their fair market values in the period the loans, or portion thereof, are deemed uncollectible, generally after the loan becomes 150 days delinquent for real estate secured first trust deed loans and 120 days delinquent for commercial business or real estate secured second trust deed loans. For loans that were modified from their original terms, were re-underwritten and identified in the Corporation's asset quality reports as troubled debt restructurings ("restructured loans"), the charge-off occurs when the loan becomes 90 days delinquent; and where borrowers file bankruptcy, the charge-off occurs when the loan becomes 60 days delinquent. The amount of the charge-off is determined by comparing the loan balance to the estimated fair value of the underlying collateral, less disposition costs, with the loan balance in excess of the estimated fair value charged-off against the allowance for loan losses. The allowance for loan losses for non-performing loans is determined by applying Accounting Standards Codification ("ASC") 310, "Receivables." For restructured loans that are less than 90 days delinquent, the allowance for loan losses are segregated into (a) individually evaluated allowances for those loans with applicable discounted cash flow calculations still in their restructuring period, classified lower than pass, and containing an embedded loss component or (b) collectively evaluated allowances based on the aggregated pooling method. For non-performing

loans less than 60 days delinquent where the borrower has filed bankruptcy, the collectively evaluated allowances are assigned based on the aggregated pooling method. For non-performing commercial real estate loans, an individually evaluated allowance is calculated based on the loan's fair value or collateral's fair value less estimated selling costs and if the fair value is higher than the loan balance, no allowance is required.

The following table summarizes the Corporation's allowance for loan losses at September 30, 2015 and June 30, 2015:

(In Thousands)	September 30, 2015	June 30, 2015
Collectively evaluated for impairment:		
Mortgage loans:		
Single-family	\$6,261	\$5,202
Multi-family	1,943	2,616
Commercial real estate	697	734
Construction	40	42
Other	2	—
Commercial business loans	13	23
Consumer loans	9	9
Total collectively evaluated allowance	8,965	8,626
Individually evaluated for impairment:		
Mortgage loans:		
Single-family	49	78
Commercial business loans	20	20
Total individually evaluated allowance	69	98
Total loan loss allowance	\$9,034	\$8,724

The following table is provided to disclose additional details on the Corporation's allowance for loan losses:

(Dollars in Thousands)	For the Quarters Ended		
	September 30,		
	2015	2014	
Allowance at beginning of period	\$8,724	\$9,744	
Recovery from the allowance for loan losses	(38	) (818	)
Recoveries:			
Mortgage loans:			
Single-family	69	109	
Multi-family	56	71	
Commercial real estate	216	—	
Commercial business loans	85	—	
Consumer loans	—	1	
Total recoveries	426	181	
Charge-offs:			
Mortgage loans:			
Single-family	(78	) (219	)
Total charge-offs	(78	) (219	)
Net recoveries (charge-offs)	348	(38	)
Balance at end of period	\$9,034	\$8,888	
Allowance for loan losses as a percentage of gross loans held for investment	1.11	% 1.11	%
Net (recoveries) charge-offs as a percentage of average loans receivable, net, during the period (annualized)	(0.14	)%0.02	%
Allowance for loan losses as a percentage of gross non-performing loans at the end of the period	57.33	% 66.62	%

The following tables denote the past due status of the Corporation's loans held for investment, gross, at the dates indicated.

(In Thousands)	September 30, 2015			Total Loans Held for Investment, Gross
	Current	30-89 Days Past Due	Non-Accrual <sup>(1)</sup>	
Mortgage loans:				
Single-family	\$ 343,126	\$ 1,217	\$ 12,620	\$ 356,963
Multi-family	353,467	—	1,975	355,442
Commercial real estate	93,564	—	1,016	94,580
Construction	6,185	—	—	6,185
Other	72	—	—	72
Commercial business loans	292	—	107	399
Consumer loans	241	2	—	243
Total loans held for investment, gross	\$ 796,947	\$ 1,219	\$ 15,718	\$ 813,884

<sup>(1)</sup> All loans 90 days or greater past due are placed on non-accrual status.

(In Thousands)	June 30, 2015			Total Loans Held for Investment, Gross
	Current	30-89 Days Past Due	Non-Accrual <sup>(1)</sup>	
Mortgage loans:				
Single-family	\$ 354,082	\$ 1,335	\$ 10,544	\$ 365,961
Multi-family	344,774	—	2,246	347,020
Commercial real estate	99,198	—	1,699	100,897
Construction	8,191	—	—	8,191
Commercial business loans	557	—	109	666
Consumer loans	244	—	—	244
Total loans held for investment, gross	\$ 807,046	\$ 1,335	\$ 14,598	\$ 822,979

<sup>(1)</sup> All loans 90 days or greater past due are placed on non-accrual status.

The following tables summarize the Corporation's allowance for loan losses and recorded investment in gross loans, by portfolio type, at the dates and for the periods indicated.

(In Thousands)	Quarter Ended September 30, 2015							Total	
	Single-family	Multi-family	Commercial Real Estate	Construction	Other Mortgage	Commercial Business	Consumer		
Allowance for loan losses:									
Allowance at beginning of period	\$5,280	\$2,616	\$734	\$42	\$—	\$43	\$9	\$8,724	
Provision (recovery) for loan losses	1,039	(729 )	(253 )	(2 )	2	(95 )	—	(38 )	
Recoveries	69	56	216	—	—	85	—	426	
Charge-offs	(78 )	—	—	—	—	—	—	(78 )	
Allowance for loan losses, end of period	\$6,310	\$1,943	\$697	\$40	\$2	\$33	\$9	\$9,034	
Allowance for loan losses:									
Individually evaluated for impairment	\$49	\$—	\$—	\$—	\$—	\$20	\$—	\$69	
Collectively evaluated for impairment	6,261	1,943	697	40	2	13	9	8,965	
Allowance for loan losses, end of period	\$6,310	\$1,943	\$697	\$40	\$2	\$33	\$9	\$9,034	
Loans held for investment:									
Individually evaluated for impairment	\$8,204	\$1,975	\$1,016	\$—	\$—	\$107	\$—	\$11,302	
Collectively evaluated for impairment	348,759	353,467	93,564	6,185	72	292	243	802,582	
Total loans held for investment, gross	\$356,963	\$355,442	\$94,580	\$6,185	\$72	\$399	\$243	\$813,884	
Allowance for loan losses as a percentage of gross loans held for investment	1.77	%0.55	%0.74	%0.65	%2.78	%8.27	%3.70	%1.11	%





(In Thousands)	Quarter Ended September 30, 2014							
	Single-family	Multi-family	Commercial Real Estate	Construction	Commercial Business	Consumer	Total	
Allowance for loan losses:								
Allowance at beginning of period	\$5,476	\$3,142	\$989	\$35	\$92	\$10	\$9,744	
(Recovery) provision for loan losses	(714 )	(91 )	25	(30 )	(7 )	(1 )	(818 )	
Recoveries	109	71	—	—	—	1	181	
Charge-offs	(219 )	—	—	—	—	—	(219 )	
Allowance for loan losses, end of period	\$4,652	\$3,122	\$1,014	\$5	\$85	\$10	\$8,888	
Allowance for loan losses:								
Individually evaluated for impairment	\$—	\$—	\$—	\$—	\$41	\$—	\$41	
Collectively evaluated for impairment	4,652	3,122	1,014	5	44	10	8,847	
Allowance for loan losses, end of period	\$4,652	\$3,122	\$1,014	\$5	\$85	\$10	\$8,888	
Loans held for investment:								
Individually evaluated for impairment	\$6,515	\$2,194	\$2,317	\$—	\$118	\$—	\$11,144	
Collectively evaluated for impairment	370,718	312,680	98,410	4,378	991	271	787,448	
Total loans held for investment, gross	\$377,233	\$314,874	\$100,727	\$4,378	\$1,109	\$271	\$798,592	
Allowance for loan losses as a percentage of gross loans held for investment	1.23	%0.99	%1.01	%0.11	%7.66	%3.69	%1.11	%

The following tables identify the Corporation's total recorded investment in non-performing loans by type at the dates and for the periods indicated. Generally, a loan is placed on non-accrual status when it becomes 90 days past due as to principal or interest or if the loan is deemed impaired, after considering economic and business conditions and collection efforts, where the borrower's financial condition is such that collection of the contractual principal or interest on the loan is doubtful. In addition, interest income is not recognized on any loan where management has determined that collection is not reasonably assured. A non-performing loan may be restored to accrual status when delinquent principal and interest payments are brought current and future monthly principal and interest payments are expected to be collected on a timely basis. Loans with a related allowance reserve have been individually evaluated for impairment using either a discounted cash flow analysis or, for collateral dependent loans, current appraisals less costs to sell to establish realizable value. This analysis may identify a specific impairment amount needed or may conclude that no reserve is needed. Loans without a related allowance reserve have not been individually evaluated for impairment, but have been included in pools of homogeneous loans for evaluation of related allowance reserves.



(In Thousands)	At September 30, 2015				Net Recorded Investment
	Unpaid Principal Balance	Related Charge-offs	Recorded Investment	Allowance <sup>(1)</sup>	
Mortgage loans:					
Single-family:					
With a related allowance	\$ 5,078	\$—	\$ 5,078	\$(973)	)\$ 4,105
Without a related allowance <sup>(2)</sup>	9,387	(1,806)	)7,581	—	7,581
Total single-family	14,465	(1,806)	)12,659	(973)	)11,686
Multi-family:					
Without a related allowance <sup>(2)</sup>	3,179	(1,204)	)1,975	—	1,975
Total multi-family	3,179	(1,204)	)1,975	—	1,975
Commercial real estate:					
Without a related allowance <sup>(2)</sup>	1,016	—	1,016	—	1,016
Total commercial real estate	1,016	—	1,016	—	1,016
Commercial business loans:					
With a related allowance	107	—	107	(20)	)87
Total commercial business loans	107	—	107	(20)	)87
Total non-performing loans	\$ 18,767	\$(3,010)	)\$ 15,757	\$(993)	)\$ 14,764

<sup>(1)</sup> Consists of collectively and individually evaluated allowances, specifically assigned to the individual loan, and fair value credit adjustments.

<sup>(2)</sup> There was no related allowance for loan losses because the loans have been charged-off to their fair value or the fair value of the collateral is higher than the loan balance.

(In Thousands)	At June 30, 2015				Net Recorded Investment
	Unpaid Principal Balance	Related Charge-offs	Recorded Investment	Allowance <sup>(1)</sup>	
Mortgage loans:					
Single-family:					
With a related allowance	\$ 3,881	\$—	\$ 3,881	\$(630)	)\$3,251
Without a related allowance <sup>(2)</sup>	8,462	(1,801)	)6,661	—	6,661
Total single-family	12,343	(1,801)	)10,542	(630)	)9,912
Multi-family:					
Without a related allowance <sup>(2)</sup>	3,506	(1,260)	)2,246	—	2,246
Total multi-family	3,506	(1,260)	)2,246	—	2,246
Commercial real estate:					
Without a related allowance <sup>(2)</sup>	1,699	—	1,699	—	1,699
Total commercial real estate	1,699	—	1,699	—	1,699
Commercial business loans:					
With a related allowance	109	—	109	(20)	)89
Total commercial business loans	109	—	109	(20)	)89
Total non-performing loans	\$ 17,657	\$(3,061)	)\$ 14,596	\$(650)	)\$ 13,946

<sup>(1)</sup> Consists of collectively and individually evaluated allowances, specifically assigned to the individual loan.

<sup>(2)</sup> There was no related allowance for loan losses because the loans have been charged-off to their fair value or the fair value of the collateral is higher than the loan balance.

At September 30, 2015 and June 30, 2015, there were no commitments to lend additional funds to those borrowers whose loans were classified as non-performing.

For the quarters ended September 30, 2015 and 2014, the Corporation's average investment in non-performing loans was \$15.3 million and \$15.9 million, respectively. The Corporation records payments on non-performing loans utilizing the cash basis or cost recovery method of accounting during the periods when the loans are on non-performing status. For the quarters ended September 30, 2015 and 2014, interest income of \$101,000 and \$97,000, respectively, was recognized, based on cash receipts from loan payments on non-performing loans; and \$65,000 and \$93,000, respectively, was collected and applied to the net loan balances under the cost recovery method. Foregone interest income, which would have been recorded had the non-performing loans been current in accordance with their original terms, amounted to \$66,000 and \$57,000 for the quarters ended September 30, 2015 and 2014, respectively, and was not included in the results of operations.

The following table presents the average recorded investment in non-performing loans and the related interest income recognized for the quarters ended September 30, 2015 and 2014:

	Quarter Ended September 30,			
	2015		2014	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Without related allowances:				
Mortgage loans:				
Single-family	\$8,032	\$3	\$7,917	\$34
Multi-family	2,065	66	2,288	4
Commercial real estate	1,322	18	2,327	26
	11,419	87	12,532	64
With related allowances:				
Mortgage loans:				
Single-family	3,801	12	2,560	17
Multi-family	—	—	725	13
Commercial business loans	107	2	132	3
	3,908	14	3,417	33
Total	\$15,327	\$101	\$15,949	\$97

For the quarters ended September 30, 2015 and 2014, there were no loans that were newly modified from their original terms, re-underwritten or identified in the Corporation's asset quality reports as restructured loans. During the quarters ended September 30, 2015 and 2014, no restructured loans were in default within a 12-month period subsequent to their original restructuring. Additionally, during the quarter ended September 30, 2015 and 2014, there were no loans whose modification were extended beyond the initial maturity of the modification.

As of September 30, 2015, the net outstanding balance of the 15 restructured loans was \$5.5 million: two were classified as special mention and remain on accrual status (\$980,000); and 13 were classified as substandard (\$4.5 million, all on non-accrual status). As of June 30, 2015, the net outstanding balance of the 18 restructured loans was \$6.6 million: two were classified as special mention on accrual status (\$989,000); and 16 were classified as substandard (\$5.6 million, all on non-accrual status). Substandard assets have one or more defined weaknesses and are characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected. Assets that do not currently expose the Corporation to sufficient risk to warrant adverse classification but possess weaknesses are designated as special mention and are closely monitored by the Corporation. As of September 30, 2015 and June 30, 2015, \$4.1 million or 74%, and \$4.9 million or 74%, respectively, of the restructured loans were current with respect to their modified payment terms.

The Corporation upgrades restructured single-family loans to the pass category if the borrower has demonstrated satisfactory contractual payments for at least six consecutive months; 12 months for those loans that were restructured more than once; and if the borrower has demonstrated satisfactory contractual payments beyond 12 consecutive months, the loan is no longer categorized as a restructured loan. In addition to the payment history described above, multi-family, commercial real estate, construction and commercial business loans (which are sometimes referred to in this report as "preferred loans") must also demonstrate a combination of the following characteristics to be upgraded: satisfactory cash flow, satisfactory guarantor support, and additional collateral support, among others.

To qualify for restructuring, a borrower must provide evidence of their creditworthiness such as, current financial statements, their most recent income tax returns, current paystubs, current W-2s, and most recent bank statements, among other documents, which are then verified by the Corporation. The Corporation re-underwrites the loan with the borrower's updated financial information,

new credit report, current loan balance, new interest rate, remaining loan term, updated property value and modified payment schedule, among other considerations, to determine if the borrower qualifies.

The following table summarizes at the dates indicated the restructured loan balances, net of allowance for loan losses, by loan type and non-accrual versus accrual status:

(In Thousands)	September 30, 2015	June 30, 2015
Restructured loans on non-accrual status:		
Mortgage loans:		
Single-family	\$2,879	\$2,902
Multi-family	1,576	1,593
Commercial real estate	—	1,019
Commercial business loans	87	89
Total	4,542	5,603
Restructured loans on accrual status:		
Mortgage loans:		
Single-family	980	989
Total	980	989
Total restructured loans	\$5,522	\$6,592



The following tables identify the Corporation's total recorded investment in restructured loans by type at the dates and for the periods indicated.

(In Thousands)	At September 30, 2015			Allowance <sup>(1)</sup>	Net Recorded Investment
	Unpaid Principal Balance	Related Charge-offs	Recorded Investment		
Mortgage loans:					
Single-family:					
With a related allowance	\$ 572	\$—	\$ 572	\$(114)	)\$458
Without a related allowance <sup>(2)</sup>	4,340	(939)	)3,401	—	3,401
Total single-family	4,912	(939)	)3,973	(114)	)3,859
Multi-family:					
Without a related allowance <sup>(2)</sup>	2,729	(1,153)	)1,576	—	1,576
Total multi-family	2,729	(1,153)	)1,576	—	1,576
Commercial business loans:					
With a related allowance	107	—	107	(20)	)87
Total commercial business loans	107	—	107	(20)	)87
Total restructured loans	\$ 7,748	\$(2,092)	)\$5,656	\$(134)	)\$5,522

<sup>(1)</sup> Consists of collectively and individually evaluated allowances, specifically assigned to the individual loan.

<sup>(2)</sup> There was no related allowance for loan losses because the loans have been charged-off to their fair value or the fair value of the collateral is higher than the loan balance.

(In Thousands)	At June 30, 2015				Net Recorded Investment
	Unpaid Principal Balance	Related Charge-offs	Recorded Investment	Allowance <sup>(1)</sup>	
Mortgage loans:					
Single-family					
With a related allowance	\$ 576	\$ —	\$ 576	\$(115)	)\$461
Without a related allowance <sup>(2)</sup>	4,397	(967)	)3,430	—	3,430
Total single-family	4,973	(967)	)4,006	(115)	)3,891
Multi-family:					
Without a related allowance <sup>(2)</sup>	2,795	(1,202)	)1,593	—	1,593
Total multi-family	2,795	(1,202)	)1,593	—	1,593
Commercial real estate:					
Without a related allowance <sup>(2)</sup>	1,019	—	1,019	—	1,019
Total commercial real estate	1,019	—	1,019	—	1,019
Commercial business loans:					
With a related allowance	109	—	109	(20)	)89
Total commercial business loans	109	—	109	(20)	)89
Total restructured loans	\$ 8,896	\$(2,169)	)\$6,727	\$(135)	)\$6,592

<sup>(1)</sup> Consists of collectively and individually evaluated allowances, specifically assigned to the individual loan.

<sup>(2)</sup> There was no related allowance for loan losses because the loans have been charged-off to their fair value or the fair value of the collateral is higher than the loan balance.

During the quarter ended September 30, 2015, two properties were acquired in the settlement of loans, while two previously foreclosed upon properties were sold. This compares to the quarter ended September 30, 2014 when three properties were acquired in the settlement of loans, while two previously foreclosed upon properties were sold and one real estate owned property was written off. As of September 30, 2015, the net fair value of real estate owned was \$3.7 million, comprised of two properties located in Southern California and one property located in Arizona. This compares the real estate owned net fair value of \$2.4 million at June 30, 2015, comprised of two properties located in Southern California and one property located in Nevada. A new appraisal was obtained on each of the properties at the time of foreclosure and fair value was calculated by using the lower of the appraised value or the listing price of the property, net of selling costs. Any initial loss was recorded as a charge to the allowance for loan losses before being transferred to real estate owned. Subsequent to transfer to real estate owned, if there is further deterioration in real estate values, specific real estate owned loss reserves are established and charged to the statement of operations. In addition, the Corporation records costs to carry real estate owned as real estate operating expenses as incurred.

#### Note 7: Derivative and Other Financial Instruments with Off-Balance Sheet Risks

The Corporation 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 in the form of originating loans or providing funds under existing lines of credit, loan sale commitments to third parties and option

contracts. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the accompanying Condensed Consolidated Statements of Financial Condition. The Corporation's exposure to credit loss, in the event of non-performance by the counterparty to these financial instruments, is represented by the contractual amount of these instruments. The Corporation uses the same credit policies in entering into financial instruments with off-balance sheet risk as it does for on-balance

sheet instruments. As of September 30, 2015 and June 30, 2015, the Corporation had commitments to extend credit (on loans to be held for investment and loans to be held for sale) of \$143.5 million and \$144.3 million, respectively.

The following table provides information at the dates indicated regarding undisbursed funds to borrowers on existing lines of credit with the Corporation as well as commitments to originate loans to be held for investment at the dates indicated below.

Commitments	September 30, 2015	June 30, 2015
(In Thousands)		
Undisbursed loan funds - Construction loans	\$2,691	\$3,359
Undisbursed lines of credit – Mortgage loans	95	414
Undisbursed lines of credit – Commercial business loans	817	822
Undisbursed lines of credit – Consumer loans	697	708
Commitments to extend credit on loans to be held for investment	4,607	4,745
Total	\$8,907	\$10,048

In accordance with ASC 815, “Derivatives and Hedging,” and interpretations of the Derivatives Implementation Group of the FASB, the fair value of the commitments to extend credit on loans to be held for sale, loan sale commitments, to be announced (“TBA”) MBS trades, put option contracts and call option contracts are recorded at fair value on the Condensed Consolidated Statements of Financial Condition. At September 30, 2015, \$2.5 million was included in other assets and \$1.6 million was included in other liabilities; at June 30, 2015, \$2.6 million was included in other assets and \$208,000 was included in other liabilities. The Corporation does not apply hedge accounting to its derivative financial instruments; therefore, all changes in fair value are recorded in earnings.

The following table provides information regarding the allowance for loan losses for the undisbursed funds and commitments to extend credit on loans to be held for investment for the quarters ended September 30, 2015 and 2014.

(In Thousands)	For the Quarters Ended September 30,	
	2015	2014
Balance, beginning of the period	\$76	\$61
(Recovery) provision	(11)	)47
Balance, end of the period	\$65	\$108

The net impact of derivative financial instruments on the gain on sale of loans contained in the Condensed Consolidated Statements of Operations during the quarters ended September 30, 2015 and 2014 was as follows:

Derivative Financial Instruments	For the Quarters Ended September 30,	
(In Thousands)	2015	2014
Commitments to extend credit on loans to be held for sale	\$1,005	\$(781)
Mandatory loan sale commitments and TBA MBS trades	(2,433)	)937
Option contracts	(88)	)(105)
Total net (loss) gain	\$(1,516)	)\$51



The outstanding derivative financial instruments and other loan sale agreements at the dates indicated were as follows:

Derivative Financial Instruments (In Thousands)	September 30, 2015		June 30, 2015	
	Amount	Fair Value	Amount	Fair Value
Commitments to extend credit on loans to be held for sale <sup>(1)</sup>	\$138,849	\$2,504	\$139,565	\$1,499
Best efforts loan sale commitments	(42,947)	)—	(36,908)	)—
Mandatory loan sale commitments and TBA MBS trades	(243,409)	)(1,692)	)(320,197)	)741
Option contracts	(2,000)	)57	4,000	192
Total	\$(149,507)	)\$869	\$(213,540)	)\$2,432

(1) Net of 30.1% at September 30, 2015 and 26.9% at June 30, 2015 of commitments which management has estimated may not fund.

#### Note 8: Income Taxes

ASC 740, "Income Taxes," requires the affirmative evaluation that it is more likely than not, based on the technical merits of a tax position, that an enterprise is entitled to economic benefits resulting from positions taken in income tax returns. If a tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements. Management has determined that there are no unrecognized tax benefits to be reported in the Corporation's financial statements.

ASC 740 requires that when determining the need for a valuation allowance against a deferred tax asset, management must assess both positive and negative evidence with regard to the realizability of the tax losses represented by that asset. To the extent available sources of taxable income are insufficient to absorb tax losses, a valuation allowance is necessary. Sources of taxable income for this analysis include prior years' tax returns, the expected reversals of taxable temporary differences between book and tax income, prudent and feasible tax-planning strategies, and future taxable income. The deferred tax asset related to the allowance will be realized when actual charge-offs are made against the allowance. Based on the availability of loss carry-backs and projected taxable income during the periods for which loss carry-forwards are available, management believes it is more likely than not the Corporation will realize the deferred tax asset. The Corporation continues to monitor the deferred tax asset on a quarterly basis for a valuation allowance. The future realization of these tax benefits primarily hinges on adequate future earnings to utilize the tax benefit. Prospective earnings or losses, tax law changes or capital changes could prompt the Corporation to reevaluate the assumptions which may be used to establish a valuation allowance. The Corporation maintains net deferred income tax assets for deductible temporary tax differences, such as loss reserves, deferred compensation, non-accrued interest and unrealized gains. The Corporation did not have any liabilities for uncertain tax positions or any known unrecognized tax benefit at September 30, 2015 or June 30, 2015.

The Corporation files income tax returns for the United States and state of California jurisdictions. The Internal Revenue Service has audited the Bank's income tax returns through 1996 and the California Franchise Tax Board has audited the Bank through 1990. Also, the Internal Revenue Service completed a review of the Corporation's income tax returns for fiscal 2006 and 2007; and the California Franchise Tax Board completed a review of the Corporation's income tax returns for fiscal 2009 and 2010. Tax years subsequent to fiscal 2010 remain subject to federal examination; and the California state income tax returns for years subsequent to fiscal 2010 are subject to future examination by state taxing authorities.

It is the Corporation's policy to record any penalties or interest charges arising from federal or state taxes as a component of income tax expense. During the quarter ended September 30, 2015, there were no tax penalties or interest charges. For the quarter ended September 30, 2014, the Corporation paid \$4,000 in interest charges to the State of California tax authority for the fiscal 2010 tax obligation.

## Note 9: Fair Value of Financial Instruments

The Corporation adopted ASC 820, "Fair Value Measurements and Disclosures," and elected the fair value option pursuant to ASC 825, "Financial Instruments" on loans originated for sale by PBM. ASC 820 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. ASC 825 permits entities to elect to measure many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis (the "Fair Value Option") at specified election dates. At each subsequent reporting date, an entity is required to report unrealized gains and losses on items in earnings for which the fair value option has been elected. The objective of the Fair Value Option is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions.

The following table describes the difference at the dates indicated between the aggregate fair value and the aggregate unpaid principal balance of loans held for investment at fair value and loans held for sale at fair value:

(In Thousands)	Aggregate Fair Value	Aggregate Unpaid Principal Balance	Net Unrealized (Loss) Gain
As of September 30, 2015:			
Loans held for investment, at fair value	\$4,036	\$4,167	\$(131)
Loans held for sale, measured at fair value	\$163,644	\$156,901	\$6,743
As of June 30, 2015:			
Loans held for investment, at fair value	\$4,518	\$4,495	\$23
Loans held for sale, measured at fair value	\$224,715	\$219,143	\$5,572

ASC 820-10-65-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly," provides additional guidance for estimating fair value in accordance with ASC 820, "Fair Value Measurements," when the volume and level of activity for the asset or liability have significantly decreased.

ASC 820 establishes a three-level valuation hierarchy that prioritizes inputs to valuation techniques used in fair value calculations. The three levels of inputs are defined as follows:

- Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date.
- Level 2 - Observable inputs other than Level 1 such as: quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated to observable market data for substantially the full term of the asset or liability.
- Level 3 - Unobservable inputs for the asset or liability that use significant assumptions, including assumptions of risks. These unobservable assumptions reflect the Corporation's estimate of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of pricing models, discounted cash flow models and similar techniques.

ASC 820 requires the Corporation to maximize the use of observable inputs and minimize the use of unobservable inputs. If a financial instrument uses inputs that fall in different levels of the hierarchy, the instrument will be categorized based upon the lowest level of input that is significant to the fair value calculation.



The Corporation's financial assets and liabilities measured at fair value on a recurring basis consist of investment securities, loans held for investment at fair value, loans held for sale at fair value, interest-only strips and derivative financial instruments; while non-performing loans, mortgage servicing assets ("MSA") and real estate owned are measured at fair value on a nonrecurring basis.

Investment securities are primarily comprised of U.S. government agency MBS, U.S. government sponsored enterprise MBS, a privately issued CMO and common stock of a community development financial institution. The Corporation utilizes quoted prices in active and less than active markets for similar securities for its fair value measurement of MBS and debt securities (Level

2), broker price indications for similar securities in non-active markets for its fair value measurement of the CMO (Level 3) and a relative value analysis for the common stock in non-active markets (Level 3).

Derivative financial instruments are comprised of commitments to extend credit on loans to be held for sale, mandatory loan sale commitments, TBA MBS trades and option contracts. The fair value of TBA MBS trades is determined using quoted secondary-market prices (Level 2). The fair values of other derivative financial instruments are determined by quoted prices for a similar commitment or commitments, adjusted for the specific attributes of each commitment (Level 3).

Loans held for investment at fair value are primarily single-family loans which have been transferred from loans held for sale. The fair value is determined by the quoted secondary-market prices which account for interest rate characteristics, adjusted for management estimates of the specific credit risk attributes of each loan (Level 3).

Loans held for sale at fair value are primarily single-family loans. The fair value is determined, when possible, using quoted secondary-market prices such as mandatory loan sale commitments. If no such quoted price exists, the fair value of a loan is determined by quoted prices for a similar loan or loans, adjusted for the specific attributes of each loan (Level 2).

Non-performing loans are loans which are inadequately protected by the current net worth and paying capacity of the borrowers or of the collateral pledged. The non-performing loans are characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected. The fair value of a non-performing loan is determined based on an observable market price or current appraised value of the underlying collateral. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the borrower. For non-performing loans which are restructured loans, the fair value is derived from discounted cash flow analysis (Level 3), except those which are in the process of foreclosure or 90 days delinquent for which the fair value is derived from the appraised value of its collateral (Level 2). For other non-performing loans which are not restructured loans, other than non-performing commercial real estate loans, the fair value is derived from relative value analysis: historical experience and management estimates by loan type for which collectively evaluated allowances are assigned (Level 3), or the appraised value of its collateral for loans which are in the process of foreclosure or where borrowers file bankruptcy, for which the charge-off will occur when the loan becomes 60 days delinquent (Level 2). For non-performing commercial real estate loans, the fair value is derived from the appraised value of its collateral (Level 2). Non-performing loans are reviewed and evaluated on at least a quarterly basis for additional allowance and adjusted accordingly, based on the same factors identified above. This loss is not recorded directly as an adjustment to current earnings or other comprehensive income (loss), but rather as a component in determining the overall adequacy of the allowance for loan losses. These adjustments to the estimated fair value of non-performing loans may result in increases or decreases to the provision for loan losses recorded in current earnings.

The Corporation uses the amortization method for its MSA, which amortizes the MSA in proportion to and over the period of estimated net servicing income and assesses the MSA for impairment based on fair value at each reporting date. The fair value of MSA is calculated using the present value method; which includes a third party's prepayment projections of similar instruments, weighted-average coupon rates and the estimated average life (Level 3).

The rights to future income from serviced loans that exceed contractually specified servicing fees are recorded as interest-only strips. The fair value of interest-only strips is calculated using the same assumptions that are used to value the related MSA (Level 3).

The fair value of real estate owned is derived from the lower of the appraised value or the listing price, net of estimated selling costs (Level 2).

The Corporation's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Corporation's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following fair value hierarchy tables present information at the dates indicated about the Corporation's assets measured at fair value on a recurring basis:

(In Thousands)	Fair Value Measurement at September 30, 2015 Using:			
	Level 1	Level 2	Level 3	Total
Assets:				
Investment securities:				
U.S. government agency MBS	\$—	\$7,573	\$—	\$7,573
U.S. government sponsored enterprise MBS	—	5,046	—	5,046
Private issue CMO	—	—	691	691
Common stock - community development financial institution	—	—	151	151
Investment securities	—	12,619	842	13,461
Loans held for investment, at fair value	—	—	4,036	4,036
Loans held for sale, at fair value	—	163,644	—	163,644
Interest-only strips	—	—	60	60
Derivative assets:				
Commitments to extend credit on loans to be held for sale	—	—	2,510	2,510
Option contracts	—	—	57	57
Derivative assets	—	—	2,567	2,567
Total assets	\$—	\$176,263	\$7,505	\$183,768
Liabilities:				
Derivative liabilities:				
Commitments to extend credit on loans to be held for sale	\$—	\$—	\$6	\$6
Mandatory loan sale commitments	—	—	150	150
TBA MBS trades	—	1,542	—	1,542
Derivative liabilities	—	1,542	156	1,698
Total liabilities	\$—	\$1,542	\$156	\$1,698

(In Thousands)	Fair Value Measurement at June 30, 2015 Using:			
	Level 1	Level 2	Level 3	Total
Assets:				
Investment securities:				
U.S. government agency MBS	\$—	\$7,906	\$—	\$7,906
U.S. government sponsored enterprise MBS	—	5,387	—	5,387
Private issue CMO	—	—	717	717
Common stock - community development financial institution	—	—	151	151
Investment securities	—	13,293	868	14,161
Loans held for investment, at fair value	—	4,518	—	4,518
Loans held for sale, at fair value	—	224,715	—	224,715
Interest-only strips	—	—	63	63
Derivative assets:				
Commitments to extend credit on loans to be held for sale	—	—	1,636	1,636
TBA MBS trades	—	812	—	812
Option contracts	—	—	192	192
Derivative assets	—	812	1,828	2,640
Total assets	\$—	\$243,338	\$2,759	\$246,097
Liabilities:				
Derivative liabilities:				
Commitments to extend credit on loans to be held for sale	\$—	\$—	\$137	\$137
Mandatory loan sale commitments	—	—	71	71
Derivative liabilities	—	—	208	208
Total liabilities	\$—	\$—	\$208	\$208

The following tables summarize reconciliations of the beginning and ending balances during the periods shown of recurring fair value measurements recognized in the Condensed Consolidated Statements of Financial Condition using Level 3 inputs:

For the Quarter Ended September 30, 2015  
Fair Value Measurement  
Using Significant Other Unobservable Inputs  
(Level 3)

(In Thousands)	Private Issue CMO	Common stock <sup>(1)</sup>	Loans Held For Investment, at fair value <sup>(2)</sup>	Interest-Only Strips	Loan Commitments to Originate <sup>(3)</sup>	Mandatory Commitments <sup>(4)</sup>	Option Contracts	Total
Beginning balance at June 30, 2015	\$717	\$151	\$—	\$63	\$1,499	\$(71)	)\$192	\$2,551
Total gains or losses (realized/unrealized):								
Included in earnings	—	—	(155)	)—	1,005	(96)	)(88)	)666
Included in other comprehensive loss	(1)	)—	—	(3)	)—	—	—	(4)
Purchases	—	—	—	—	—	—	89	89
Issuances	—	—	—	—	—	—	—	—
Settlements	(25)	)—	(638)	)—	—	17	(136)	)(782)
Transfers in and/or out of Level 3	—	—	4,829	—	—	—	—	4,829
Ending balance at September 30, 2015	\$691	\$151	\$4,036	\$60	\$2,504	\$(150)	)\$57	\$7,349

<sup>(1)</sup> Common stock of a community development financial institution.

Beginning fiscal 2016, the valuation of loans held for investment at fair value includes the management estimates

<sup>(2)</sup> of the specific credit risk attributes of each loan (Level 3), in addition to the quoted secondary-market prices which account for interest rate characteristics.

<sup>(3)</sup> Consists of commitments to extend credit on loans to be held for sale.

<sup>(4)</sup> Consists of mandatory loan sale commitments.

For the Quarter Ended September 30, 2014  
Fair Value Measurement  
Using Significant Other Unobservable Inputs  
(Level 3)

(In Thousands)	Private Issue CMO	Common stock <sup>(1)</sup>	Interest-Only Strips	Loan Commitments to Originate <sup>(2)</sup>	Mandatory Commitments <sup>(3)</sup>	Option Contracts	Total
Beginning balance at June 30, 2014	\$853	\$—	\$62	\$2,566	\$(93)	)\$—	\$3,388
Total gains or losses (realized/unrealized):							
Included in earnings	—	—	—	(781)	)(156)	)(105)	)(1,042)
Included in other comprehensive	(1)	)—	8	—	—	—	7

Edgar Filing: PROVIDENT FINANCIAL HOLDINGS INC - Form 10-Q

(loss) income							
Purchases	—	250	—	—	—	187	437
Issuances	—	—	—	—	—	—	—
Settlements	(24	)—	—	—	4	(49	)(69 )
Transfers in and/or out of Level 3	—	—	—	—	—	—	—
Ending balance at September 30, 2014	\$ 828	\$ 250	\$ 70	\$ 1,785	\$(245	)\$33	\$ 2,721

(1) Common stock of a community development financial institution.

(2) Consists of commitments to extend credit on loans to be held for sale.

(3) Consists of mandatory loan sale commitments.

The following fair value hierarchy tables present information about the Corporation's assets measured at fair value at the dates indicated on a nonrecurring basis:

(In Thousands)	Fair Value Measurement at September 30, 2015 Using:			
	Level 1	Level 2	Level 3	Total
Non-performing loans	\$—	\$11,146	\$3,618	\$14,764
MSA	—	—	417	417
Real estate owned, net	—	3,674	—	3,674
Total	\$—	\$14,820	\$4,035	\$18,855

(In Thousands)	Fair Value Measurement at June 30, 2015 Using:			
	Level 1	Level 2	Level 3	Total
Non-performing loans	\$—	\$11,816	\$2,130	\$13,946
MSA	—	—	269	269
Real estate owned, net	—	2,398	—	2,398
Total	\$—	\$14,214	\$2,399	\$16,613



Edgar Filing: PROVIDENT FINANCIAL HOLDINGS INC - Form 10-Q

The following table presents additional information about valuation techniques and inputs used for assets and liabilities, including derivative financial instruments, which are measured at fair value and categorized within Level 3 as of September 30, 2015:

(Dollars In Thousands)	Fair Value As of September 30, 2015	Valuation Techniques	Unobservable Inputs	Range <sup>(1)</sup> (Weighted Average)	Impact to Valuation from an Increase in Inputs <sup>(2)</sup>
Assets:					
Securities available-for-sale: Private issue CMO	\$691	Market comparable pricing	Comparability adjustment	0.0% – 1.5% (1.2%)	Increase
Securities available-for-sale: Common stock <sup>(3)</sup>	\$151	Relative value analysis	Adjusted book value	\$ 38.6 million	Increase
Loans held for investment, at fair value	\$4,036	Relative value analysis	Broker quotes	99.5% – 105.8% (102.2%) of par	Increase
			Credit risk factors	1.2% - 100.0% (5.3%)	Decrease
Non-performing loans	\$87	Discounted cash flow	Default rates	5.0%	Decrease
Non-performing loans	\$3,531	Relative value analysis	Loss severity	20.0% - 30.0% (20.8%)	Decrease
MSA	\$417	Discounted cash flow	Prepayment speed (CPR)	7.8% - 60.0% (17.2%)	Decrease
			Discount rate	9.0% - 10.5% (9.1%)	Decrease
Interest-only strips	\$60	Discounted cash flow	Prepayment speed (CPR)	16.4% - 23.6% (17.7%)	Decrease
			Discount rate	9.0%	Decrease
Commitments to extend credit on loans to be held for sale	\$2,510	Relative value analysis	TBA-MBS broker quotes	98.0% – 105.0% (102.2%) of par	Decrease
			Fall-out ratio <sup>(4)</sup>	19.8% - 31.7% (30.1%)	Decrease
Option contracts	\$57	Relative value analysis	Broker quotes	128.9% of par	Increase
Liabilities:					
Commitments to extend credit on loans to be held for sale	\$6	Relative value analysis	TBA-MBS broker quotes	100.5% – 102.8% (101.0%) of par	Increase
				19.8% - 31.7%	Increase

			Fall-out ratio <sup>(4)</sup>	(30.1%)	
			Investor quotes		
Mandatory loan sale commitments	\$ 150	Relative value analysis	TBA MBS broker quotes	104.5% - 106.6% (104.8%) of par	Increase
				0.005%	Increase
			Roll-forward costs <sup>(5)</sup>		

(1) The range is based on the estimated fair values and management estimates.

Unless otherwise noted, this column represents the directional change in the fair value of the Level 3 investments that would result from an increase to the corresponding unobservable input. A decrease to the unobservable input would have the opposite effect. Significant changes in these inputs in isolation could result in significantly higher or lower fair value measurements.

(2) Common stock of a community development financial institution.

(3) The percentage of commitments to extend credit on loans to be held for sale which management has estimated may not fund.

(4) An estimated cost to roll forward the mandatory loan sale commitments which management has estimated may not be delivered to the corresponding investors in a timely manner.

The significant unobservable inputs used in the fair value measurement of the Corporation's assets and liabilities include the following: prepayment speeds, discount rates, MBS – TBA quotes, fallout ratios, broker quotes and roll-forward costs, among others. Significant increases or decreases in any of these inputs in isolation could result in significantly lower or higher fair value measurement. The various unobservable inputs used to determine valuations may have similar or diverging impacts on valuation.

The carrying amount and fair value of the Corporation's other financial instruments as of September 30, 2015 and June 30, 2015 were as follows:

(In Thousands)	September 30, 2015				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Loans held for investment, not recorded at fair value	\$801,651	\$807,570	—	—	\$807,570
FHLB – San Francisco stock	\$8,094	\$8,094	—	\$8,094	—
Financial liabilities:					
Deposits	\$924,866	\$896,555	—	—	\$896,555
Borrowings	\$91,351	\$94,330	—	—	\$94,330
(In Thousands)	June 30, 2015				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Loans held for investment, not recorded at fair value	\$809,716	\$815,385	—	—	\$815,385
FHLB – San Francisco stock	\$8,094	\$8,094	—	\$8,094	—
Financial liabilities:					
Deposits	\$924,086	\$895,664	—	—	\$895,664
Borrowings	\$91,367	\$93,219	—	—	\$93,219

Loans held for investment, not recorded at fair value: For loans that reprice frequently at market rates, the carrying amount approximates the fair value. For fixed-rate loans, the fair value is determined by either (i) discounting the estimated future cash flows of such loans over their estimated remaining contractual maturities using a current interest rate at which such loans would be made to borrowers, or (ii) quoted market prices. The allowance for loan losses is subtracted as an estimate of the underlying credit risk.

FHLB – San Francisco stock: The carrying amount reported for FHLB – San Francisco stock approximates fair value. When redeemed, the Corporation will receive an amount equal to the par value of the stock.

Deposits: The fair value of time deposits is estimated using a discounted cash flow calculation. The discount rate is based upon rates currently offered for deposits of similar remaining maturities. The fair value of transaction accounts (checking, money market and savings accounts) is based on management estimates, consistent with current market conditions.

Borrowings: The fair value of borrowings has been estimated using a discounted cash flow calculation. The discount rate on such borrowings is based upon rates currently offered for borrowings of similar remaining maturities.

The Corporation has various processes and controls in place to ensure that fair value is reasonably estimated. The Corporation generally determines fair value of their Level 3 assets and liabilities by using internally developed models

which primarily utilize discounted cash flow techniques and prices obtained from independent management services or brokers. The Corporation performs due diligence procedures over third-party pricing service providers in order to support their use in the valuation process. The fair values of investment securities, commitments to extend credit on loans held for sale, mandatory commitments and option contracts are determined from the independent management services or brokers; while the fair value of MSA and interest-only strips are determined using the internally developed models which are based on discounted cash flow analysis. The fair value of non-performing loans is determined by calculating discounted cash flows, relative value analysis or collateral value, less selling costs.

While the Corporation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. During the quarter ended September 30, 2015, there were no significant changes to the Corporation's valuation techniques that had, or are expected to have, a material impact on its consolidated financial position or results of operations.

#### Note 10: Incentive Plans

As of September 30, 2015, the Corporation had four active share-based compensation plans, which are described below. These plans are the 2013 Equity Incentive Plan ("2013 Plan"), the 2010 Equity Incentive Plan ("2010 Plan"), the 2006 Equity Incentive Plan ("2006 Plan") and the 2003 Stock Option Plan.

For the quarters ended September 30, 2015 and 2014, the compensation cost for these plans was \$289,000 and \$143,000, respectively. The income tax effect recognized in the Condensed Consolidated Statements of Financial Condition for share-based compensation plans was a \$1,000 credit and a \$16,000 debit in the quarters ended September 30, 2015 and 2014, respectively.

**Equity Incentive Plan.** The Corporation established and the shareholders approved the 2013 Plan, the 2010 Plan and the 2006 Plan for directors, advisory directors, directors emeriti, officers and employees of the Corporation and its subsidiary. The 2013 Plan authorizes 300,000 stock options and 300,000 shares of restricted stock. The 2013 Plan also provides that no person may be granted more than 60,000 stock options or 45,000 shares of restricted stock in any one year. The 2010 Plan authorizes 586,250 stock options and 288,750 shares of restricted stock. The 2010 Plan also provides that no person may be granted more than 117,250 stock options or 43,312 shares of restricted stock in any one year. The 2006 Plan authorizes 365,000 stock options and 185,000 shares of restricted stock. The 2006 Plan also provides that no person may be granted more than 73,000 stock options or 27,750 shares of restricted stock in any one year.

**Equity Incentive Plan - Stock Options.** Under the 2013 Plan, 2010 Plan and 2006 Plan (collectively, "the Plans"), options may not be granted at a price less than the fair market value at the date of the grant. Options typically vest over a five-year or shorter period as long as the director, advisory director, director emeritus, officer or employee remains in service to the Corporation. The options are exercisable after vesting for up to the remaining term of the original grant. The maximum term of the options granted is 10 years.

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option valuation model with the following assumptions. The expected volatility is based on implied volatility from historical common stock closing prices for the prior 84 months. The expected dividend yield is based on the most recent quarterly dividend on an annualized basis. The expected term is based on the historical experience of all fully vested stock option grants and is reviewed annually. The risk-free interest rate is based on the U.S. Treasury note rate with a term similar to the underlying stock option on the particular grant date.

During the first quarter of fiscal 2016, no options were granted, while 13,000 options were exercised and 3,000 options were forfeited. This compares to the first quarter of fiscal 2015 when 369,000 options were granted, and 2,000 options were exercised with no options were forfeited. As of September 30, 2015 and 2014, there were 133,750 and 130,750 stock options available for future grants under the Plans, respectively.



The following tables summarize the stock option activity in the Plans for the quarter ended September 30, 2015.

Options	For the Quarter Ended September 30, 2015			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (\$000)
Outstanding at June 30, 2015	961,500	\$13.83		
Granted	—	\$—		
Exercised	(13,000)	)\$7.34		
Forfeited	(3,000)	)\$7.43		
Outstanding at September 30, 2015	945,500	\$13.92	6.10	\$4,481
Vested and expected to vest at September 30, 2015	866,300	\$13.85	5.84	\$4,313
Exercisable at September 30, 2015	549,500	\$13.38	4.06	\$3,643

As of September 30, 2015 and 2014, there was \$1.9 million and \$2.8 million of unrecognized compensation expense, respectively, related to unvested share-based compensation arrangements under the Plans. The expense is expected to be recognized over a weighted-average period of 2.9 years and 3.5 years, respectively. The forfeiture rate during the first three months of fiscal 2016 and 2015 was 20 percent for both periods, and was calculated by using the historical forfeiture experience of all fully vested stock option grants and is reviewed annually.

Equity Incentive Plan – Restricted Stock. The Corporation used 300,000 shares, 288,750 shares and 185,000 shares of its treasury stock to fund the 2013 Plan, the 2010 Plan and the 2006 Plan, respectively. Awarded shares typically vest over a five-year or shorter period as long as the director, advisory director, director emeriti, officer or employee remains in service to the Corporation. Once vested, a recipient of restricted stock will have all rights of a shareholder, including the power to vote and the right to receive dividends. The Corporation recognizes compensation expense for the restricted stock awards based on the fair value of the shares at the award date.

There was no restricted stock activity in the first quarters of fiscal 2016 and 2015, other than the vesting of 2,500 shares in the first quarter of fiscal 2016 and the award of 185,000 shares in the first quarter of fiscal 2015. As of September 30, 2015 and 2014, there were 276,850 shares and 275,350 shares of restricted stock available for future awards under the Plans.

The following tables summarize the unvested restricted stock activity in the quarter ended September 30, 2015.

Unvested Shares	For the Quarter Ended September 30, 2015	
	Shares	Weighted-Average Award Date Fair Value
Unvested at June 30, 2015	200,000	\$13.35
Granted	—	\$—
Vested	(2,500)	)\$—
Forfeited	—	\$—
Unvested at September 30, 2015	197,500	\$13.35
Expected to vest at September 30, 2015	158,000	\$13.35

As of September 30, 2015 and 2014, the unrecognized compensation expense was \$2.1 million and \$2.9 million, respectively, related to unvested share-based compensation arrangements under the Plans, and reported as a reduction to stockholders' equity. This expense is expected to be recognized over a weighted-average period of 3.0 years and 3.7

years, respectively. Similar to stock options, a forfeiture rate of 20 percent has been applied for the restricted stock compensation expense calculations in the first three months of fiscal 2016 and 2015.

Stock Option Plans. The Corporation established the 2003 Stock Option Plan and the 1996 Stock Option Plan (collectively, the “Stock Option Plans”) for key employees and eligible directors under which options to acquire up to 352,500 shares and 1.15

38

---



million shares of common stock, respectively, may be granted. Under the Stock Option Plans, stock options may not be granted at a price less than the fair market value at the date of the grant. Stock options typically vest over a five-year period on a pro-rata basis as long as the employee or director remains in service to the Corporation. The stock options are exercisable after vesting for up to the remaining term of the original grant. The maximum term of the stock options granted is 10 years. As of September 30, 2015, no stock options remain available for future grants under the 2003 and 1996 Stock Option Plans, which expired in November 2013 and January 2007, respectively. The final 5,000 stock options in the 1996 Stock Option Plan were forfeited in the quarter ended September 30, 2015 and the 1996 Stock Option Plan is now inactive.

The fair value of each stock option grant was estimated on the date of the grant using the Black-Scholes option valuation model with the following assumptions. The expected volatility was based on implied volatility from historical common stock closing prices for the prior 84 months. The expected dividend yield was based on the most recent quarterly dividend on an annualized basis. The expected term was based on the historical experience of all fully vested stock option grants and is reviewed annually. The risk-free interest rate was based on the U.S. Treasury note rate with a term similar to the underlying stock option on the particular grant date.

For the first quarter of fiscal 2016 and 2015, there was no activity in the Stock Option Plans, except forfeitures of 7,500 shares and 17,500 shares, respectively. As of September 30, 2015 and 2014, there were no stock options available for future grants under the Stock Option Plans.

The following tables summarize the activity in the Stock Option Plans for the quarter ended September 30, 2015.

	For the Quarter Ended September 30, 2015			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (\$000)
Options Outstanding at June 30, 2015	70,000	\$22.81		
Granted	—	\$—		
Exercised	—	\$—		
Forfeited	(7,500)	)\$29.93		
Outstanding at September 30, 2015	62,500	\$21.95	1.64	\$—
Vested and expected to vest at September 30, 2015	62,500	\$21.95	1.64	\$—
Exercisable at September 30, 2015	62,500	\$21.95	1.64	\$—

As of September 30, 2015 and 2014, there was no unrecognized compensation expense at either date, related to unvested share-based compensation arrangements under the Stock Option Plans.

## Note 11: Reclassification adjustment of Accumulated Other Comprehensive Income ("AOCI")

The following tables provide the changes in AOCI by component for the quarters ended September 30, 2015 and 2014.

(In Thousands)	For the Quarter Ended September 30, 2015		
	Unrealized gains and losses on Investment securities available for sale	Interest-only strips	Total
Beginning balance at June 30, 2015	\$294	\$37	\$331
Other comprehensive loss before reclassifications	(29)	(2)	(31)
Amount reclassified from accumulated other comprehensive income	—	—	—
Net other comprehensive loss	(29)	(2)	(31)
Ending balance at September 30, 2015	\$265	\$35	\$300
	For the Quarter Ended September 30, 2014		
(In Thousands)	Unrealized gains and losses on Investment securities available for sale		
	Interest-only strips	Total	
Beginning balance at June 30, 2014	\$351	\$35	\$386
Other comprehensive (loss) income before reclassifications	(14)	5	(9)
Amount reclassified from accumulated other comprehensive income	—	—	—
Net other comprehensive (loss) income	(14)	5	(9)
Ending balance at September 30, 2014	\$337	\$40	\$377

There were no significant items reclassified out of AOCI for the quarters ended September 30, 2015 and 2014.

## Note 12: Offsetting Derivative and Other Financial Instruments

The Corporation's derivative transactions are generally governed by International Swaps and Derivatives Association Master Agreements and similar arrangements, which include provisions governing the setoff of assets and liabilities between the parties. When the Corporation has more than one outstanding derivative transaction with a single counterparty, the setoff provisions contained within these agreements generally allow the non-defaulting party the right to reduce its liability to the defaulting party by amounts eligible for setoff, including the collateral received as well as eligible offsetting transactions with that counterparty, irrespective of the currency, place of payment, or booking office. The Corporation's policy is to present its derivative assets and derivative liabilities on the Condensed Consolidated Statements of Financial Condition on a net basis for each type of derivative. The derivative assets and liabilities are comprised of mandatory loan sale commitments, TBA MBS trades and option contracts.



The following tables present the gross and net amounts of derivative assets and liabilities and other financial instruments as reported in the Corporation's Condensed Consolidated Statement of Financial Condition, and the gross amount not offset in the Corporation's Condensed Consolidated Statement of Financial Condition as of the dates indicated.

As of September 30, 2015:

(In Thousands)	Gross Amount of Recognized Assets	Gross Amount	Net Amount	Gross Amount Not Offset in the Condensed Consolidated Statements of Financial Condition		
		Offset in the Condensed Consolidated Statements of Financial Condition	of Assets in the Condensed Consolidated Statements of Financial Condition	Financial Instruments	Cash Collateral Received	Net Amount
Assets						
Derivatives	\$57	\$—	\$57	\$—	\$—	\$57
Total	\$57	\$—	\$57	\$—	\$—	\$57

(In Thousands)	Gross Amount of Recognized Liabilities	Gross Amount	Net Amount	Gross Amount Not Offset in the Condensed Consolidated Statements of Financial Condition		
		Offset in the Condensed Consolidated Statements of Financial Condition	of Liabilities in the Condensed Consolidated Statements of Financial Condition	Financial Instruments	Cash Collateral Received	Net Amount
Liabilities						
Derivatives	\$1,692	\$—	\$1,692	\$—	\$—	\$1,692
Total	\$1,692	\$—	\$1,692	\$—	\$—	\$1,692

As of June 30, 2015:

(In Thousands)	Gross Amount of Recognized Assets	Gross Amount	Net Amount	Gross Amount Not Offset in the Condensed Consolidated Statements of Financial Condition		
		Offset in the Condensed Consolidated Statements of Financial Condition	of Assets in the Condensed Consolidated Statements of Financial Condition	Financial Instruments	Cash Collateral Received	Net Amount
Assets						
Derivatives	\$1,004	\$—	\$1,004	\$—	\$—	\$1,004
Total	\$1,004	\$—	\$1,004	\$—	\$—	\$1,004

(In Thousands)	Gross Amount of Recognized Liabilities	Gross	Net	Gross Amount Not Offset in the Condensed Consolidated Statements of Financial Condition	Gross Amount Not Offset in the Condensed Consolidated Statements of Financial Condition	Net Amount
		Amount Offset in the Condensed Consolidated Statements of Financial Condition	Amount of Liabilities in the Condensed Consolidated Statements of Financial Condition			
Liabilities						
Derivatives	\$71	\$—	\$71	\$—	\$—	\$71
Total	\$71	\$—	\$71	\$—	\$—	\$71

### Note 13: Subsequent Events

On October 22, 2015, the Corporation announced that the Corporation's Board of Directors declared a quarterly cash dividend of \$0.12 per share. Shareholders of the Corporation's common stock at the close of business on November 12, 2015 will be entitled to receive the cash dividend. The cash dividend will be payable on December 3, 2015.

On October 22, 2015, the Corporation announced that the Corporation's Board of Directors authorized the repurchase of up to five percent of the Corporation's common stock, or approximately 421,633 shares. The Corporation will purchase the shares from time to time in the open market or through privately negotiated transactions over a one-year period depending on market conditions, the capital requirements of the Corporation, and available cash that can be allocated to the stock repurchase program, among other considerations. The October 2015 stock repurchase plan will become effective once the Corporation has completed the April 2015 stock repurchase plan by purchasing the remaining 133,055 shares available as of September 30, 2015 under the April 2015 plan.

## ITEM 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations

### General

Provident Financial Holdings, Inc., a Delaware corporation, was organized in January 1996 for the purpose of becoming the holding company of Provident Savings Bank, F.S.B. ("the Bank") upon the Bank's conversion from a federal mutual to a federal stock savings bank ("Conversion"). The Conversion was completed on June 27, 1996. The Corporation is regulated by the Federal Reserve Board ("FRB"). At September 30, 2015, the Corporation had total assets of \$1.18 billion, total deposits of \$924.9 million and total stockholders' equity of \$139.3 million. The Corporation has not engaged in any significant activity other than holding the stock of the Bank. Accordingly, the information set forth in this report, including financial statements and related data, relates primarily to the Bank and its subsidiaries. As used in this report, the terms "we," "our," "us," and "Corporation" refer to Provident Financial Holdings, Inc. and its consolidated subsidiaries, unless the context indicates otherwise.

The Bank, founded in 1956, is a federally chartered stock savings bank headquartered in Riverside, California. The Bank is regulated by the Office of the Comptroller of the Currency ("OCC"), its primary federal regulator, and the Federal Deposit Insurance Corporation ("FDIC"), the insurer of its deposits. The Bank's deposits are federally insured up to applicable limits by the FDIC. The Bank has been a member of the Federal Home Loan Bank System since 1956.

The Corporation's business consists of community banking activities and mortgage banking activities, conducted by Provident Bank and Provident Bank Mortgage ("PBM"), a division of the Bank. Community banking activities primarily consist of accepting deposits from customers within the communities surrounding the Bank's full service offices and investing those funds in single-family loans, multi-family loans, commercial real estate loans, construction loans, commercial business loans, consumer loans and other real estate loans. The Bank also offers business checking accounts, other business banking services, and services loans for others. Mortgage banking activities consist of the origination, purchase and sale of mortgage loans secured primarily by single-family residences. The Bank currently operates 15 retail/business banking offices in Riverside County and San Bernardino County (commonly known as the Inland Empire). Provident Bank Mortgage operates two wholesale loan production offices: one in Pleasanton and one in Rancho Cucamonga, California; and 13 retail loan production offices located throughout California. The Corporation's revenues are derived principally from interest on its loans and investment securities and fees generated through its community banking and mortgage banking activities. There are various risks inherent in the Corporation's business including,

among others, the general business environment, interest rates, the California real estate market, the demand for loans, the prepayment of loans, the repurchase of loans previously sold to investors, the secondary market conditions to sell loans, competitive conditions, legislative and regulatory changes, fraud and other risks.

The Corporation began to distribute quarterly cash dividends in the quarter ended September 30, 2002. On July 21, 2015, the Corporation declared a quarterly cash dividend of \$0.12 per share for the Corporation's shareholders of record at the close of business on August 11, 2015, which was paid on September 1, 2015. Future declarations or payments of dividends will be subject to the consideration of the Corporation's Board of Directors, which will take into account the Corporation's financial condition, results of operations, tax considerations, capital requirements, industry standards, legal restrictions, economic conditions and other factors, including the regulatory restrictions which affect the payment of dividends by the Bank to the Corporation. Under Delaware law, dividends may be paid either out of surplus or, if there is no surplus, out of net profits for the current fiscal year and/or the preceding fiscal year in which the dividend is declared. For further discussion, see Note 13 of the Notes to Unaudited Interim Condensed Consolidated Financial Statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to assist in understanding the financial condition and results of operations of the Corporation. The information contained in this section should be read in conjunction with the Unaudited Interim Condensed Consolidated Financial Statements and accompanying selected Notes to Unaudited Interim Condensed Consolidated Financial Statements.

#### Safe-Harbor Statement

Certain matters in this Form 10-Q constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. This Form 10-Q contains statements that the Corporation believes are "forward-looking statements." These statements relate to the Corporation's financial condition, results of operations, plans, objectives, future performance or business. When considering these forward-looking statements, you should keep in mind these risks and uncertainties, as well as any cautionary statements the Corporation may make. Moreover, you should treat these statements as speaking only as of the date they are made and based only on information then actually known to the Corporation. There are a number of important factors that could cause future results to differ materially from historical performance and these forward-looking statements. Factors which could cause actual results to differ materially include, but are not limited to, the credit risks of lending activities, including changes in the level and trend of loan delinquencies and charge-offs and changes in our allowance for loan losses and provision for loan losses that may be impacted by deterioration in the residential and commercial real estate markets and may lead to increased losses and non-performing assets and may result in our allowance for loan losses not being adequate to cover actual losses and require us to materially increase our reserve; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources; fluctuations in the demand for loans, the number of unsold homes, land and other properties and fluctuations in real estate values in our market areas; secondary market conditions for loans and our ability to sell loans in the secondary market; results of examinations of the Corporation by the FRB or of the Bank by the OCC or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, require us to enter into a formal enforcement action or to increase our allowance for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds or maintain or increase deposits, or impose additional requirements and restrictions on us, any of which could adversely affect our liquidity and earnings; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, including the interpretation of regulatory capital or other rules, including as a result of Basel III; the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd Frank Act") and the implementing regulations; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory

actions; adverse changes in the securities markets; our ability to attract and retain deposits; increases in premiums for deposit insurance; our ability to control operating costs and expenses; the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; difficulties in reducing risk associated with the loans on our balance sheet; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our workforce and potential associated charges; computer systems on which we depend could fail or experience a security breach; our ability to implement our branch expansion strategy; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we have acquired or may in the future acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto; our ability to manage loan delinquency rates; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; our ability to pay dividends on our common stock; adverse changes in the securities markets; the inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board,



including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; war or terrorist activities; and other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services and other risks detailed in this report and in the Corporation's other reports filed with or furnished to the SEC, including its Annual Report on Form 10-K for the fiscal year ended June 30, 2015. These developments could have an adverse impact on our financial position and our results of operations. Forward-looking statements are based upon management's beliefs and assumptions at the time they are made. We undertake no obligation to publicly update or revise any forward-looking statements included in this document or to update the reasons why actual results could differ from those contained in such statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking statements discussed in this document might not occur, and you should not put undue reliance on any forward-looking statements.

### Critical Accounting Policies

The discussion and analysis of the Corporation's financial condition and results of operations is based upon the Corporation's condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of the condensed consolidated financial statements. Actual results may differ from these estimates under different assumptions or conditions.

The allowance for loan losses involves significant judgment and assumptions by management, which has a material impact on the carrying value of net loans. Management considers the accounting estimate related to the allowance for loan losses a critical accounting estimate because it is highly susceptible to change from period to period, requiring management to make assumptions about probable incurred losses inherent in the loans held for investment at the date of the Condensed Consolidated Statements of Financial Condition. The impact of a sudden large loss could deplete the allowance and require increased provisions to replenish the allowance, which would negatively affect earnings.

The allowance is based on two principles of accounting: (i) ASC 450, "Contingencies," which requires that losses be accrued when they are probable of occurring and can be estimated; and (ii) ASC 310, "Receivables." The allowance has two components: collectively evaluated allowances and individually evaluated allowances on loans held for investment. Each of these components is based upon estimates that can change over time. The allowance is based on historical experience and as a result can differ from actual losses incurred in the future. Additionally, differences may result from changes to qualitative factors such as unemployment data, gross domestic product, interest rates, retail sales, the value of real estate and real estate market conditions. The historical data is reviewed at least quarterly and adjustments are made as needed. Various techniques are used to arrive at an individually evaluated allowance, including discounted cash flows and the fair market value of collateral. Management considers, based on currently available information, the allowance for loan losses sufficient to absorb probable losses inherent in loans held for investment. The use of these techniques is inherently subjective and the actual losses could be greater or less than the estimates, which, can materially affect amounts recognized in the Condensed Consolidated Statements of Financial Condition and Condensed Consolidated Statements of Operations.

The Corporation assesses loans individually and classifies loans when the accrual of interest has been discontinued, loans have been restructured or management has serious doubts about the future collectibility of principal and interest, even though the loans may currently be performing. Factors considered in determining classification include, but are not limited to, expected future cash flows, the financial condition of the borrower and current economic conditions. The Corporation measures each non-performing loan based on the fair value of its collateral, less selling costs, or discounted cash flow and charges off those loans or portions of loans deemed uncollectible.

Non-performing loans are charged-off to their fair values in the period the loans, or portion thereof, are deemed uncollectible, generally after the loan becomes 150 days delinquent for real estate secured first trust deed loans and 120 days delinquent for commercial business or real estate secured second trust deed loans. For restructured loans, the charge-off occurs when the loans becomes 90 days delinquent; and where borrowers file bankruptcy, the charge-off occurs when the loan becomes 60 days delinquent. The amount of the charge-off is determined by comparing the loan balance to the estimated fair value of the underlying collateral, less disposition costs, with the loan balance in excess of the estimated fair value charged-off against the allowance for loan losses. The allowance for loan losses for non-performing loans is determined by applying ASC 310. For restructured loans that are less than 90 days delinquent, the allowance for loan losses are segregated into (a) individually evaluated allowances for those loans with applicable discounted cash flow calculations or (b) collectively evaluated allowances based on the aggregated pooling method. For non-performing loans less than 60 days delinquent where the borrower has filed bankruptcy, the collectively evaluated allowances are assigned based on the aggregated pooling method. For non-performing commercial real estate loans,

an individually evaluated allowance is calculated based on the loan's fair value and if the fair value is higher than the individual loan balance, no allowance is required.

A troubled debt restructuring (“restructured loan”) is a loan which the Corporation, for reasons related to a borrower’s financial difficulties, grants a concession to the borrower that the Corporation would not otherwise consider.

The loan terms which have been modified or restructured due to a borrower’s financial difficulty, include but are not limited to:

- a) A reduction in the stated interest rate.
- b) An extension of the maturity at an interest rate below market.
- c) A reduction in the accrued interest.
- d) Extensions, deferrals, renewals and rewrites.

The Corporation measures the allowance for loan losses of restructured loans based on the difference between the original loan’s carrying amount and the present value of expected future cash flows discounted at the original effective yield of the loan. Based on published guidance with respect to restructured loans from certain banking regulators and to conform to general practices within the banking industry, the Corporation determined it was appropriate to maintain certain restructured loans on accrual status because there is reasonable assurance of repayment and performance, consistent with the modified terms based upon a current, well-documented credit evaluation.

Other restructured loans are classified as “Substandard” and placed on non-performing status. The loans may be upgraded and placed on accrual status once there is a sustained period of payment performance (usually six months or, for loans that have been restructured more than once, 12 months) and there is a reasonable assurance that the payments will continue; and if the borrower has demonstrated satisfactory contractual payments beyond 12 consecutive months, the loan is no longer categorized as a restructured loan. In addition to the payment history described above, multi-family, commercial real estate, construction and commercial business loans must also demonstrate a combination of corroborating characteristics to be upgraded, such as: satisfactory cash flow, satisfactory guarantor support, and additional collateral support, among others.

To qualify for restructuring, a borrower must provide evidence of their creditworthiness such as, current financial statements, their most recent income tax returns, current paystubs, current W-2s, and most recent bank statements, among other documents, which are then verified by the Corporation. The Corporation re-underwrites the loan with the borrower’s updated financial information, new credit report, current loan balance, new interest rate, remaining loan term, updated property value and modified payment schedule, among other considerations, to determine if the borrower qualifies.

Interest is not accrued on any loan when its contractual payments are more than 90 days delinquent or if the loan is deemed impaired. In addition, interest is not recognized on any loan where management has determined that collection is not reasonably assured. A non-performing loan may be restored to accrual status when delinquent principal and interest payments are brought current and future monthly principal and interest payments are expected to be collected.

When a loan is categorized as non-performing, all previously accrued but uncollected interest is reversed in the current operating results. When a full recovery of the outstanding principal loan balance is in doubt, subsequent payments received are first applied as a recovery of principal charge-offs and then to unpaid principal. This is referred to as the cost recovery method. A loan may be returned to accrual status at such time as the loan is brought fully current as to both principal and interest, and, in management’s judgment, such loan is considered to be fully collectible on a timely basis. However, the Corporation’s policy also allows management to continue the recognition of interest income on certain non-performing loans. This is referred to as the cash basis method under which the accrual of interest is

suspended and interest income is recognized only when collected. This policy applies to non-performing loans that are considered to be fully collectible but the timely collection of payments is in doubt.

ASC 815, "Derivatives and Hedging," requires that derivatives of the Corporation be recorded in the condensed consolidated financial statements at fair value. Management considers its accounting policy for derivatives to be a critical accounting policy because these instruments have certain interest rate risk characteristics that change in value based upon changes in the capital markets. The Corporation's derivatives are primarily the result of its mortgage banking activities in the form of commitments to extend credit, commitments to sell loans, TBA MBS trades and option contracts to mitigate the risk of the commitments to extend credit. Estimates of the percentage of commitments to extend credit on loans to be held for sale that may not fund are based upon historical data and current market trends. The fair value adjustments of the derivatives are recorded in the Condensed Consolidated Statements of Operations with offsets to other assets or other liabilities in the Condensed Consolidated Statements of Financial Condition.

Management accounts for income taxes by estimating future tax effects of temporary differences between the tax and book basis of assets and liabilities considering the provisions of enacted tax laws. These differences result in deferred tax assets and liabilities,

which are included in the Corporation's Condensed Consolidated Statements of Financial Condition. The application of income tax law is inherently complex. Laws and regulations in this area are voluminous and are often ambiguous. As such, management is required to make many subjective assumptions and judgments regarding the Corporation's income tax exposures, including judgments in determining the amount and timing of recognition of the resulting deferred tax assets and liabilities, including projections of future taxable income. Interpretations of and guidance surrounding income tax laws and regulations change over time. As such, changes in management's subjective assumptions and judgments can materially affect amounts recognized in the Condensed Consolidated Statements of Financial Condition and Condensed Consolidated Statements of Operations. Therefore, management considers its accounting for income taxes a critical accounting policy.

### Executive Summary and Operating Strategy

Provident Savings Bank, F.S.B., established in 1956, is a financial services company committed to serving consumers and small to mid-sized businesses in the Inland Empire region of Southern California. The Bank conducts its business operations as Provident Bank, Provident Bank Mortgage, a division of the Bank, and through its subsidiary, Provident Financial Corp. The business activities of the Corporation, primarily through the Bank and its subsidiary, consist of community banking, mortgage banking and, to a lesser degree, investment services for customers and trustee services on behalf of the Bank.

Community banking operations primarily consist of accepting deposits from customers within the communities surrounding the Corporation's full service offices and investing those funds in single-family, multi-family and commercial real estate loans. Also, to a lesser extent, the Corporation makes construction, commercial business, consumer and other mortgage loans. The primary source of income in community banking is net interest income, which is the difference between the interest income earned on loans and investment securities, and the interest expense paid on interest-bearing deposits and borrowed funds. Additionally, certain fees are collected from depositors, such as returned check fees, deposit account service charges, ATM fees, IRA/KEOGH fees, safe deposit box fees, travelers check fees, wire transfer fees and overdraft protection fees, among others.

During the next three years, subject to market conditions, the Corporation intends to improve its community banking business by moderately growing total assets; by decreasing the concentration of single-family mortgage loans within loans held for investment; and by increasing the concentration of higher yielding preferred loans (i.e., multi-family, commercial real estate, construction and commercial business loans). In addition, the Corporation intends to decrease the percentage of time deposits in its deposit base and to increase the percentage of lower cost checking and savings accounts. This strategy is intended to improve core revenue through a higher net interest margin and ultimately, coupled with the growth of the Corporation, an increase in net interest income. While the Corporation's long-term strategy is for moderate growth, management recognizes that the total balance sheet may decline or stabilize at current levels in response to weaknesses in general economic conditions, which may improve capital ratios and mitigate credit and liquidity risk.

Mortgage banking operations primarily consist of the origination, purchase and sale of mortgage loans secured by single-family residences. The primary sources of income in mortgage banking are gain on sale of loans and certain fees collected from borrowers in connection with the loan origination process. The Corporation will continue to modify its operations, including the number of mortgage banking personnel, in response to the rapidly changing mortgage banking environment. Changes may include a different product mix, further tightening of underwriting standards, variations in its operating expenses or a combination of these and other changes.

Provident Financial Corp performs trustee services for the Bank's real estate secured loan transactions and has in the past held, and may in the future hold real estate for investment. Investment services operations primarily consist of

selling alternative investment products such as annuities and mutual funds to the Bank's depositors. Investment services and trustee services contribute a very small percentage of gross revenue.

There are a number of risks associated with the business activities of the Corporation, many of which are beyond the Corporation's control, including: changes in accounting principles, laws, regulation, interest rates and the economy, among others. The Corporation attempts to mitigate many of these risks through prudent banking practices, such as interest rate risk management, credit risk management, operational risk management, and liquidity risk management. The California economic environment presents heightened risk for the Corporation primarily with respect to real estate values and loan delinquencies. Although real estate values and unemployment rates have been improving since 2009, any future decline in real estate values or increase in unemployment rates may lead to higher loan losses since the majority of the Corporation's loans are secured by real estate located within California. Significant declines in the value of California real estate may also inhibit the Corporation's ability to recover on defaulted loans by selling the underlying real estate. The Corporation's operating costs may increase significantly as a result of the Dodd-Frank Act. Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Corporation.

## Off-Balance Sheet Financing Arrangements and Contractual Obligations

**Commitments and Derivative Financial Instruments.** The Corporation 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, in the form of originating loans or providing funds under existing lines of credit, loan sale agreements to third parties and option contracts. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the accompanying Condensed Consolidated Statements of Financial Condition. The Corporation's exposure to credit loss, in the event of non-performance by the counterparty to these financial instruments, is represented by the contractual amount of these instruments. The Corporation uses the same credit policies in entering into financial instruments with off-balance sheet risk as it does for on-balance sheet instruments. For a discussion on commitments and derivative financial instruments, see Note 7 of the Notes to Unaudited Interim Condensed Consolidated Financial Statements.

**Contractual Obligations.** The following table summarizes the Corporation's contractual obligations at September 30, 2015 and the effect these obligations are expected to have on the Corporation's liquidity and cash flows in future periods:

(In Thousands)	Payments Due by Period				Total
	Less than 1 year	1 to less than 3 years	3 to 5 years	Over 5 years	
Operating obligations	\$ 1,696	\$ 2,465	\$ 810	\$ 37	\$ 5,008
Pension benefits	228	456	456	6,902	8,042
Time deposits	162,868	103,697	71,690	5,180	343,435
FHLB – San Francisco advances	2,538	14,917	14,266	75,748	107,469
FHLB – San Francisco letter of credit	8,000	—	—	—	8,000
FHLB – San Francisco MPF credit enhancement <sup>(1)</sup>	28	56	56	2,349	2,489
Total	\$ 175,358	\$ 121,591	\$ 87,278	\$ 90,216	\$ 474,443

Represents the potential future obligation for loans previously sold by the Bank to the FHLB – San Francisco under <sup>(1)</sup> its Mortgage Partnership Finance (“MPF”) program. As of September 30, 2015, the Bank serviced \$26.1 million of loans under this program. The estimated amounts by period are based on historical loss experience.

The expected obligation for time deposits and FHLB – San Francisco advances include anticipated interest accruals based on the respective contractual terms.

In addition to the off-balance sheet financing arrangements and contractual obligations mentioned above, the Corporation has derivatives and other financial instruments with off-balance sheet risks as described in Note 7 of the Notes to Unaudited Interim Condensed Consolidated Financial Statements.

## Comparison of Financial Condition at September 30, 2015 and June 30, 2015

Total assets increased \$2.7 million to \$1.18 billion at September 30, 2015 from \$1.17 billion at June 30, 2015. The increase was primarily attributable to an increase in cash and cash equivalents, partly offset by decreases in loans held for sale and loans held for investment.

Total cash and cash equivalents, primarily excess cash deposited with the Federal Reserve Bank of San Francisco, increased \$74.7 million, or 92 percent, to \$156.1 million at September 30, 2015 from \$81.4 million at June 30, 2015. The increase in the total cash and cash equivalents was primarily attributable to temporarily investing excess cash received from the increase in long-term FHLB - San Francisco advances over the last year as part of the Corporation's interest rate risk management strategy.

Total investment securities decreased \$700,000, or five percent, to \$14.3 million at September 30, 2015 from \$15.0 million at June 30, 2015. The decrease was primarily the result of scheduled and accelerated principal payments on mortgage-backed securities. For further analysis on investment securities, see Note 5 of the Notes to Unaudited Interim Condensed Consolidated Financial Statements.



Loans held for investment decreased \$8.5 million, or one percent, to \$805.7 million at September 30, 2015 from \$814.2 million at June 30, 2015. During the first three months of fiscal 2016 and 2015, the Corporation originated \$35.0 million and \$42.4 million, respectively, of loans held for investment, consisting primarily of single-family, multi-family and commercial real estate loans. During the first three months of fiscal 2016 and 2015, the Corporation purchased \$193,000 and \$218,000 of single-family loans to be held for investment, respectively. Total loan principal payments during the first three months of fiscal 2016 were \$45.8 million, up 88% from \$24.4 million during the comparable period in fiscal 2015, due primarily to higher loan refinancing activity. In addition, real estate owned acquired in the settlement of loans in the first three months of fiscal 2016 and 2015 was \$1.0 million and \$927,000, respectively. The balance of preferred loans increased \$501,000 to \$453.9 million at September 30, 2015, compared to \$453.4 million at June 30, 2015, and represented 56 percent and 55 percent of loans held for investment, respectively. The balance of single-family loans held for investment decreased \$9.0 million, or two percent, to \$357.0 million at September 30, 2015, compared to \$366.0 million at June 30, 2015, and represented approximately 44 percent and 44 percent of loans held for investment, respectively. The increase of the mix between the preferred loans and single-family loans was consistent with the Corporation's strategy to increase the average loan yield.

The tables below describe the geographic dispersion of gross real estate secured loans held for investment at September 30, 2015 and June 30, 2015, as a percentage of the total dollar amount outstanding:

As of September 30, 2015

Loan Category	Inland Empire		Southern California <sup>(1)</sup>		Other California		Other States		Total	
	Balance	%	Balance	%	Balance	%	Balance	%	Balance	%
Single-family	\$107,167	30	% \$187,845	52	% \$60,173	17	% \$1,778	1	% \$356,963	100
Multi-family	72,588	20	% 188,606	53	% 91,347	26	% 2,901	1	% 355,442	100
Commercial real estate	33,407	35	% 42,572	45	% 18,601	20	% —	—	% 94,580	100
Construction	1,095	18	% 4,683	76	% 407	6	% —	—	% 6,185	100
Other	—	—	% 72	100	% —	—	% —	—	% 72	100
Total	\$214,257	26	% \$423,778	52	% \$170,528	21	% \$4,679	1	% \$813,242	100

<sup>(1)</sup> Other than the Inland Empire.

As of June 30, 2015

Loan Category	Inland Empire		Southern California <sup>(1)</sup>		Other California		Other States		Total	
	Balance	%	Balance	%	Balance	%	Balance	%	Balance	%
Single-family	\$108,490	30	% \$194,321	53	% \$60,586	16	% \$2,564	1	% \$365,961	100
Multi-family	72,758	21	% 181,130	52	% 90,214	26	% 2,918	1	% 347,020	100
Commercial real estate	41,991	42	% 42,856	42	% 16,050	16	% —	—	% 100,897	100
Construction	1,095	13	% 5,320	65	% 1,776	22	% —	—	% 8,191	100
Total	\$224,334	27	% \$423,627	52	% \$168,626	20	% \$5,482	1	% \$822,069	100

<sup>(1)</sup> Other than the Inland Empire.

Loans held for sale decreased \$61.1 million, or 27 percent, to \$163.6 million at September 30, 2015 from \$224.7 million at June 30, 2015. The decrease was primarily due to the lower volume of loans originated for sale of \$540.3 million during the quarter ended September 30, 2015 as compared to \$720.7 million during the quarter ended June 30,

2015 and the timing difference between loan fundings and loan sale settlements. In addition, mortgage interest rates have increased since June 30, 2015, contributing to decline in loans originated and purchased for sale.

Total deposits increased \$780,000 to \$924.9 million at September 30, 2015 from \$924.1 million at June 30, 2015. Transaction accounts increased \$10.7 million, or two percent, to \$589.1 million at September 30, 2015 from \$578.4 million at June 30, 2015; while time deposits decreased \$10.0 million, or three percent, to \$335.7 million at September 30, 2015 from \$345.7 million at

June 30, 2015. The change in deposit mix was consistent with the Corporation's marketing strategy to promote transaction accounts and the strategic decision to increase the percentage of lower cost transaction accounts in its deposit base and decrease the percentage of time deposits by competing less aggressively for time deposits.

Total borrowings decreased \$16,000 to \$91.4 million at September 30, 2015 as compared to \$91.4 million at June 30, 2015, due to the scheduled amortization payments.

Total stockholders' equity decreased \$1.8 million, or one percent, to \$139.3 million at September 30, 2015, from \$141.1 million at June 30, 2015, primarily as a result of stock repurchases totaling \$3.6 million (see Part II, Item 2, "Unregistered Sales of Equity Securities and Use of Proceeds") and \$1.0 million of quarterly cash dividends paid, partly offset by net income of \$2.4 million during the first three months of fiscal 2016.

#### Comparison of Operating Results for the Quarters Ended September 30, 2015 and 2014

The Corporation's net income for the first quarter of fiscal 2016 was \$2.4 million, an increase of \$53,000, or two percent, as compared to the same period of fiscal 2015. The increase in net income for the first quarter of fiscal 2016 was primarily attributable to a \$1.3 million, or 14 percent, increase in non-interest income, partly offset by a \$780,000, or 95 percent, decrease in the recoveries from the allowance for loan losses and a \$621,000, or five percent, increase in non-interest expense, compared to the same period one year ago.

The Corporation's efficiency ratio, defined as non-interest expense divided by the sum of net interest income and non-interest income, improved to 78 percent for the first quarter of fiscal 2016 from 81 percent for the same period of fiscal 2015. The improvement in the efficiency ratio for the quarter was primarily the result of the increase in non-interest income, partly offset by the increase in non-interest expenses.

For the first quarter of fiscal 2016, return on average assets declined three basis points to 0.83 percent from 0.86 percent in the same period last year; while return on average equity increased 37 basis points to 6.96 percent from 6.59 percent for the same period last year. The increase in the return on average equity was due primarily to an increase of the financial leverage, attributable primarily to stock repurchases, and, to a lesser extent, the slight increase in earning assets.

Diluted earnings per share for the first quarter of fiscal 2016 were \$0.28, a 12 percent increase from \$0.25 in the same period last year. The higher percentage increase in the diluted earnings per share in comparison to the percentage increase in the net income was primarily attributable to stock repurchases during the last 12 months.

#### Net Interest Income:

For the Quarters Ended September 30, 2015 and 2014. Net interest income increased \$129,000, or two percent, to \$8.1 million for the first quarter of fiscal 2016 from \$7.9 million for the comparable period in fiscal 2015, due to a higher average earning asset balance, partly offset by a lower net interest margin. The average balance of earning assets increased \$71.6 million, or seven percent, to \$1.14 billion in the first quarter of fiscal 2016 from \$1.07 billion in the comparable period of fiscal 2015, reflecting an increase in loans receivables, funded primarily by the deployment of borrowings and customer deposits. The net interest margin was 2.82 percent in the first quarter of fiscal 2016, a 14 basis points decrease from 2.96 percent in the same period of fiscal 2015 due to a decrease in the average yield of interest-earning assets and an increase in the average cost of interest-bearing liabilities. The weighted-average yield of interest-earning assets decreased by 10 basis points to 3.45 percent while the weighted-average cost of interest-bearing liabilities increased by four basis points to 0.70 percent for the first quarter of fiscal 2016 as compared to the same period last year.

Interest Income:

For the Quarters Ended September 30, 2015 and 2014. Total interest income increased by \$348,000, or four percent, to \$9.9 million for the first quarter of fiscal 2016 from \$9.5 million in the same quarter of fiscal 2015. This increase was primarily due to the higher average outstanding balance of interest-earning assets, primarily loans held for sale and loans held for investment, partly offset by a lower average yield of earning assets.

Loans receivable interest income increased \$295,000, or three percent, to \$9.5 million in the first quarter of fiscal 2016 from \$9.2 million for the same quarter of fiscal 2015. This increase was attributable to a higher average loan balance, partly offset by a lower average loan yield. The average balance of loans receivable, including loans held for sale, increased by \$62.8 million, or seven percent, to \$962.6 million for the first quarter of fiscal 2016 as compared to \$899.8 million in the same quarter of fiscal

2015. The average loan yield during the first quarter of fiscal 2016 decreased 15 basis points to 3.94 percent from 4.09 percent during the same quarter last year. The decrease in the average loan yield was primarily attributable to the repricing of adjustable rate loans to lower interest rates, payoffs of loans which carried a higher average yield than the average yield of loans receivable and a decrease in the average yield of loans held for sale. The average balance of loans held for sale increased \$24.7 million, or 20 percent, to \$150.8 million during the first quarter of fiscal 2016 from \$126.1 million in the same quarter of fiscal 2015. The average yield on the loans held for sale decreased by 14 basis points to 3.86 percent in the first quarter of fiscal 2016 from 4.00 percent in the same quarter of fiscal 2015.

Interest income from investment securities decreased \$9,000, or 12 percent, to \$67,000 for the first quarter of fiscal 2016 from \$76,000 in the same quarter of fiscal 2015. This decrease was attributable to a lower average balance of investment securities, partly offset by a higher average yield. The average balance of investment securities decreased \$2.4 million, or 14 percent, to \$14.6 million during the first quarter of fiscal 2016 from \$17.0 million during the same quarter of fiscal 2015. The decrease in the average balance was primarily due to scheduled and accelerated principal payments on mortgage-backed securities. The average yield on investment securities increased four basis points to 1.83 percent during the quarter ended September 30, 2015 from 1.79 percent during the quarter ended September 30, 2014. The increase in the average yield of investment securities was primarily attributable to the repricing of adjustable rate mortgage-backed securities to higher interest rates.

The FHLB – San Francisco cash dividend received in the first quarter of fiscal 2016 was \$200,000, up 39 percent from \$144,000 in the same quarter of fiscal 2015.

Interest income from interest-earning deposits, primarily cash deposited at the Federal Reserve Bank of San Francisco, was \$100,000 in the first quarter of fiscal 2016, up six percent from \$94,000 in the same quarter of fiscal 2015. The increase was due to a higher average balance for the first quarter of fiscal 2016 as compared to the same period last year as the average yield was unchanged at 25 basis points during both periods. The average balance of the interest-earning deposits in the first quarter of fiscal 2016 was \$157.8 million, an increase of \$10.1 million or seven percent, from \$147.7 million in the same quarter of fiscal 2015. The increase in the average balance of the interest-earning deposits was primarily attributable to temporarily investing excess cash received from the increase in long-term FHLB - San Francisco advances over the last year as part of the Corporation's interest rate risk management strategy.

#### Interest Expense:

For the Quarters Ended September 30, 2015 and 2014. Total interest expense for the first quarter of fiscal 2016 was \$1.8 million as compared to \$1.6 million for the same period last year, an increase of \$219,000, or 14 percent. This increase was attributable to a higher average cost of interest-bearing liabilities and a higher average balance of interest-bearing liabilities.

Interest expense on deposits for the first quarter of fiscal 2016 was \$1.1 million as compared to \$1.2 million for the same period last year, a decrease of \$94,000, or eight percent. The decrease in interest expense on deposits was primarily attributable to a lower average cost, partly offset by a higher average balance. The average cost of deposits decreased to 0.49 percent during the first quarter of fiscal 2016 from 0.54 percent during the same quarter last year, a decrease of five basis points. The decrease in the average cost of deposits was attributable primarily to higher cost time deposits repricing to lower current market interest rates and a lower percentage of time deposits to the total deposit balance. The average balance of deposits increased \$23.3 million to \$926.5 million during the quarter ended September 30, 2015 from \$903.2 million during the same period last year. The increase in the average balance was primarily attributable to an increase in transaction accounts, partly offset by a decrease in time deposits. Strategically, the Corporation has been promoting transaction accounts and competing less aggressively for time deposits. The Corporation believes the increase in transaction accounts was also attributable to the impact of depositors seeking an

alternative to lower yielding time deposits in light of the current low interest rate environment. The average balance of transaction accounts to total deposits in the first quarter of fiscal 2016 was 63 percent, compared to 59 percent in the same period of fiscal 2015.

Interest expense on borrowings, consisting of FHLB – San Francisco advances, for the first quarter of fiscal 2016 increased \$313,000, or 93 percent, to \$648,000 from \$335,000 for the same period last year. The increase in interest expense on borrowings was the result of a higher average balance, partly offset by a lower average cost. The average balance of borrowings increased \$50.0 million, or 121 percent, to \$91.4 million during the quarter ended September 30, 2015 from \$41.4 million during the same period last year. The average cost of borrowings decreased to 2.81 percent for the quarter ended September 30, 2015 from 3.21 percent in the same quarter last year, a decrease of 40 basis points. The decrease in average cost was primarily due to new long-term FHLB - San Francisco advances received during calendar 2015 totaling \$50.0 million at an average cost of 2.46%.

Edgar Filing: PROVIDENT FINANCIAL HOLDINGS INC - Form 10-Q

The following tables present the average balance sheets for the quarters ended September 30, 2015 and 2014, respectively:

Average Balance Sheets

(Dollars In Thousands)	Quarter Ended September 30, 2015			Quarter Ended September 30, 2014			Yield/ Cost	Yield/ Cost
	Average Balance	Interest	Yield/ Cost	Average Balance	Interest	Yield/ Cost		
Interest-earning assets:								
Loans receivable, net <sup>(1)</sup>	\$962,635	\$9,490	3.94	%	\$899,802	\$9,195	4.09	%
Investment securities	14,648	67	1.83	%	17,010	76	1.79	%
FHLB – San Francisco stock	8,094	200	9.88	%	7,056	144	8.16	%
Interest-earning deposits	157,784	100	0.25	%	147,732	94	0.25	%
Total interest-earning assets	1,143,161	9,857	3.45	%	1,071,600	9,509	3.55	%
Non interest-earning assets	31,973				34,878			
Total assets	\$1,175,134				\$1,106,478			
Interest-bearing liabilities:								
Checking and money market accounts <sup>(2)</sup>	\$328,574	117	0.14	%	\$295,706	104	0.14	%
Savings accounts	256,911	168	0.26	%	240,761	157	0.26	%
Time deposits	340,997	858	1.00	%	366,684	976	1.06	%
Total deposits	926,482	1,143	0.49	%	903,151	1,237	0.54	%
Borrowings	91,357	648	2.81	%	41,421	335	3.21	%
Total interest-bearing liabilities	1,017,839	1,791	0.70	%	944,572	1,572	0.66	%
Non interest-bearing liabilities	16,799				16,745			
Total liabilities	1,034,638				961,317			
Stockholders' equity	140,496				145,161			
Total liabilities and stockholders' equity	\$1,175,134				\$1,106,478			
Net interest income		\$8,066				\$7,937		
Interest rate spread <sup>(3)</sup>			2.75	%			2.89	%
Net interest margin <sup>(4)</sup>			2.82	%			2.96	%
Ratio of average interest-earning assets to average interest-bearing liabilities			112.31	%			113.45	%
Return on average assets			0.83	%			0.86	%
Return on average equity			6.96	%			6.59	%

(1) Includes loans held for sale and non-performing loans, as well as net deferred loan cost amortization of \$61 and \$41 for the quarters ended September 30, 2015 and 2014, respectively.

- (2) Includes the average balance of non interest-bearing checking accounts of \$65.7 million and \$58.2 million during the quarters ended September 30, 2015 and 2014, respectively.
- (3) Represents the difference between the weighted-average yield on all interest-earning assets and the weighted-average rate on all interest-bearing liabilities.
- (4) Represents net interest income before provision for loan losses as a percentage of average interest-earning assets.



The following tables provide the rate/volume variances for the quarters ended September 30, 2015 and 2014, respectively:

## Rate/Volume Variance

(In Thousands)	Quarter Ended September 30, 2015 Compared To Quarter Ended September 30, 2014 Increase (Decrease) Due to			
	Rate	Volume	Rate/ Volume	Net
<b>Interest-earning assets:</b>				
Loans receivable <sup>(1)</sup>	\$(323	)\$642	\$(24	)\$295
Investment securities	2	(11	)—	(9
FHLB – San Francisco stock	31	21	4	56
Interest-bearing deposits	—	6	—	6
Total net change in income on interest-earning assets	(290	)658	(20	)348
<b>Interest-bearing liabilities:</b>				
Checking and money market accounts	—	13	—	13
Savings accounts	—	11	—	11
Time deposits	(53	)69	)4	(118
Borrowings	(41	)404	(50	)313
Total net change in expense on interest-bearing liabilities	(94	)359	(46	)219
Net (decrease) increase in net interest income	\$(196	)\$299	\$26	\$129

(1) Includes loans held for sale and non-performing loans. For purposes of calculating volume, rate and rate/volume variances, non-performing loans were included in the weighted-average balance outstanding.

## Recovery from the Allowance for Loan Losses:

For the Quarters Ended September 30, 2015 and 2014. During the first quarter of fiscal 2016, the Corporation recorded a recovery from the allowance for loan losses of \$38,000, a 95 percent reduction from the \$818,000 recovery from the allowance for loan losses in the same period of fiscal 2015. The reduction in the recovery primarily reflects the increase in loans held for investment over the prior year. Non-performing loans increased \$818,000, or six percent, to \$14.8 million at September 30, 2015 as compared to \$13.9 million at June 30, 2015 and were \$12.8 million at September 30, 2014. Net recoveries in the first quarter of fiscal 2016 were \$348,000 or 0.14 percent (annualized) of average loans receivable, compared to net charge-offs of \$38,000 or 0.02 percent (annualized) of average loans receivable in the same quarter of fiscal 2015. Total classified loans, consisting of special mention and substandard loans, were \$25.6 million at September 30, 2015 as compared to \$28.7 million at June 30, 2015 and to \$34.6 million at September 30, 2014.

The allowance for loan losses was determined through quantitative and qualitative adjustments including the Bank's charge-off experience and reflects the impact on loans held for investment from the current general economic conditions of the U.S. and California economies such as the improving unemployment rate and higher home prices in California. See related discussion of "Asset Quality" below.

At September 30, 2015, the allowance for loan losses was \$9.0 million, comprised of collectively evaluated allowances of \$9.0 million and individually evaluated allowances of \$69,000; in comparison to the allowance for loan

losses of \$8.7 million at June 30, 2015, comprised of collectively evaluated allowances of \$8.6 million and individually evaluated allowances of \$98,000. The allowance for loan losses as a percentage of gross loans held for investment was 1.11 percent at September 30, 2015 compared to 1.06 percent at June 30, 2015. Management considers, based on currently available information, the allowance for loan losses sufficient to absorb potential losses inherent in loans held for investment. For further analysis on the allowance for loan losses, see Note 6 of the Notes to Unaudited Interim Condensed Consolidated Financial Statements.

Non-Interest Income:

For the Quarters Ended September 30, 2015 and 2014. Total non-interest income increased \$1.3 million, or 14 percent, to \$10.4 million for the quarter ended September 30, 2015 from \$9.1 million for the same period last year. The increase was primarily attributable to an increase in the net gain on sale of loans.

The net gain on sale of loans increased \$1.2 million, or 16 percent, to \$8.9 million for the first quarter of fiscal 2016 from \$7.7 million in the same quarter of fiscal 2015 reflecting the impact of a higher average loan sale margin and a higher loan sale volume. The average loan sale margin for PBM increased 13 basis points during the first quarter of fiscal 2016 to 1.65 percent from 1.52 percent for the same period of fiscal 2015. Total loan sale volume, which includes the net change in commitments to extend credit on loans to be held for sale, increased \$41.7 million or eight percent to \$539.6 million in the quarter ended September 30, 2015 from \$497.9 million in the comparable quarter last year. The gain on sale of loans includes an unfavorable fair-value adjustment on loans held for sale and derivative financial instruments (commitments to extend credit, commitments to sell loans, commitments to sell mortgage-backed securities, and option contracts) pursuant to ASC 815 and ASC 825 that amounted to a net loss of \$345,000 in the first quarter of fiscal 2016 as compared to an unfavorable fair-value adjustment net loss of \$646,000 in the same period last year. The fair-value adjustment on loans held for sale and derivative financial instruments was consistent with the Bank's mortgage banking activity and the volatility of mortgage interest rates. As of September 30, 2015, the fair value of derivative financial instruments pursuant to ASC 815 and ASC 825 was \$7.6 million, compared to \$8.0 million at June 30, 2015 and \$7.3 million at September 30, 2014.

Non-Interest Expense:

For the Quarters Ended September 30, 2015 and 2014. Total non-interest expense in the quarter ended September 30, 2015 was \$14.4 million, an increase of \$621,000 or five percent, as compared to \$13.7 million in the quarter ended September 30, 2014. The increase in non-interest expense was primarily due to an increase in salaries and employee benefits expense, partly offset by decreases in premises and occupancy and other operating expenses.

Total salaries and employee benefits expense increased \$1.2 million, or 13 percent, to \$10.8 million in the first quarter of fiscal 2016 from \$9.6 million in the same period of fiscal 2015. The increase was primarily attributable to higher incentive compensation, resulting from employee bonus accruals and increased mortgage banking operations. PBM loan originations increased \$17.8 million, or three percent, to \$545.9 million in the first quarter of fiscal 2016 from \$528.2 million in the comparable period in fiscal 2015.

Provision for Income Taxes:

The income tax provision reflects accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income, adjusted for the effect of all permanent differences between income for tax and financial reporting purposes, such as non-deductible stock-based compensation, bank-owned life insurance policies and certain California tax-exempt loans. Therefore, there are fluctuations in the effective income tax rate from period to period based on the relationship of net permanent differences to income before tax.

For the Quarters Ended September 30, 2015 and 2014. The income tax provision was \$1.8 million for the quarter ended September 30, 2015 as compared to \$1.7 million for the same quarter last year. The effective income tax rate for the quarter ended September 30, 2015 was 41.7 percent as compared to 42.1 percent in the same quarter last year. The Corporation believes that the effective income tax rate applied in the first quarter of fiscal 2016 reflects its current income tax obligations.



## Asset Quality

Non-performing loans, net of the allowance for loan losses, consisting of loans with collateral primarily located in Southern California, increased \$818,000, or six percent, to \$14.8 million at September 30, 2015 from \$13.9 million at June 30, 2015. Non-performing loans as a percentage of loans held for investment increased to 1.83 percent at September 30, 2015 from 1.71 percent at June 30, 2015. The non-performing loans at September 30, 2015 were primarily comprised of 38 single-family loans (\$11.7 million); three multi-family loans (\$2.0 million); three commercial real estate loans (\$1.0 million); and one commercial business loan (\$87,000). This compares to the non-performing loans at June 30, 2015 which were primarily comprised of 34 single-family loans (\$9.9 million); four multi-family loans (\$2.2 million); five commercial real estate loans (\$1.7 million); and one commercial business loan (\$89,000). No interest accruals were made for loans that were past due 90 days or more or if the loans were deemed non-performing.

When a loan is considered non-performing, as defined by ASC 310 "Receivables," the Corporation measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate. However, if the loan is "collateral-dependent" or foreclosure is probable, impairment is measured based on the fair value of the collateral. At least quarterly, management reviews non-performing loans. When the measured value of an individually identified non-performing loan is less than the recorded investment in the loan, the Corporation charges-off or records an individually evaluated allowance equal to the excess of the recorded investment in the loan over its measured value. For non-performing commercial real estate loans, an individually evaluated allowance is calculated based on the loan's fair value and if the fair value is higher than the loan balance, no allowance is required. A collectively evaluated allowance is provided on loans which do not have a charge-off or individually evaluated allowance and is determined based on a quantitative and a qualitative analysis using a loss migration methodology. The loans are classified by type and loan grade, and the historical loss migration is tracked for the various stratifications. Loss experience is quantified for the most recent 12 quarters, and that loss experience is applied to the stratified portfolio at each quarter end. The qualitative analysis data includes current unemployment rates, retail sales, gross domestic product, employment growth, real estate value trends, home sales, and commercial real estate vacancy rates, among other current economic data.

As of September 30, 2015, total restructured loans, net of allowance for loan losses decreased 17 percent to \$5.5 million from \$6.6 million at June 30, 2015. At September 30, 2015 and June 30, 2015, \$4.5 million and \$5.6 million, respectively, of these restructured loans were classified as non-performing. As of September 30, 2015, \$4.1 million, or 74 percent, of the restructured loans have a current payment status, consistent with their modified payment terms; this compares to \$4.9 million, or 74 percent, of restructured loans that had a current payment status, consistent with their modified payment terms as of June 30, 2015.

Real estate owned was \$3.7 million at September 30, 2015, an increase of \$1.3 million or 54 percent from \$2.4 million at June 30, 2015. Real estate owned at September 30, 2015 was comprised of one single-family property (\$919,000) and two commercial real estate properties (\$2.8 million). The Corporation has not suspended foreclosure activity at anytime through the most recent credit cycle because, to date, the Corporation has not been in a situation where its foreclosure documentation, process or legal standing has been challenged by a court. The Corporation maintains the original promissory note and deed of trust for loans held for investment. As a result, the Corporation does not rely on lost-note affidavits to fulfill foreclosure filing requirements.

Non-performing assets, which includes non-performing loans and real estate owned, increased \$2.1 million, or 13 percent, to \$18.4 million or 1.57 percent of total assets at September 30, 2015 from \$16.3 million or 1.39 percent of total assets at June 30, 2015. Restructured loans which are performing in accordance with their modified terms and are not otherwise classified non-accrual are not included in non-performing assets. For further analysis on non-performing loans and restructured loans, see Note 6 of the Notes to Unaudited Interim Condensed Consolidated

Financial Statements.

Occasionally, the Corporation is required to repurchase loans sold to Freddie Mac, Fannie Mae or other institutional investors if it is determined that such loans do not meet the credit requirements of the investor, or if one of the parties involved in the loan misrepresented pertinent facts, committed fraud, or if such loans were 90-days past due within 120 days of the loan funding date. During the first three months of fiscal 2016, the Corporation repurchased four loans, totaling \$1.2 million, from investors pursuant to the recourse/repurchase covenants contained in the loan sale agreements, while additional repurchase requests were settled that did not result in the repurchase of the loan itself. This compares to the first three months of fiscal 2015 when the Corporation repurchased one loan of \$396,000 from an investor pursuant to the recourse/repurchase covenants contained in the loan sale agreements, while additional repurchase requests were settled that did not result in the repurchase of the loan itself. The primary reasons for honoring the repurchase requests are borrower fraud, undisclosed liabilities on borrower applications, and documentation, verification and appraisal disputes. For the first three months of fiscal 2016, the Corporation had a recourse provision of \$3,000 and settled claims for \$3,000. This compares to the first three months of fiscal 2015 when the Corporation had a recourse reserve recovery of \$199,000 and received net reimbursement of \$7,000 on settled claims. As of September 30,

2015, the total recourse reserve for loans sold that are subject to repurchase was \$768,000, unchanged from June 30, 2015 and up from \$712,000 at September 30, 2014.

Beginning in 2008, in connection with the down turn in the real estate market, the Corporation implemented tighter underwriting standards to reduce potential loan repurchase requests, including requiring higher credit scores, generally lower debt-to-income ratios, and verification of income and assets, among other criteria. Despite management's diligent estimate of the recourse reserve, the Corporation is still subject to risks and uncertainties associated with potentially higher loan repurchase claims from investors, primarily those related to loans originated and sold in the calendar years 2004 through 2007.

The following table shows the summary of the recourse liability for the quarters ended September 30, 2015 and 2014:

Recourse Liability (In Thousands)	For the Quarters Ended September 30,	
	2015	2014
Balance, beginning of the period	\$768	\$904
Provision (recovery) from recourse liability	3	(199 )
Net settlements in lieu of loan repurchases	(3	)7
Balance, end of the period	\$768	\$712

A decline in real estate values subsequent to the time of origination of the Corporation's real estate secured loans could result in higher loan delinquency levels, foreclosures, provisions for loan losses and net charge-offs. Real estate values and real estate markets are beyond the Corporation's control and are generally affected by changes in national, regional or local economic conditions and other factors. These factors include fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies and acts of nature, such as earthquakes and national disasters particular to California where substantially all of the Corporation's real estate collateral is located. If real estate values decline from the levels described in the following tables (which were calculated at the time of loan origination), the value of the real estate collateral securing the Corporation's loans as set forth in the table could be significantly overstated. The Corporation's ability to recover on defaulted loans by foreclosing and selling the real estate collateral would then be diminished and it would be more likely to suffer losses on defaulted loans. The Corporation generally does not update the loan-to-value ratio ("LTV") on its loans held for investment by obtaining new appraisals or broker price opinions (nor does the Corporation intend to do so in the future as a result of the costs and inefficiencies associated with completing the task) unless a specific loan has demonstrated deterioration or the Corporation receives a loan modification request from a borrower (in which case individually evaluated allowances are established, if required). Therefore, it is reasonable to assume that the LTV ratios disclosed in the following tables may be understated in comparison to their current LTV ratios as a result of their year of origination, the subsequent general decline in real estate values that occurred and the specific location of the individual properties. The Corporation has not quantified the current LTVs of its loans held for investment nor the impact the decline in real estate values has had on the original LTVs of its loans held for investment.

The following table describes certain credit risk characteristics of the Corporation's single-family, first trust deed, mortgage loans held for investment as of September 30, 2015:

(Dollars In Thousands)	Outstanding Balance <sup>(1)</sup>	Weighted-Average FICO <sup>(2)</sup>	Weighted-Average LTV <sup>(3)</sup>	Weighted-Average Seasoning <sup>(4)</sup>
Interest only	\$131,312	734	72%	8.91 years
Stated income <sup>(5)</sup>	\$152,804	730	66%	9.74 years
FICO less than or equal to 660	\$10,943	642	64%	9.66 years
Over 30-year amortization	\$13,086	731	64%	10.05 years

The outstanding balance presented on this table may overlap more than one category. Of the outstanding balance, <sup>(1)</sup> \$5.1 million of "interest only," \$6.4 million of "stated income," \$2.2 million of "FICO less than or equal to 660," and \$227 of "over 30-year amortization" balances were non-performing.

Based on borrowers' FICO scores at the time of loan origination. The FICO score represents the creditworthiness of a borrower based on the borrower's credit history, as reported by an independent third party. A higher FICO score indicates a greater degree of creditworthiness. Bank regulators have issued guidance stating that a FICO score of 660 and below is indicative of a "subprime" borrower.

<sup>(3)</sup> LTV is the ratio calculated by dividing the current loan balance by the lower of the original appraised value or purchase price of the real estate collateral.

<sup>(4)</sup> Seasoning describes the number of years since the funding date of the loan.

<sup>(5)</sup> Stated income is defined as borrower stated income on his/her loan application which was not subject to verification during the loan origination process.

The following table summarizes the amortization schedule of the Corporation's interest only single-family, first trust deed, mortgage loans held for investment, including the percentage of those which are identified as non-performing or 30 – 89 days delinquent as of September 30, 2015:

(Dollars In Thousands)	Balance	Non-Performing <sup>(1)</sup>	30 - 89 Days Delinquent <sup>(1)</sup>
Fully amortize in the next 12 months	\$65,376	6%	1%
Fully amortize between 1 year and 5 years	65,096	2%	—%
Fully amortize after 5 years	840	—%	—%
Total	\$131,312	4%	—%

<sup>(1)</sup> As a percentage of each category.

The following table summarizes the interest rate reset (repricing) schedule of the Corporation's stated income single-family, first trust deed, mortgage loans held for investment, including the percentage of those which are identified as non-performing or 30 – 89 days delinquent as of September 30, 2015:

(Dollars In Thousands)	Balance <sup>(1)</sup>	Non-Performing <sup>(1)</sup>	30 - 89 Days Delinquent <sup>(1)</sup>
Interest rate reset in the next 12 months	\$150,277	4%	—%
Interest rate reset between 1 year and 5 years	2,527	28%	—%
Interest rate reset after 5 years	—	—%	—%
Total	\$152,804	4%	—%

<sup>(1)</sup> As a percentage of each category. Also, the loan balances and percentages on this table may overlap with the interest only single-family, first trust deed, mortgage loans held for investment table.



The reset of interest rates on adjustable rate mortgage loans (primarily interest only single-family loans) has not created a payment shock for a large percentage of the Corporation's borrowers primarily because the majority of the loans are repricing at a 2.75 percent margin over six-month LIBOR which has resulted in a lower interest rate than the borrowers pre-adjustment interest rate and a large percentage of the loans are still in their interest-only period. Management expects that the economic recovery from the recent recession will be slow to develop, which may translate to an extended period of lower interest rates and a reduced risk of mortgage payment shock for the foreseeable future, though the continuation of weak economic conditions may increase

the risk of delinquencies and defaults. The higher delinquency levels experienced by the Bank in fiscal 2008 through 2011 was primarily due to high unemployment, the recent U.S. recession, weak economic conditions and the decline in real estate values, particularly in California. It should be noted, however, that delinquency levels experienced since fiscal 2011 have significantly improved, primarily due to an improvement in real estate markets and general economic conditions, as compared to the levels experienced in fiscal 2008 through 2011.

The following table describes certain credit risk characteristics, geographic locations and the calendar year of loan origination of the Corporation's single-family, first trust deed, mortgage loans held for investment, at September 30, 2015:

(Dollars In Thousands)	Calendar Year of Origination									Total
	2007 & Prior	2008	2009	2010	2011	2012	2013	2014	YTD 2015	
Loan balance (in thousands)	\$271,953	\$18,161	\$883	\$122	\$1,047	\$4,780	\$5,826	\$25,186	\$19,051	\$347,009
Weighted-average LTV <sup>(1)</sup>	66%	75%	51%	69%	64%	56%	54%	67%	75%	67%
Weighted-average age (in years)	9.95	7.52	6.15	4.88	4.16	3.14	2.26	1.18	0.41	8.41
Weighted-average FICO <sup>(2)</sup>	729	745	750	700	712	748	750	744	744	732
Number of loans	827	36	3	1	4	23	32	44	29	999
Geographic breakdown (%)										
Inland Empire	30%	22%	100%	100%	59%	21%	29%	34%	26%	30%
Southern California <sup>(3)</sup>	57%	49%	—%	—%	41%	35%	27%	34%	49%	53%
Other California <sup>(4)</sup>	12%	29%	—%	—%	—%	44%	44%	32%	25%	16%
Other States	1%	—%	—%	—%	—%	—%	—%	—%	—%	1%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

(1) LTV is the ratio calculated by dividing the current loan balance by the lower of the original appraised value or purchase price of the real estate collateral.

(2) At time of loan origination.

(3) Other than the Inland Empire.

(4) Other than the Inland Empire and Southern California.

The following table describes certain credit risk characteristics, geographic locations and the calendar year of loan origination of the Corporation's multi-family loans held for investment, at September 30, 2015:

(Dollars In Thousands)	Calendar Year of Origination									Total
	2007 & Prior	2008	2009	2010	2011	2012	2013	2014	YTD 2015	
Loan balance (in thousands)	\$52,626	\$4,012	\$—	\$—	\$17,962	\$26,689	\$85,751	\$94,620	\$73,782	\$355,442
Weighted-average LTV <sup>(1)</sup>	47%	43%	—%	—%	57%	55%	57%	56%	56%	55%
Weighted-average DCR <sup>(2)</sup>	1.45x	1.38x	—	—	1.42x	1.74x	1.71x	1.65x	1.66x	1.63x
Weighted-average age (in years)	10.11	7.42	—	—	4.01	3.10	2.15	1.22	0.40	2.94
Weighted-average FICO <sup>(3)</sup>	701	701	—	—	741	728	761	764	755	748
Number of loans	98	4	—	—	19	32	116	111	107	487

Geographic breakdown (%)

Inland Empire	21%	34%	—%	—%	32%	15%	31%	12%	17%	20%
Southern California <sup>(4)</sup>	54%	66%	—%	—%	53%	53%	44%	54%	62%	53%
Other California <sup>(5)</sup>	20%	—%	—%	—%	15%	32%	25%	34%	21%	26%
Other States	5%	—%	—%	—%	—%	—%	—%	—%	—%	1%
Total	100%	100%	—%	—%	100%	100%	100%	100%	100%	100%

(1) LTV is the ratio calculated by dividing the current loan balance by the lower of the original appraised value or purchase price of the real estate collateral.

(2) Debt Coverage Ratio ("DCR") at time of origination.

(3) At time of loan origination.

(4) Other than the Inland Empire.

(5) Other than the Inland Empire and Southern California.

The following table summarizes the interest rate reset or maturity schedule of the Corporation's multi-family loans held for investment, including the percentage of those which are identified as non-performing, 30 – 89 days delinquent or not fully amortizing as of September 30, 2015:

(Dollars In Thousands)	Balance	Non-Performing <sup>(1)</sup>	30 - 89 Days Delinquent	Percentage Not Fully Amortizing <sup>(1)</sup>
Interest rate reset or mature in the next 12 months	\$67,229	3%	—%	29%
Interest rate reset or mature between 1 year and 5 years	278,524	—%	—%	9%
Interest rate reset or mature after 5 years	9,689	—%	—%	14%
Total	\$355,442	1%	—%	13%

(1) As a percentage of each category.

Edgar Filing: PROVIDENT FINANCIAL HOLDINGS INC - Form 10-Q

The following table describes certain credit risk characteristics, geographic locations and the calendar year of loan origination of the Corporation's commercial real estate loans held for investment, at September 30, 2015:

(Dollars In Thousands)	Calendar Year of Origination								YTD 2015	Total (5)(6)
	2007 & Prior	2008	2009	2010	2011	2012	2013	2014		
Loan balance (in thousands)	\$17,827	\$428	\$—	\$359	\$756	\$14,878	\$18,910	\$25,941	\$15,481	\$94,580
Weighted-average LTV (1)	46%	40%	—%	56%	60%	49%	47%	47%	49%	48%
Weighted-average DCR (2)	1.89x	1.43x	—	1.26x	1.47x	1.90x	1.82x	1.90x	1.59x	1.82x
Weighted-average age (in years)	9.85	7.44	—	5.35	3.77	2.99	2.16	1.17	0.39	3.23
Weighted-average FICO (2)	706	700	—	704	770	753	755	749	732	743
Number of loans	22	2	—	2	1	14	23	31	20	115

Geographic breakdown  
(%):

Inland Empire	25%	41%	—%	51%	—%	71%	34%	34%	17%	35%
Southern California (3)	66%	59%	—%	49%	100%	29%	37%	48%	40%	45%
Other California (4)	9%	—%	—%	—%	—%	—%	29%	18%	43%	20%
Other States	—%	—%	—%	—%	—%	—%	—%	—%	—%	—%
Total	100%	100%	—%	100%	100%	100%	100%	100%	100%	100%

(1) LTV is the ratio calculated by dividing the current loan balance by the lower of the original appraised value or purchase price of the real estate collateral.

(2) At time of loan origination.

(3) Other than the Inland Empire.

(4) Other than the Inland Empire and Southern California.

(5) Comprised of the following: \$31.9 million in Mixed Use; \$16.3 million in Office; \$13.6 million in Retail; \$12.1 million in Mobile Home Park; \$5.0 million in Warehouse; \$4.7 million in Mini-Storage; \$3.8 million in Restaurant/Fast Food; \$2.0 million in Medical/Dental Office; \$1.8 million in Light Industrial/Manufacturing; \$1.7 million in Hotel and Motel; and \$1.7 million in Automotive – Non Gasoline.

(6) Consisting of \$79.8 million or 84.4 percent in investment properties and \$14.8 million or 15.6 percent in owner occupied properties.

The following table summarizes the interest rate reset or maturity schedule of the Corporation's commercial real estate loans held for investment, including the percentage of those which are identified as non-performing, 30 – 89 days delinquent or not fully amortizing as of September 30, 2015:

(Dollars In Thousands)	Balance	Non-Performing (1)	30 - 89 Days Delinquent	Percentage Not Fully Amortizing (1)
Interest rate reset or mature in the next 12 months	\$15,221	4%	—%	63%
Interest rate reset or mature between 1 year and 5 years	79,359	—%	—%	84%
Interest rate reset or mature after 5 years	—	—%	—%	—%
Total	\$94,580	1%	—%	81%

(1) As a percentage of each category.



The following table sets forth information with respect to the Corporation's non-performing assets and restructured loans, net of allowance for loan losses and fair value adjustments, at the dates indicated:

(In Thousands)	At September 30, 2015	At June 30, 2015	
Loans on non-accrual status (excluding restructured loans):			
Mortgage loans:			
Single-family	\$8,807	\$7,010	
Multi-family	399	653	
Commercial real estate	1,016	680	
Total	10,222	8,343	
Accruing loans past due 90 days or more	—	—	
Restructured loans on non-accrual status:			
Mortgage loans:			
Single-family	2,879	2,902	
Multi-family	1,576	1,593	
Commercial real estate	—	1,019	
Commercial business loans	87	89	
Total	4,542	5,603	
Total non-performing loans	14,764	13,946	
Real estate owned, net	3,674	2,398	
Total non-performing assets	\$18,438	\$16,344	
Restructured loans on accrual status:			
Mortgage loans:			
Single-family	\$980	\$989	
Total	\$980	\$989	
Non-performing loans as a percentage of loans held for investment, net of allowance for loan losses	1.83	% 1.71	%
Non-performing loans as a percentage of total assets	1.25	% 1.19	%
Non-performing assets as a percentage of total assets	1.57	% 1.39	%

The following table describes the non-performing loans, net of allowance for loan losses and fair value adjustments, by the calendar year of origination as of September 30, 2015:

(In Thousands)	Calendar Year of Origination									Total
	2007 & Prior	2008	2009	2010	2011	2012	2013	2014	YTD 2015	
Mortgage loans:										
Single-family	\$9,935	\$443	\$—	\$—	\$—	\$92	\$—	\$1,216	\$—	\$11,686
Multi-family	1,975	—	—	—	—	—	—	—	—	1,975
Commercial real estate	675	—	—	—	—	—	—	341	—	1,016
Commercial business loans	—	—	87	—	—	—	—	—	—	87
Total	\$12,585	\$443	\$87	\$—	\$—	\$92	\$—	\$1,557	\$—	\$14,764

The following table describes the non-performing loans, net of allowance for loan losses and fair value adjustments, by the geographic location as of September 30, 2015:

(In Thousands)	Geographic Location				Total
	Inland Empire	Southern California <sup>(1)</sup>	Other California <sup>(2)</sup>	Other States	
Mortgage loans:					
Single-family	\$2,921	\$5,896	\$2,869	\$—	\$11,686
Multi-family	239	—	1,337	399	1,975
Commercial real estate	437	238	341	—	1,016
Commercial business loans	—	87	—	—	87
Total	\$3,597	\$6,221	\$4,547	\$399	\$14,764

(1) Other than the Inland Empire.

(2) Other than the Inland Empire and Southern California.

The following table summarizes classified assets, which is comprised of classified loans, net of allowance for loan losses and fair value adjustments, and real estate owned at the dates indicated:

(Dollars In Thousands)	At September 30, 2015		At June 30, 2015	
	Balance	Count	Balance	Count
Special mention loans:				
Mortgage loans:				
Single-family	\$7,318	21	\$7,797	18
Multi-family	409	1	413	1
Total special mention loans	7,727	22	8,210	19
Substandard loans:				
Mortgage loans:				
Single-family	11,686	38	10,261	36
Multi-family	4,111	7	7,514	11
Commercial real estate	1,952	5	2,643	7
Commercial business loans	87	1	89	1
Total substandard loans	17,836	51	20,507	55
Total classified loans	25,563	73	28,717	74
Real estate owned:				
Single-family	919	1	432	2
Commercial real estate	2,755	2	1,966	1
Total real estate owned	3,674	3	2,398	3
Total classified assets	\$29,237	76	\$31,115	77



Loan Volume Activities

The following table is provided to disclose details related to the volume of loans originated, purchased and sold for the quarters indicated:

(In Thousands)	For the Quarters Ended September 30,	
	2015	2014
Loans originated and purchased for sale:		
Retail originations	\$275,098	\$251,331
Wholesale originations and purchases	265,191	262,439
Total loans originated and purchased for sale <sup>(1)</sup>	540,289	513,770
Loans sold:		
Servicing released	(589,590	)(488,741
Servicing retained	(11,421	)(1,684
Total loans sold <sup>(2)</sup>	(601,011	)(490,425
Loans originated for investment:		
Mortgage loans:		
Single-family	5,430	12,951
Multi-family	22,703	21,233
Commercial real estate	6,444	5,150
Construction	382	3,009
Other	72	—
Commercial business loans	—	75
Total loans originated for investment <sup>(3)</sup>	35,031	42,418
Loans purchased for investment:		
Mortgage loans:		
Single-family	193	218
Total loans purchased for investment <sup>(3)</sup>	193	218
Mortgage loan principal payments	(45,847	)(24,384
Real estate acquired in settlement of loans	(1,006	)(927
Increase (decrease) in other items, net <sup>(4)</sup>	2,732	(2,178
Net (decrease) increase in loans held for investment and loans held for sale at fair value	\$(69,619	)\$38,492

(1) Includes PBM loans originated and purchased for sale during the quarters ended September 30, 2015 and 2014 totaling \$540.3 million and \$513.8 million, respectively.

(2) Includes PBM loans sold during the quarters ended September 30, 2015 and 2014 totaling \$601.0 million and \$490.4 million, respectively.

(3) Includes PBM loans originated and purchased for investment during the quarters ended September 30, 2015 and 2014 totaling \$5.6 million and \$14.4 million, respectively.

(4) Includes net changes in undisbursed loan funds, deferred loan fees or costs, allowance for loan losses, fair value of loans held for sale, advance payments of escrows and repurchases.

Loans that the Corporation has originated for sale are primarily sold on a servicing released basis. Clear ownership is conveyed to the investor by endorsing the original note in favor of the investor; transferring the servicing to a new servicer consistent with

investor instructions; communicating the servicing transfer to the borrower as required by law; and sending the loan file and collateral instruments electronically to the investor contemporaneous with receiving the cash proceeds from the sale of the loan. Additionally, the Corporation registers the change of ownership in the mortgage electronic registration system known as MERS as required by the contractual terms of the loan sale agreement. The Corporation does not believe that completing this additional registration clouds ownership of the note since the steps previously described have also been taken. Also, the Corporation retains an imaged copy of the entire loan file and collateral instruments as an abundance of caution in the event questions arise that can only be answered by reviewing the loan file. Additionally, the Corporation does not originate or sponsor mortgage-backed securities.

#### Liquidity and Capital Resources

The Corporation's primary sources of funds are deposits, proceeds from the sale of loans originated and purchased for sale, proceeds from principal and interest payments on loans, proceeds from the maturity and sale of investment securities, FHLB – San Francisco advances, and access to the discount window facility at the Federal Reserve Bank of San Francisco. While maturities and scheduled amortization of loans and investment securities are a relatively predictable source of funds, deposit flows, mortgage prepayments and loan sales are greatly influenced by general interest rates, economic conditions and competition.

The primary investing activity of the Corporation is the origination and purchase of loans held for investment and loans held for sale. During the first three months of fiscal 2016 and 2015, the Corporation originated and purchased \$575.5 million and \$556.4 million of loans, respectively. The total loans sold in the first three months of fiscal 2016 and 2015 were \$601.0 million and \$490.4 million, respectively. At September 30, 2015, the Corporation had loan origination commitments totaling \$143.5 million, undisbursed lines of credit totaling \$1.6 million and undisbursed loan funds totaling \$2.7 million. The Corporation anticipates that it will have sufficient funds available to meet its current loan commitments.

The Corporation's primary financing activity is gathering deposits. During the first three months of fiscal 2016, the net increase in deposits was \$780,000, primarily due to the increase in transaction accounts, which was partly offset by scheduled maturities in time deposits. The increase in transaction accounts and the decrease in time deposits were consistent with the Corporation's operating strategy. As of September 30, 2015, total deposits were \$924.9 million. At September 30, 2015, time deposits scheduled to mature in one year or less were \$160.7 million and total time deposits with a principal amount of \$100,000 or higher were \$169.9 million. Historically, the Corporation has been able to retain a significant percentage of its time deposits as they mature by adjusting deposit rates to the current interest rate environment.

The Corporation must maintain an adequate level of liquidity to ensure the availability of sufficient funds to support loan growth and deposit withdrawals, to satisfy financial commitments and to take advantage of investment opportunities. The Corporation generally maintains sufficient cash and cash equivalents to meet short-term liquidity needs. At September 30, 2015, total cash and cash equivalents were \$156.1 million, or 13 percent of total assets. Depending on market conditions and the pricing of deposit products and FHLB – San Francisco advances, the Bank may rely on FHLB – San Francisco advances for part of its liquidity needs. As of September 30, 2015, total borrowings were \$91.4 million and the financing availability at FHLB – San Francisco was limited to 35 percent of total assets; the remaining borrowing facility was \$309.3 million and the remaining available collateral was \$548.8 million. In addition, the Bank has secured an \$11.6 million discount window facility at the Federal Reserve Bank of San Francisco, collateralized by investment securities with a fair market value of \$12.3 million. As of September 30, 2015, the Bank also has a borrowing arrangement in the form of a federal funds facility with its correspondent bank for \$12.0 million which matures on June 30, 2016 which the Bank intends to renew upon maturity. The Bank has no advances under its correspondent bank or discount window facility as of September 30, 2015.

Regulations require thrifts to maintain adequate liquidity to assure safe and sound operations. The Bank's average liquidity ratio (defined as the ratio of average qualifying liquid assets to average deposits and borrowings) for the quarter ended September 30, 2015 increased slightly to 35.0 percent from 34.5 percent for the quarter ended June 30, 2015.

Effective January 1, 2015, the Bank is subject to capital requirements which created a required ratio for common equity Tier 1 ("CET1") capital, increased the Tier1 leverage and Tier 1 capital ratios, changed the risk-weightings of certain assets for purposes of the risk-based capital ratios, created an additional capital conservation buffer over the required capital ratios and changed what qualifies as capital for purposes of meeting these various capital requirements. In addition, Provident Financial Holdings, Inc. as a savings and loan holding company registered with the FRB, is required by the FRB to maintain capital adequacy that generally parallels the OCC requirements. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by bank regulators that, if undertaken, could have a direct material effect on the Corporation's financial statements. Provident Financial Holdings, Inc. and the Bank are required to maintain additional levels of Tier 1 common equity over the minimum risk-based capital levels before they may pay dividends, repurchase shares or pay discretionary bonuses.

The new minimum requirements include a ratio of common equity Tier 1 capital (CET1 capital) to total risk-weighted assets ("CET1 risk-based ratio") of 4.5%, a Tier 1 capital ratio of 6.0%, a total capital ratio of 8.0%, and a Tier1 leverage ratio of 4.0%.

In addition to the capital requirements, there are a number of changes in what constitutes regulatory capital, subject to transition periods. These changes include the phasing-out of certain instruments as qualifying capital. Provident Financial Holdings, Inc. and the Bank do not have any of these instruments. Mortgage servicing and deferred tax assets over designated percentages of CET1 will be deducted from capital, subject to a four-year transition period. CET1 will consist of Tier 1 capital less all capital components that are not considered common equity. In addition, Tier 1 capital will include accumulated other comprehensive income, which includes all unrealized gains and losses on available for sale debt and equity securities, subject to a four-year transition period. Because of the Bank's asset size, it is not considered an advanced approaches banking organization and has elected to take the one-time option to permanently opt-out of the inclusion of unrealized gains and losses on available for sale debt and equity securities in the Bank's capital calculations.

The new requirements also include changes in the risk-weighting of assets to better reflect credit risk and other risk exposure. These include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and for non-residential mortgage loans that are 90 days past due or otherwise in nonaccrual status; a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable (currently set at 0%); and a 250% risk weight (up from 100%) for mortgage servicing and deferred tax assets that are not deducted from capital.

In addition to the minimum CET1, Tier 1 and total capital ratios, Provident Financial Holdings, Inc. and the Bank will have to maintain a capital conservation buffer consisting of additional CET1 capital equal to 2.5% of risk-weighted assets above the required minimum levels in order to avoid limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses based on percentages of eligible retained income that could be utilized for such actions. This new capital conservation buffer requirement is to be phased in beginning in January 2016 at 0.625% of risk-weighted assets and increasing each year until fully implemented in January 2019.

Under the new standards, in order to be considered well-capitalized, the Bank must have to have a CET1 risk-based ratio of 6.5% (new), a Tier 1 risk-based ratio of 8% (increased from 6%), a total risk-based capital ratio of 10% (unchanged) and a Tier1 leverage ratio of 5% (unchanged).

At September 30, 2015, Provident Financial Holdings, Inc. and the Bank each exceeded all regulatory capital requirements. The Bank was categorized "well-capitalized" at September 30, 2015 under the regulations of the OCC.

Edgar Filing: PROVIDENT FINANCIAL HOLDINGS INC - Form 10-Q

Provident Financial Holdings, Inc. and the Bank's actual and required minimum capital amounts and ratios at the dates indicated are as follows (dollars in thousands):

	Actual		Regulatory Requirements			
	Amount	Ratio	Minimum for Capital Adequacy Purposes		Minimum to Be Well Capitalized	
			Amount	Ratio	Amount	Ratio
Provident Financial Holdings, Inc.:						
As of September 30, 2015						
Tier 1 leverage capital (to adjusted average assets)	\$ 138,829	11.82 %	\$ 46,992	4.00 %	\$ 58,740	5.00 %
CET1 capital (to risk-weighted assets) <sup>(1)</sup>	\$ 138,829	19.92 %	\$ 31,358	4.50 %	\$ 45,295	6.50 %
Tier 1 capital (to risk-weighted assets)	\$ 138,829	19.92 %	\$ 41,811	6.00 %	\$ 55,748	8.00 %
Total capital (to risk-weighted assets)	\$ 147,554	21.17 %	\$ 55,748	8.00 %	\$ 69,685	10.00 %
As of June 30, 2015						
Tier 1 leverage capital (to adjusted assets)	\$ 140,735	11.94 %	\$ 47,161	4.00 %	\$ 58,951	5.00 %
CET1 capital (to risk-weighted assets)	\$ 140,735	19.24 %	\$ 32,923	4.50 %	\$ 47,555	6.50 %
Tier 1 capital (to risk-weighted assets)	\$ 140,735	19.24 %	\$ 43,897	6.00 %	\$ 58,529	8.00 %
Total capital (to risk-weighted assets)	\$ 149,886	20.49 %	\$ 58,529	8.00 %	\$ 73,161	10.00 %
Provident Savings Bank, F.S.B.:						
As of September 30, 2015						
Tier 1 leverage capital (to adjusted average assets)	\$ 113,741	9.68 %	\$ 46,992	4.00 %	\$ 58,740	5.00 %
CET1 capital (to risk-weighted assets)	\$ 113,741	16.32 %	\$ 31,354	4.50 %	\$ 45,290	6.50 %
Tier 1 capital (to risk-weighted assets)	\$ 113,741	16.32 %	\$ 41,806	6.00 %	\$ 55,741	8.00 %
Total capital (to risk-weighted assets)	\$ 122,524	17.58 %	\$ 55,741	8.00 %	\$ 69,677	10.00 %
As of June 30, 2015						
Tier 1 leverage capital (to adjusted assets)	\$ 125,946	10.68 %	\$ 47,161	4.00 %	\$ 58,951	5.00 %
CET1 capital (to risk-weighted assets)	\$ 125,946	17.22 %	\$ 32,922	4.50 %	\$ 47,554	6.50 %
Tier 1 capital (to risk-weighted assets)	\$ 125,946	17.22 %	\$ 43,896	6.00 %	\$ 58,528	8.00 %
Total capital (to risk-weighted assets)	\$ 135,096	18.47 %	\$ 58,528	8.00 %	\$ 73,160	10.00 %

The ability of the Corporation to pay dividends to stockholders depends primarily on the ability of the Bank to pay dividends to the Corporation. The Bank may not declare or pay a cash dividend if the effect thereof would cause its net worth to be reduced below the regulatory capital requirements imposed by federal regulation. In the first quarter of fiscal 2016, the Bank paid a cash dividend of \$15.0 million to the Corporation; while the Corporation paid \$1.0 million of cash dividends to its shareholders.

Supplemental Information

	At September 30, 2015	At June 30, 2015	At September 30, 2014
--	-----------------------------	------------------------	-----------------------------

Edgar Filing: PROVIDENT FINANCIAL HOLDINGS INC - Form 10-Q

Loans serviced for others (in thousands)	\$86,658	\$80,058	\$78,661
Book value per share	\$16.52	\$16.35	\$15.84

66

---

ITEM 3 – Quantitative and Qualitative Disclosures about Market Risk.

One of the Corporation’s principal financial objectives is to achieve long-term profitability while reducing its exposure to fluctuating interest rates. The Corporation has sought to reduce the exposure of its earnings to changes in interest rates by attempting to manage the repricing mismatch between interest-earning assets and interest-bearing liabilities. The principal element in achieving this objective is to increase the interest-rate sensitivity of the Corporation’s interest-earning assets by retaining for its portfolio new loan originations with interest rates subject to periodic adjustment to market conditions and by selling fixed-rate, single-family mortgage loans. In addition, the Corporation maintains an investment portfolio, which is largely in U.S. government agency MBS and U.S. government sponsored enterprise MBS with contractual maturities of up to 30 years that reprice frequently. The Corporation relies on retail deposits as its primary source of funds while utilizing FHLB – San Francisco advances as a secondary source of funding. Management believes retail deposits, unlike brokered deposits, reduces the effects of interest rate fluctuations because they generally represent a more stable source of funds. As part of its interest rate risk management strategy, the Corporation promotes transaction accounts and time deposits with terms up to five years.

Through the use of an internal interest rate risk model, the Corporation is able to analyze its interest rate risk exposure by measuring the change in net portfolio value (“NPV”) over a variety of interest rate scenarios. NPV is defined as the net present value of expected future cash flows from assets, liabilities and off-balance sheet contracts. The calculation is intended to illustrate the change in NPV that would occur in the event of an immediate change in interest rates of -100, +100, +200, +300 and +400 basis points (“bp”) with no effect given to steps that management might take to counter the effect of the interest rate movement. The current federal funds rate is 0.25 percent making an immediate change of -200 and -300 basis points improbable.

The following table is derived from the internal interest rate risk model and represents the NPV based on the indicated changes in interest rates as of September 30, 2015 (dollars in thousands).

Basis Points ("bp") Change in Rates	Net Portfolio Value	NPV Change <sup>(1)</sup>	Portfolio Value of Assets	NPV as Percentage of Portfolio Value Assets <sup>(2)</sup>	Sensitivity Measure <sup>(3)</sup>
+400 bp	\$259,676	\$109,066	\$1,294,806	20.06%	+767 bp
+300 bp	\$238,058	\$87,448	\$1,280,930	18.58%	+619 bp
+200 bp	\$211,948	\$61,338	\$1,263,406	16.78%	+439 bp
+100 bp	\$182,271	\$31,661	\$1,241,826	14.68%	+229 bp
0 bp	\$150,610	\$—	\$1,215,531	12.39%	- bp
-100 bp	\$129,752	\$(20,858)	\$1,206,440	10.75%	-164 bp

(1) Represents the increase (decrease) of the NPV at the indicated interest rate change in comparison to the NPV at September 30, 2015 (“base case”).

(2) Calculated as the NPV divided by the portfolio value of total assets.

(3) Calculated as the change in the NPV ratio from the base case amount assuming the indicated change in interest rates (expressed in basis points).

The following table is derived from the internal interest rate risk model and represents the change in the NPV at a -100 basis point rate shock at September 30, 2015 and June 30, 2015.

	At September 30, 2015 (-100 bp rate shock)	At June 30, 2015 (-100 bp rate shock)
Pre-Shock NPV Ratio: NPV as a % of PV Assets	12.39%	13.60%
Post-Shock NPV Ratio: NPV as a % of PV Assets	10.75%	12.05%
Sensitivity Measure: Change in NPV Ratio	-164 bp	-155 bp



TB 13a Level of Risk

Minimal

Minimal

The pre-shock NPV ratio declined 121 basis points to 12.39% at September 30, 2015 from 13.60% at June 30, 2015 and the post-shock NPV ratio declined 130 basis points to 10.75% at September 30, 2015 from 12.05% at June 30, 2015. The decline of the NPV ratios was primarily attributable to a \$15.0 million cash dividend distribution from the Bank to the Corporation in September 2015, partly offset by the net income in the first three months of fiscal 2016.

67

---

As with any method of measuring interest rate risk, certain shortcomings are inherent in the method of analysis presented in the foregoing tables. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types of assets and liabilities may lag behind changes in market interest rates. Additionally, certain assets, such as adjustable rate mortgage (“ARM”) loans, have features that restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, expected rates of prepayments on loans and early withdrawals from time deposits could likely deviate significantly from those assumed when calculating the results described in the tables above. It is also possible that, as a result of an interest rate increase, the higher mortgage payments required from ARM borrowers could result in an increase in delinquencies and defaults. Changes in market interest rates may also affect the volume and profitability of the Corporation’s mortgage banking operations. Accordingly, the data presented in the tables in this section should not be relied upon as indicative of actual results in the event of changes in interest rates. Furthermore, the NPV presented in the foregoing tables is not intended to present the fair market value of the Corporation, nor does it represent amounts that would be available for distribution to shareholders in the event of the liquidation of the Corporation.

The Corporation also models the sensitivity of net interest income for the 12-month period subsequent to any given month-end assuming a dynamic balance sheet (accounting for the Corporation’s current balance sheet, 12-month business plan, embedded options, rate floors, periodic caps, lifetime caps, and loan, investment, deposit and borrowing cash flows, among others), and immediate, permanent and parallel movements in interest rates of plus 400, 300, 200 and 100 and minus 100 basis points. The following table describes the results of the analysis at September 30, 2015 and June 30, 2015.

At September 30, 2015		At June 30, 2015	
Basis Point (bp)	Change in	Basis Point (bp)	Change in
Change in Rates	Net Interest Income	Change in Rates	Net Interest Income
+400 bp	0.75%	+400 bp	(0.56)%
+300 bp	7.68%	+300 bp	6.11%
+200 bp	4.76%	+200 bp	3.74%
+100 bp	0.31%	+100 bp	0.20%
-100 bp	(18.89)%	-100 bp	(18.57)%

At both September 30, 2015 and June 30, 2015, the Corporation was asset sensitive as its interest-earning assets are expected to reprice more quickly than its interest-bearing liabilities during the subsequent 12-month period. Therefore, in a rising interest rate environment, the model projects an increase in net interest income over the subsequent 12-month period. In a falling interest rate environment, the results project a decrease in net interest income over the subsequent 12-month period.

Management believes that the assumptions used to complete the analysis described in the table above are reasonable. However, past experience has shown that immediate, permanent and parallel movements in interest rates will not necessarily occur. Additionally, while the analysis provides a tool to evaluate the projected net interest income to changes in interest rates, actual results may be substantially different if actual experience differs from the assumptions used to complete the analysis, particularly with respect to the 12-month business plan when asset growth is forecast. Therefore, the model results that the Corporation discloses should be thought of as a risk management tool to compare the trends of the Corporation’s current disclosure to previous disclosures, over time, within the context of the actual performance of the treasury yield curve.

ITEM 4 – Controls and Procedures.

a) An evaluation of the Corporation's disclosure controls and procedures (as defined in Section 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934 (the "Act")) was carried out under the supervision and with the participation of the Corporation's Chief Executive Officer, Chief Financial Officer and the Corporation's Disclosure Committee as of the end of the period covered by this quarterly report. In designing and evaluating the Corporation's disclosure controls and procedures, management recognizes that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Also, because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Corporation have been detected. Additionally, in designing disclosure controls and procedures, management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future

conditions. Based on their evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer concluded that the Corporation's disclosure controls and procedures as of September 30, 2015 are effective, at the reasonable assurance level, in ensuring that the information required to be disclosed by the Corporation in the reports it files or submits under the Act is (i) accumulated and communicated to the Corporation's management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

b) There have been no changes in the Corporation's internal control over financial reporting (as defined in Rule 13a-15(f) of the Act) that occurred during the quarter ended September 30, 2015, that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting. The Corporation does not expect that its internal control over financial reporting will prevent all error and all fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Corporation have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings.

From time to time, the Corporation or its subsidiaries are engaged in legal proceedings in the ordinary course of business, none of which are currently considered to have a material impact on the Corporation's financial position or results of operations, except as previously disclosed in Part I, Item 3 of the Corporation's Annual Report on Form 10-K for the year ended June 30, 2015.

### Item 1A. Risk Factors.

There have been no material changes in the risk factors previously disclosed in Part I, Item 1A of the Corporation's Annual Report on Form 10-K for the year ended June 30, 2015.

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

The table below represents the Corporation's purchases of its equity securities for the first quarter of fiscal 2016.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plan	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plan <sup>(1)</sup>
July 1 – 31, 2015	12,149	\$16.12	12,149	336,835

Edgar Filing: PROVIDENT FINANCIAL HOLDINGS INC - Form 10-Q

August 1 – 31, 2015	110,337	16.57	105,837	230,998
September 1 – 30, 2015	97,943	16.59	97,943	133,055
Total	220,429	\$16.55	215,929	133,055

On April 28, 2015, the Corporation announced a new stock repurchase plan of up to five percent of the  
(1) Corporation's outstanding common stock, or approximately 430,651 shares. The April 2015 stock repurchase plan will expire on April 28, 2016.

During the quarter ended September 30, 2015, the Corporation purchased 220,429 shares of the Corporation's common stock at an average cost of \$16.55 per share, including the purchase of 4,500 shares of common stock from stock options exercised during the quarter with an average cost of \$16.09 per share. As of September 30, 2015, a total of 297,596 shares or 69 percent of the

shares authorized in the April 2015 stock repurchase plan have been purchased at an average cost of \$16.88 per share, leaving 133,055 shares available for future purchases. During the quarter ended September 30, 2015, the Corporation did not sell any securities that were not registered under the Securities Act of 1933.

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

Not applicable.

Item 6. Exhibits.

Exhibits:

- 3.1 (a) Certificate of Incorporation of Provident Financial Holdings, Inc. (incorporated by reference to Exhibit 3.1 to the Corporation's Registration Statement on Form S-1 (File No. 333-2230))
- 3.1 (b) Certificate of Amendment to Certificate of Incorporation of Provident Financial Holdings, Inc. as filed with the Delaware Secretary of State on November 24, 2009 (incorporated by reference to Exhibit 3.1 to the Corporation's Quarterly Report on Form 10-Q filed on November 9, 2010)
- 3.1 (c) Bylaws of Provident Financial Holdings, Inc. (incorporated by reference to Exhibit 3.1 to the Corporation's Current Report on Form 8-K filed on December 1, 2014)
- 10.1 Employment Agreement with Craig G. Blunden (incorporated by reference to Exhibit 10.1 to the Corporation's Form 8-K dated December 19, 2005)
- 10.2 Post-Retirement Compensation Agreement with Craig G. Blunden (incorporated by reference to Exhibit 10.2 to the Corporation's Form 8-K dated December 19, 2005)
- 10.3 1996 Stock Option Plan (incorporated by reference to Exhibit A to the Corporation's proxy statement dated December 12, 1996)
- 10.4 1996 Management Recognition Plan (incorporated by reference to Exhibit B to the Corporation's proxy statement dated December 12, 1996)
- 10.5 Form of Severance Agreement with Richard L. Gale, Deborah L. Hill, Lilian Salter, Donavon P. Ternes, David S. Weiant and Gwendolyn L. Wertz (incorporated by reference to Exhibit 10.1 and 10.2 in the Corporation's Form 8-K dated February 24, 2012)

- 10.6 2003 Stock Option Plan (incorporated by reference to Exhibit A to the Corporation's proxy statement dated October 21, 2003)
- 10.7 Form of Incentive Stock Option Agreement for options granted under the 2003 Stock Option Plan (incorporated by reference to Exhibit 10.13 to the Corporation's Annual Report on Form 10-K for the fiscal year June 30, 2005).

70

---

- 10.8 Form of Non-Qualified Stock Option Agreement for options granted under the 2003 Stock Option Plan (incorporated by reference to Exhibit 10.14 to the Corporation's Annual Report on Form 10-K for the fiscal year June 30, 2005).
- 10.9 2006 Equity Incentive Plan (incorporated by reference to Exhibit A to the Corporation's proxy statement dated October 12, 2006)
- 10.10 Form of Incentive Stock Option Agreement for options granted under the 2006 Equity Incentive Plan (incorporated by reference to Exhibit 10.10 in the Corporation's Form 10-Q for the quarter ended December 31, 2006)
- 10.11 Form of Non-Qualified Stock Option Agreement for options granted under the 2006 Equity Incentive Plan (incorporated by reference to Exhibit 10.11 in the Corporation's Form 10-Q for the quarter ended December 31, 2006)
- 10.12 Form of Restricted Stock Agreement for restricted shares awarded under the 2006 Equity Incentive Plan (incorporated by reference to Exhibit 10.12 in the Corporation's Form 10-Q for the quarter ended December 31, 2006)
- 10.13 2010 Equity Incentive Plan (incorporated by reference to Exhibit A to the Corporation's proxy statement dated October 28, 2010)
- 10.14 Form of Incentive Stock Option Agreement for options granted under the 2010 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 in the Corporation's Form 8-K dated November 30, 2010)
- 10.15 Form of Non-Qualified Stock Option Agreement for options granted under the 2010 Equity Incentive Plan (incorporated by reference to Exhibit 10.2 in the Corporation's Form 8-K dated November 30, 2010)
- 10.16 Form of Restricted Stock Agreement for restricted shares awarded under the 2010 Equity Incentive Plan (incorporated by reference to Exhibit 10.3 in the Corporation's Form 8-K dated November 30, 2010)
- 10.17 Post-Retirement Compensation Agreement with Donavon P. Ternes (incorporated by reference to Exhibit 10.13 to the Corporation's Form 8-K dated July 7, 2009)
- 10.18 2013 Equity Incentive Plan (incorporated by reference to Exhibit A to the Corporation's proxy statement dated October 24, 2013)
- 10.19 Form of Incentive Stock Option Agreement for options granted under the 2013 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 in the Corporation's Form 8-K dated November 30, 2013)
- 10.20 Form of Non-Qualified Stock Option Agreement for options granted under the 2013 Equity Incentive Plan (incorporated by reference to Exhibit 10.2 in the Corporation's Form 8-K dated November 30, 2013)
- 10.21 Form of Restricted Stock Agreement for restricted shares awarded under the 2013 Equity Incentive Plan (incorporated by reference to Exhibit 10.3 in the Corporation's Form 8-K dated November 30, 2013)
- 14 Code of Ethics for the Corporation's directors, officers and employees (incorporated by reference to Exhibit 14 in the Corporation's Annual Report on Form 10-K dated September 12, 2007)



Edgar Filing: PROVIDENT FINANCIAL HOLDINGS INC - Form 10-Q

- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

71

---

32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101 The following materials from the Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2015, formatted in Extensible Business Reporting Language (XBRL): (1) Condensed Consolidated Statements of Financial Condition; (2) Condensed Consolidated Statements of Operations; (3) Condensed Consolidated Statements of Comprehensive Income; (4) Condensed Consolidated Statements of Stockholders' Equity; (5) Condensed Consolidated Statements of Cash Flows; and (6) Selected Notes to Condensed Consolidated Financial Statements.

72

---

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.

Provident Financial Holdings, Inc.

Date: November 9, 2015

/s/ Craig G. Blunden  
Craig G. Blunden  
Chairman and Chief Executive Officer  
(Principal Executive Officer)

Date: November 9, 2015

/s/ Donavon P. Ternes  
Donavon P. Ternes  
President, Chief Operating Officer and  
Chief Financial Officer  
(Principal Financial and Accounting Officer)



Exhibit Index

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101 The following materials from the Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2015, formatted in Extensible Business Reporting Language (XBRL): (1) Condensed Consolidated Statements of Financial Condition; (2) Condensed Consolidated Statements of Operations; (3) Condensed Consolidated Statements of Comprehensive Income; (4) Condensed Consolidated Statements of Stockholders' Equity; (5) Condensed Consolidated Statements of Cash Flows; and (6) Selected Notes to Condensed Consolidated Financial Statements.

74