ESSA Bancorp, Inc.
Form 10-Q
February 11, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended December 31, 2018

OR

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

Commission File No. 001-33384

ESSA Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	20-8023072 (I.R.S. Employer Identification Number)
200 Palmer Street, Stroudsburg, Pennsylvania (Address of Principal Executive Offices)	18360 (Zip Code)

(570) 421-0531

(Registrant's telephone number)

N/A

(Former name or former address, 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 requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filers,” “accelerated filers,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of February 4, 2019, there were 11,819,814 shares of the Registrant’s common stock, par value $0.01 per share, outstanding.

ESSA Bancorp, Inc.

FORM 10-Q

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Part I. Financial Information

Item 1. Financial Statements
ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEET

(UNAUDITED)

	December 31, 2018	September 30, 2018
	(dollars in thousands)	
Cash and due from banks	$35,849	$39,197
Interest-bearing deposits with other institutions	3,801	4,342
Total cash and cash equivalents	39,650	43,539
Certificates of deposit	500	500
Investment securities available for sale, at fair value	376,054	371,438
Loans receivable (net of allowance for loan losses of $12,221 and $11,688)	1,334,304	1,305,071
Regulatory stock, at cost	15,121	12,973
Premises and equipment, net	14,448	14,601
Bank-owned life insurance	38,874	38,630
Foreclosed real estate	876	1,141
Intangible assets, net	1,291	1,375
Goodwill	13,801	13,801
Deferred income taxes	6,836	8,441
Other assets	21,123	22,280
TOTAL ASSETS	$1,862,878	$1,833,790
LIABILITIES		
Deposits	$1,307,917	$1,336,855
Short-term borrowings	239,824	179,773
Other borrowings	112,373	118,723
Advances by borrowers for taxes and insurance	8,435	6,826
Other liabilities	9,554	12,427
TOTAL LIABILITIES	1,678,103	1,654,604
STOCKHOLDERS' EQUITY		
Preferred Stock ($0.01 par value; 10,000,000 shares authorized, none issued)	—	—
Common stock ($0.01 par value; 40,000,000 shares authorized, 18,133,095 issued; 11,819,814 and 11,782,718 outstanding at December 31, 2018 and September 30, 2018, respectively)	181	181
Additional paid in capital	180,631	180,765
Unallocated common stock held by the Employee Stock Ownership Plan (ESOP)	(8,142)	(8,255)
Retained earnings	96,026	94,112
Treasury stock, at cost; 6,313,281 and 6,350,377 shares outstanding at	(77,259)	(77,707)

December 31, 2018 and September 30, 2018, respectively		
Accumulated other comprehensive loss	(6,662)	(9,910)
TOTAL STOCKHOLDERS' EQUITY	184,775	179,186
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$1,862,878	$1,833,790

See accompanying notes to the unaudited consolidated financial statements.

ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF OPERATIONS

(UNAUDITED)

	For the Three Months Ended December 31,	
	2018	2017
	(dollars in thousands, except per share data)	
INTEREST INCOME		
Loans receivable, including fees	$13,907	$12,783
Investment securities:		
Taxable	2,482	2,058
Exempt from federal income tax	136	288
Other investment income	344	247
Total interest income	16,869	15,376
INTEREST EXPENSE		
Deposits	3,388	2,377
Short-term borrowings	1,077	584
Other borrowings	519	647
Total interest expense	4,984	3,608
NET INTEREST INCOME	11,885	11,768
Provision for loan losses	876	1,000
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	11,009	10,768
NONINTEREST INCOME		
Service fees on deposit accounts	863	883
Services charges and fees on loans	330	369
Unrealized losses on equity securities	(2)	—
Trust and investment fees	239	240
Gain on sale of investments, net	4	—
Earnings on Bank-owned life insurance	244	255
Insurance commissions	201	171
Other	247	51
Total noninterest income	2,126	1,969
NONINTEREST EXPENSE		
Compensation and employee benefits	6,124	6,008
Occupancy and equipment	1,026	1,185
Professional fees	524	566
Data processing	903	929

Advertising	155	158
Federal Deposit Insurance Corporation (FDIC) premiums	187	189
Gain on foreclosed real estate	(115)	(36)
Amortization of intangible assets	84	144
Other	764	1,139
Total noninterest expense	9,652	10,282
Income before income taxes	3,483	2,455
Income taxes	474	4,093
NET INCOME (LOSS)	$3,009	$(1,638)
Earnings per share		
Basic	$0.27	$(0.15)
Diluted	$0.27	$(0.15)
Dividends per share	$0.10	$0.09

See accompanying notes to the unaudited consolidated financial statements.

ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

	For the Three Months Ended December 31,	
	2018	2017
	(dollars in thousands)	
Net income (loss)	$3,009	$(1,638)
Other comprehensive income(loss)		
Investment securities available for sale:		
Unrealized holding gain(loss)	5,059	(1,951)
Tax effect	(1,068)	663
Reclassification of gains recognized in net income	(4)	—
Tax effect	1	—
Net of tax amount	3,988	(1,288)
Derivative and hedging activities adjustments:		
Changes in unrealized holding (losses) gains on derivatives included in net income	(725)	457
Tax effect	152	(156)
Reclassification adjustment for gains on derivatives included in net income	(217)	(23)
Tax effect	46	8
Net of tax amount	(744)	286
Total other comprehensive income (loss)	3,244	(1,002)
Comprehensive income (loss)	$6,253	$(2,640)

See accompanying notes to the unaudited consolidated financial statements.

ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(UNAUDITED)

	Common Stock Number of Shares	Amount	Additional Paid In Capital	Unallocated Common Stock Held by the ESOP	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	(dollars in thousands except share data)							
Balance, September 30, 2017	11,596,263	$ 181	$ 180,764	$ (8,720)	$ 91,147	$ (79,891)	$ (754)	$ 182,727
Net loss					(1,638)			(1,638)
Other comprehensive loss							(1,002)	(1,002)
Cash dividends declared ($0.09 per share)					(963)			(963)
Stock based compensation			80					80
Allocation of ESOP stock			67	116				183
Allocation of treasury shares to incentive plan	22,994		(281)			281		—
Stock options exercised	15,533		(98)			190		92
Balance, December 31, 2017	11,634,790	$ 181	$ 180,532	$ (8,604)	$ 88,546	$ (79,420)	$ (1,756)	$ 179,479

	Common Stock Number of Shares	Amount	Additional Paid In Capital	Unallocated Common Stock Held by the ESOP	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	(dollars in thousands except share data)							
Balance, September 30, 2018	11,782,718	$ 181	$ 180,765	$ (8,255)	$ 94,112	$ (77,707)	$ (9,910)	$ 179,186
Net income					3,009			3,009
Other comprehensive income							3,244	3,244

Change in accounting principal for adoption of ASU 2016-01					(4)		4	—
Cash dividends declared ($0.10 per share)					(1,091)			(1,091)
Stock based compensation			252					252
Allocation of ESOP stock			62	113				175
Allocation of treasury shares to incentive plan	37,096		(448)			448		—
Balance, December 31, 2018	11,819,814	$ 181	$ 180,631	$ (8,142)	$ 96,026	$ (77,259)	$ (6,662)	$ 184,775

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ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CASH FLOWS

(UNAUDITED)

	For the three months ended December 31,	
	2018	2017
	(dollars in thousands)	
OPERATING ACTIVITIES		
Net income (loss)	$3,009	$(1,638)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision for loan losses	876	1,000
Provision for depreciation and amortization	286	305
Amortization and accretion of discounts and premiums, net	848	1,167
Net gain on sale of investment securities	(4)	—
Net loss recognized on equity securities- financial	2	—
Compensation expense on ESOP	175	183
Stock based compensation	252	80
Decrease (increase) in accrued interest receivable	379	(124)
Increase in accrued interest payable	119	184
Earnings on bank-owned life insurance	(244)	(255)
Deferred federal income taxes	743	3,329
Decrease in accrued pension liability	(119)	(135)
Gain on foreclosed real estate, net	(115)	(36)
Amortization of identifiable assets	84	144
Other, net	(2,942)	1,660
Net cash provided by operating activities	3,349	5,864
INVESTING ACTIVITIES		
Investment securities available for sale:		
Proceeds from sale of investment securities	9,931	—
Proceeds from principal repayments and maturities	10,833	19,254
Purchases	(20,729)	(22,455)
Increase in loans receivable, net	(30,601)	(41,724)
Redemption of regulatory stock	4,239	3,151
Purchase of regulatory stock	(6,387)	(6,164)
Proceeds from sale of foreclosed real estate	432	498
Purchase of premises, equipment and software	(237)	45
Net cash used for investing activities	(32,519)	(47,395)
FINANCING ACTIVITIES		
Decrease in deposits, net	(28,938)	(23,840)
Net increase in short-term borrowings	60,051	76,590
Proceeds from other borrowings	20,000	14,600
Repayment of other borrowings	(26,350)	(34,000)

Increase in advances by borrowers for taxes and insurance	1,609	6,246
Dividends on common stock	(1,091)	(963)
Net cash provided by financing activities	25,281	38,633
Decrease in cash and cash equivalents	(3,889)	(2,898)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	43,539	41,683
CASH AND CASH EQUIVALENTS AT END OF YEAR	$39,650	$38,785
SUPPLEMENTAL CASH FLOW DISCLOSURES		
Cash Paid:		
Interest	$4,865	$3,424
Income taxes	—	(2)
Noncash items:		
Transfers from loans to foreclosed real estate	52	403
Unrealized holding gains (losses)	5,055	(1,951)

See accompanying notes to the unaudited consolidated financial statements.

ESSA BANCORP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(unaudited)

1. Nature of Operations and Basis of Presentation

The consolidated financial statements include the accounts of ESSA Bancorp, Inc. (the “Company”), its wholly owned subsidiary, ESSA Bank & Trust (the “Bank”), and the Bank’s wholly owned subsidiaries, ESSACOR Inc.; Pocono Investments Company; ESSA Advisory Services, LLC; Integrated Financial Corporation; and Integrated Abstract Incorporated, a wholly owned subsidiary of Integrated Financial Corporation. The primary purpose of the Company is to act as a holding company for the Bank. On November 6, 2014, the Company converted its status from a savings and loan holding company to a bank holding company. In addition, the Bank converted from a Pennsylvania-chartered savings association to a Pennsylvania-chartered savings bank. The Bank’s primary business consists of the taking of deposits and granting of loans to customers generally in Monroe, Northampton, Lehigh, Delaware, Chester, Montgomery, Lackawanna, and Luzerne Counties, Pennsylvania. The Bank is subject to regulation and supervision by the Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation (the “FDIC”). The investment in the Bank on the parent company’s financial statements is carried at the parent company’s equity in the underlying net assets.

ESSACOR, Inc. is a Pennsylvania corporation that has been used to purchase properties at tax sales that represent collateral for delinquent loans of the Bank and is currently inactive. Pocono Investment Company is a Delaware corporation formed as an investment company subsidiary to hold and manage certain investments, including certain intellectual property. ESSA Advisory Services, LLC is a Pennsylvania limited liability company owned 100 percent by ESSA Bank & Trust. ESSA Advisory Services, LLC is a full-service insurance benefits consulting company offering group services such as health insurance, life insurance, short-term and long-term disability, dental, vision, and 401(k) retirement planning as well as individual health products. Integrated Financial Corporation is a Pennsylvania corporation that provided investment advisory services to the general public and is currently inactive. Integrated Abstract Incorporated is a Pennsylvania corporation that provided title insurance services and is currently inactive. All significant intercompany accounts and transactions have been eliminated in consolidation.

The unaudited consolidated financial statements reflect all adjustments, which in the opinion of management, are necessary for a fair presentation of the results of the interim periods and are of a normal and recurring nature. Operating results for the three month period ended December 31, 2018 are not necessarily indicative of the results that may be expected for the year ending September 30, 2019.

2. Earnings per Share

The following table sets forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation for the three month period ended June 30, 2018 and 2017.

	Three Months Ended	
	December 31, 2018	December 31, 2017
Weighted-average common shares outstanding	18,133,095	18,133,095
Average treasury stock shares	(6,316,361)	(6,521,843)
Average unearned ESOP shares	(809,051)	(854,325)

Average unearned non-vested shares	(56,327)	(39,789)
Weighted average common shares and common stock equivalents used to calculate basic earnings per share	10,951,356	10,717,138
Additional common stock equivalents (non-vested stock) used to calculate diluted earnings per share	—	—
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	—	—
Weighted average common shares and common stock equivalents used to calculate diluted earnings per share	10,951,356	10,717,138

At December 31, 2018 there were 52,272 shares of nonvested stock outstanding at an average weighted price of $15.95 per share that were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive. At December 31, 2017 there were 41,062 shares of nonvested stock outstanding at an average weighted price of $15.98 per share that were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive.

3. Use of Estimates in the Preparation of Financial Statements

The accounting principles followed by the Company and its subsidiaries and the methods of applying these principles conform to U.S. generally accepted accounting principles (“GAAP”) and to general practice within the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the Consolidated Balance Sheet date and related revenues and expenses for the period. Actual results could differ from those estimates.

4. Accounting Pronouncements

Adoption of New Standards

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from contracts with customers.” The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In addition, this update specifies the accounting for certain costs to obtain or fulfill a contract with a customer and expands disclosure requirements for revenue recognition. This update is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The Company adopted this standard on October 1, 2018. The required disclosures under the new standard are presented in Note 14.

In January 2016, the FASB issued ASU No. 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities.” This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to GAAP as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (4) eliminate the requirement for public business entities to disclose the method (s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (5) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (6) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (7) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (8) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets. The adoption of ASU No. 2016-01 on October 1, 2018 resulted in a cumulative effect adjustment from accumulated other comprehensive loss to retained earnings of $4,000. In accordance with (5) above, the Company measured the fair value of its loan portfolio as of December 31, 2018 using an exit price notion (see Note 10 Fair Value). In accordance with (1) above the Company measured its equity securities at fair value and recognized changes in fair value in net income (see Note 5 Investment Securities).

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The standard requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. A short-term lease is defined as one in which (a) the lease term is 12 months or less and (b) there is not an option to purchase the underlying asset that the lessee is reasonably certain to exercise. For short-term leases, lessees may elect to recognize lease payments over the lease term on a straight-line basis. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within those years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020. The amendments should be applied at the beginning of the earliest period presented using a modified retrospective approach with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently assessing the practical expedients it may elect at adoption, but does not anticipate the amendments will have a significant impact on the financial statements. Based on the Company’s preliminary analysis of its current portfolio, the impact to the Company’s balance sheet is estimated to result in less than a 1 percent increase in assets and liabilities. The Company also anticipates additional disclosures to be provided at adoption.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments, which changes the impairment model for most financial assets. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the Update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management's current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be affected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019, and early adoption is permitted for annual and interim periods beginning after December 15, 2018. With certain exceptions, transition to the new requirements will be through a cumulative effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the guidance is adopted. We expect to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, but cannot yet determine the magnitude of any such one-time adjustment or the overall impact of the new guidance on the consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment. To simplify the subsequent measurement of goodwill, the FASB eliminated Step 2 from the goodwill impairment test. In computing the implied fair value of goodwill under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in this Update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting units fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. A public business entity that is a U.S. Securities and Exchange Commission (SEC) filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. A public business entity that is not an SEC filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2020. All other entities, including not-for-profit entities, that are adopting the amendments in this Update should do so for their annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2021 The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In March 2017, the FASB issued ASU 2017-08, Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20). The amendments in this Update shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity should apply the amendments in this Update on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Additionally, in the period of

adoption, an entity should provide disclosures about a change in accounting principle. This Update is not expected to have a significant impact on the Company's financial statements.

In July 2017, the FASB issued ASU 2017-11, Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), and Derivative and Hedging (Topic 815). The amendments in Part I of this Update change the classification analysis of certain equity-linked financial instruments (or embedded features) with down-round features. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down-round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. The amendments also clarify existing disclosure requirements for equity-classified instruments. As a result, a freestanding equity-linked financial instrument (or embedded conversion option) no longer would be accounted for as a derivative liability at fair value as a result of the existence of a down-round feature. For freestanding equity classified financial instruments, the amendments require entities that present earnings per share (EPS) in accordance with Topic 260 to recognize the effect of the down-round feature when it is triggered. That effect is treated as a dividend and as a reduction of income available to common shareholders in basic EPS. Convertible instruments with embedded conversion options that have down- round features are now subject to the specialized guidance for contingent beneficial conversion features (in Subtopic 470-20, Debt—Debt with Conversion and Other Options), including related EPS guidance (in Topic 260). The amendments in Part II of this Update recharacterize the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Accounting Standards Codification, to a scope exception. Those amendments do not have an accounting effect. For public business entities, the amendments in Part I of this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments in Part I of this Update are effective for fiscal years

beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted for all entities, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments in Part I of this Update should be applied either retrospectively to outstanding financial instruments with a down-round feature by means of a cumulative-effect adjustment to the statement of financial position as of the beginning of the first fiscal year and interim period(s) in which the pending content that links to this paragraph is effective or retrospectively to outstanding financial instruments with a down-round feature for each prior reporting period presented in accordance with the guidance on accounting changes in paragraphs 250-10-45-5 through 45-10. The amendments in Part II of this Update do not require any transition guidance because those amendments do not have an accounting effect. This Update is not expected to have a significant impact on the Company's financial statements.

In January 2018, the FASB issued ASU 2018-01, Leases (Topic 842), which provides an optional transition practical expedient to not evaluate under Topic 842 existing or expired land easements that were not previously accounted for as leases under the current lease guidance in Topic 840. An entity that elects this practical expedient should evaluate new or modified land easements under Topic 842 beginning at the date the entity adopts Topic 842; otherwise, an entity should evaluate all existing or expired land easements in connection with the adoption of the new lease requirements in Topic 842 to assess whether they meet the definition of a lease. The effective date and transition requirements for the amendments are the same as the effective date and transition requirements in ASU 2016-02. This Update is not expected to have a significant impact on the Company's financial statements.

In June 2018, the FASB issued ASU 2018-07, Compensation – Stock Compensation (Topic 718), which simplified the accounting for nonemployee share-based payment transactions. The amendments in this update expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. The amendments in this Update improve the following areas of nonemployee share-based payment accounting: (a) the overall measurement objective, (b) the measurement date, (c) awards with performance conditions, (d) classification reassessment of certain equity-classified awards, (e) calculated value (nonpublic entities only), and (f) intrinsic value (nonpublic entities only). The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. This Update is not expected to have a significant impact on the Company's financial statements.

In July 2018, the FASB issued ASU 2018-09, Codification Improvements, represents changes to clarify, correct errors in, or make minor improvements to the Codification. The amendments make the Codification easier to understand and easier to apply by eliminating inconsistencies and providing clarifications. The transition and effective date guidance is based on the facts and circumstances of each amendment. Some of the amendments do not require transition guidance and will be effective upon issuance of this ASU. However, many of the amendments in this ASU do have transition guidance and effective dates for annual periods beginning after December 15, 2018, for public business entities. This update is not expected to have a significant impact on the Company's financial statements.

In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases, represents changes to clarify, correct errors in, or make minor improvements to the Codification. The amendments in this ASU affect the amendments in ASU 2016-02, which are not yet effective, but for which early adoption upon issuance is permitted. For entities that early adopted Topic 842, the amendments are effective upon issuance of this ASU, and the transition requirements are the same as those in Topic 842. For entities that have not adopted Topic 842, the effective date and transition requirements will be the same as the effective date and transition requirements in Topic 842. This Update is not expected to have a significant impact on the Company’s financial statements.

In July 2018, the FASB issued ASU 2018-11, Leases (Topic 842): Targeted Improvements. This Update provides another transition method which allows entities to initially apply ASC 842 at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Entities that elect this approach should report comparative periods in accordance with ASC 840, Leases. In addition, this Update provides a practical expedient under which lessors may elect, by class of underlying assets, to not separate nonlease components from the associated lease component, similar to the expedient provided for lessees. However, the lessor practical expedient is limited to circumstances in which the nonlease component or components otherwise would be accounted for under the new revenue guidance and both (a) the timing and pattern of transfer are the same for the nonlease component(s) and associated lease component and (b) the lease component, if accounted for separately, would be classified as an operating lease. If the nonlease component or components associated with the lease component are the predominant component of the combined component, an entity should account for the combined component in accordance with ASC 606, Revenue from Contracts with Customers. Otherwise, the entity should account for the combined component as an operating lease in accordance with ASC 842. If a lessor elects the practical expedient, certain disclosures are required. This Update is effective for public business entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. This Update is not expected to have a significant impact on the Company’s financial statements.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes the Disclosure Requirements for Fair Value Measurements. The Update removes the requirement to disclose the amount of and reasons for transfers between Level I and Level II of the fair value hierarchy; the policy for timing of transfers between levels; and the valuation processes for Level III fair value measurements. The Update requires disclosure of changes in unrealized gains and losses for the period included in other comprehensive income (loss) for recurring Level III fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level III fair value measurements. This Update is effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. This Update is not expected to have a significant impact on the Company's financial statements.

In August 2018, the FASB issued ASU 2018-14, Compensation – Retirement Benefits (Topic 715-20). This Update amends ASC 715 to add, remove and clarify disclosure requirements related to defined benefit pension and other postretirement plans. The Update eliminates the requirement to disclose the amounts in accumulated other comprehensive income expected to be recognized as part of net periodic benefit cost over the next year. The Update also removes the disclosure requirements for the effects of a one-percentage-point change on the assumed health care costs and the effect of this change in rates on service cost, interest cost and the benefit obligation for postretirement health care benefits. This Update is effective for public business entities for fiscal years ending after December 15, 2020, and must be applied on a retrospective basis. For all other entities, this Update is effective for fiscal years ending after December 15, 2021. This Update is not expected to have a significant impact on the Company's financial statements.

In October 2018, the FASB issued ASU 2018-16, Derivatives and Hedging (Topic 815). The amendments in this Update permit use of the Overnight Index Swap (OIS) rate based on the Secured Overnight Financing Rate (SOFR) as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to the interest rates on direct Treasury obligations of the U.S. government, the London Interbank Offered Rate (LIBOR) swap rate, the OIS rate based on the Fed Funds Effective Rate, and the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate. For entities that have not already adopted Update 2017-12, the amendments in this Update are required to be adopted concurrently with the amendments in Update 2017-12. For public business entities that already have adopted the amendments in Update 2017-12, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. For all other entities that already have adopted the amendments in Update 2017-12, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted in any interim period upon issuance of this Update if an entity already has adopted Update 2017-12. This Update is not expected to have a significant impact on the Company's financial statements.

In November 2018, the FASB issued ASU 2018-19, Codification Improvements to Topic 326, Financial Instruments - Credit Losses, which amended the effective date of ASU 2016-13 for entities other than public business entities (PBEs), by requiring non-PBEs to adopt the standard for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. Therefore, the revised effective dates of ASU 2016-13 for PBEs that are SEC filers will be fiscal years beginning after December 15, 2019, including interim periods within those years, PBEs other than SEC filers will be for fiscal years beginning after December 15, 2020, including interim periods within those years, and all other entities (non-PBEs) will be for fiscal years beginning after December 15, 2021, including interim periods within those years. The ASU also clarifies that receivables arising from operating leases are not within the

scope of Subtopic 326-20. Rather, impairment of receivables arising from operating leases should be accounted for in accordance with Topic 842, Leases. The effective date and transition requirements for ASU 2018-19 are the same as those in ASU 2016-13, as amended by ASU 2018-19. This Update is not expected to have a significant impact on the Company's financial statements.

In December 2018, the FASB issued ASU 2018-20, Leases (Topic 842), which addressed implementation questions arising from stakeholders in regard to ASU 2016-02, Leases. Specifically addressed in this Update were issues related to 1) sales taxes and other similar taxes collected from lessees, 2) certain lessor costs, and 3) recognition of variable payments for contracts with lease and nonlease components. The amendments in this Update affect the amendments in Update 2016-02, which are not yet effective but can be early adopted. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements in Update 2016-02 (for example, January 1, 2019, for calendar-year-end public business entities). This Update is not expected to have a significant impact on the Company's financial statements.

5. Investment Securities

The amortized cost, gross unrealized gains and losses, and fair value of investment securities available for sale are summarized as follows (in thousands):

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for Sale				
Fannie Mae	$157,353	$ 238	$ (3,764)	$153,827
Freddie Mac	96,057	42	(2,737)	93,362
Governmental National Mortgage Association Securities	21,397	5	(598)	20,804
Total mortgage-backed securities	274,807	285	(7,099)	267,993
Obligations of states and political subdivisions	33,599	207	(882)	32,924
U.S. government agency securities	9,813	18	(42)	9,789
Corporate obligations	47,987	154	(1,297)	46,844
Other debt securities	19,186	22	(704)	18,504
Total debt securities	$385,392	$ 686	$ (10,024)	$376,054

	September 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for Sale				
Fannie Mae	$147,433	$ 17	$ (5,827)	$141,623
Freddie Mac	99,587	2	(4,415)	95,174
Governmental National Mortgage Association	22,164	—	(838)	21,326
Total mortgage-backed securities	269,184	19	(11,080)	258,123
Obligations of states and political subdivisions	42,090	251	(1,392)	40,949
U.S. government agency securities	5,678	2	(122)	5,558
Corporate obligations	48,559	116	(1,260)	47,415
Other debt securities	20,295	—	(922)	19,373
Total debt securities	385,806	388	(14,776)	371,418
Equity securities - financial services (a)	25	—	(5)	20
Total	$385,831	$ 388	$ (14,781)	$371,438

(a) As of October 1, 2018, the Company adopted ASU 2016-01 resulting in reclassification of equity securities from available for-sale investment securities to other assets. At September 30, 2018, the Company's investment in equity securities was comprised of common stock issued by an unrelated bank holding company.

At December 31, 2018 and September 30, 2018, the Company had $18,000 and $20,000 respectively, in equity securities recorded at fair value. Prior to October 1, 2018, equity securities were stated at fair value with unrealized

gains and losses reported as a separate component of AOCI, net of tax. At September 30, 2018, net unrealized loss net of tax of $4,000 had been recognized in AOCI. On October 1, 2018, these unrealized gains and losses were reclassified out of AOCI and into retained earnings with subsequent changes in fair value being recognized in net income. The following is a summary of unrealized and realized gains and losses recognized in net income on equity securities during the three months ended December 31, 2018:

(Dollars in thousands)	Three months ended December 31, 2018
Net gains and (losses) recognized during the period on equity securities	$ (2)
Less: Net gains and (losses) recognized during the period on equity securities sold during the period	-
Unrealized gains and (losses) recognized during the reporting period on equity securities still held at the reporting date	$ (2)

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The amortized cost and fair value of debt securities at December 31, 2018, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

	Available For Sale	
	Amortized Cost	Fair Value
Due in one year or less	$1	$1
Due after one year through five years	34,074	33,768
Due after five years through ten years	100,036	97,464
Due after ten years	251,281	244,821
Total	$385,392	$376,054

For the three months ended December 31, 2018, the Company realized gross gains of $43,000 and gross losses of $39,000 on proceeds from the sale of investment securities of $9.9 million. For the three months ended December 31, 2017, the Company realized no gross gains or gross losses on proceeds from the sale of investment securities.

The following tables show the Company's gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position (dollars in thousands):

	December 31, 2018						
	Number of Securities	Less than Twelve Months		Twelve Months or Greater		Total	
		Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Fannie Mae	92	$25,419	$ (163)	$94,531	$ (3,601)	$119,950	$ (3,764)
Freddie Mac	69	246	—	83,010	(2,737)	83,256	(2,737)
Governmental National Mortgage Association	16	5,474	(51)	12,295	(547)	17,769	(598)
Obligations of states and political subdivisions	22	995	(5)	24,867	(877)	25,862	(882)
U.S. government agency securities	1	—	—	1,918	(42)	1,918	(42)
Corporate obligations	38	14,315	(247)	22,978	(1,050)	37,293	(1,297)
Other debt securities	18	—	—	16,142	(704)	16,142	(704)
Total	256	$46,449	$ (466)	$255,741	$ (9,558)	$302,190	$ (10,024)

	September 30, 2018						
	Number of Securities	Less than Twelve Months		Twelve Months or Greater		Total	
		Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Fannie Mae	100	$63,997	$ (1,442)	$74,783	$ (4,385)	$138,780	$ (5,827)
Freddie Mac	74	28,902	(830)	65,812	(3,585)	94,714	(4,415)
Governmental National Mortgage Association	19	9,776	(142)	11,550	(696)	21,326	(838)
Obligations of states and political subdivisions	25	7,651	(105)	21,004	(1,287)	28,655	(1,392)
U.S. government agency securities	3	5,177	(122)	—	—	5,177	(122)
Corporate obligations	34	20,172	(363)	13,206	(897)	33,378	(1,260)
Other debt securities	20	2,399	(38)	16,974	(884)	19,373	(922)
Equity Securities (a)	1	20	(5)	—	0	20	(5)
Total	276	$138,094	$ (3,047)	$203,329	$ (11,734)	$341,423	$ (14,781)

(a) As of October 1, 2018, the Company adopted ASU 2016-01 resulting in reclassification of equity securities from available for-sale investment securities to other assets. As September 30, 2018, the Company's investment in equity securities was comprised of common stock issued by an unrelated bank holding company.

The Company’s investment securities portfolio contains unrealized losses on securities, including mortgage-related instruments issued or backed by the full faith and credit of the United States government, or generally viewed as having the implied guarantee of the U.S. government, other mortgage backed securities, debt obligations of a U.S. state or political subdivision, U.S. government agency securities, corporate obligations, other debt securities and equity securities.

The Company reviews its position quarterly and has asserted that at December 31, 2018, the declines outlined in the above table represent temporary declines and the Company would not be required to sell the above securities before their anticipated recovery in market value.

The Company has concluded that any impairment of its investment securities portfolio is not other than temporary but is the result of interest rate changes that are not expected to result in the non-collection of principal and interest during the period.

6. Loans Receivable, Net and Allowance for Loan Losses

Loans receivable consist of the following (in thousands):

	December 31, 2018	September 30, 2018
Real estate loans:		
Residential	$600,564	$580,561
Construction	4,755	3,920
Commercial	434,427	416,573
Commercial	57,381	49,479
Obligations of states and political subdivisions	75,041	73,362
Home equity loans and lines of credit	43,271	43,962
Auto Loans	128,216	146,220
Other	2,870	2,682
	1,346,525	1,316,759
Less allowance for loan losses	12,221	11,688
Net loans	$1,334,304	$1,305,071

Purchased loans acquired in a business combination are recorded at fair value on their purchase date without a carryover of the related allowance for loan losses.

The following table presents additional information regarding loans acquired and accounted for in accordance with ASC 310-30 (in thousands):

	December 31, 2018 Acquired Loans with Specific	September 30, 2018 Acquired Loans with Specific

	Evidence or Deterioration in Credit Quality (ASC 310-30)	Evidence or Deterioration in Credit Quality (ASC 310-30)
Outstanding balance	$ 1,653	$ 2,497
Carrying amount	$ 1,526	$ 1,802

The following tables show the amount of loans in each category that were individually and collectively evaluated for impairment at the dates indicated (in thousands):

	Total Loans	Individually Evaluated for Impairment	Loans Acquired with Deteriorated Credit Quality	Collectively Evaluated for Impairment
December 31, 2018				
Real estate loans:				
Residential	$ 600,564	$ 4,961	$ —	$ 595,603
Construction	4,755	—	—	4,755
Commercial	434,427	2,110	1,526	430,791
Commercial	57,381	82	—	57,299
Obligations of states and political subdivisions	75,041	—	—	75,041
Home equity loans and lines of credit	43,271	268	—	43,003
Auto loans	128,216	458	—	127,758
Other	2,870	17	—	2,853
Total	$ 1,346,525	$ 7,896	$ 1,526	$ 1,337,103

	Total Loans	Individually Evaluated for Impairment	Loans Acquired with Deteriorated Credit Quality	Collectively Evaluated for Impairment
September 30, 2018				
Real estate loans:				
Residential	$ 580,561	$ 5,317	$ —	$ 575,244
Construction	3,920	—	—	3,920
Commercial	416,573	5,892	1,801	408,880
Commercial	49,479	85	1	49,393
Obligations of states and political sub divisions	73,362	—	—	73,362
Home equity loans and lines of credit	43,962	114	—	43,848
Auto loans	146,220	445	—	145,775
Other	2,682	17	—	2,665
Total	$ 1,316,759	$ 11,870	$ 1,802	$ 1,303,087

The Company maintains a loan review system that allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified losses based on a review of such information. A loan evaluated for impairment is considered to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. The Company does not aggregate such loans for evaluation purposes. Impairment is measured on a loan-by-loan basis for commercial and construction loans by the present value of

expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral-dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential mortgage loans for impairment disclosures, unless such loans are part of a larger relationship that is impaired, or are classified as a troubled debt restructuring.

A loan is considered to be a troubled debt restructuring ("TDR") loan when the Company grants a concession to the borrower that it would not otherwise consider because of the borrower's financial condition. Such concessions include the reduction of interest rates, forgiveness of principal or interest, or other modifications of interest rates that are less than the current market rate for new obligations with similar risk. TDR loans that are in compliance with their modified terms and that yield a market rate at the time of modification may be removed from TDR status after one year of performance.

The following tables include the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount at the dates indicated, if applicable (in thousands):

	Recorded Investment	Unpaid Principal Balance	Associated Allowance
December 31, 2018			
With no specific allowance recorded:			
Real estate loans			
Residential	$ 3,732	$ 5,305	$ —
Construction	—	—	—
Commercial	2,110	2,824	—
Commercial	82	348	—
Obligations of states and political subdivisions	—	—	—
Home equity loans and lines of credit	227	247	—
Auto loans	97	225	—
Other	17	24	—
Total	6,265	8,973	—
With an allowance recorded:			
Real estate loans			
Residential	1,229	1,467	154
Construction	—	—	—
Commercial	—	—	—
Commercial	—	—	—
Obligations of states and political subdivisions	—	—	—
Home equity loans and lines of credit	41	49	8
Auto loans	361	372	164
Other	—	—	—
Total	1,631	1,888	326
Total:			
Real estate loans			
Residential	4,961	6,772	154
Construction	—	—	—
Commercial	2,110	2,824	—
Commercial	82	348	—
Obligations of states and political subdivisions	—	—	—
Home equity loans and lines of credit	268	296	8
Auto loans	458	597	164
Other	17	24	—
Total Impaired Loans	$ 7,896	$ 10,861	$ 326

	Recorded Investment	Unpaid Principal Balance	Associated Allowance
September 30, 2018			
With no specific allowance recorded:			
Real Estate Loans			
Residential	$ 4,449	$ 6,176	$ —
Construction	—	—	—
Commercial	5,892	6,790	—
Commercial	85	349	—
Obligations of states and political subdivisions	—	—	—
Home equity loans and lines of credit	114	138	—
Auto Loans	87	223	—
Other	17	25	—
Total	10,644	13,701	—
With an allowance recorded:			
Real Estate Loans			
Residential	868	938	149
Construction	—	—	—
Commercial	—	—	—
Commercial	—	—	—
Obligations of states and political subdivisions	—	—	—
Home equity loans and lines of credit	—	—	—
Auto Loans	358	375	164
Other	—	—	—
Total	1,226	1,313	313
Total:			
Real Estate Loans			
Residential	5,317	7,114	149
Construction	—	—	—
Commercial	5,892	6,790	—
Commercial	85	349	—
Obligations of states and political subdivisions	—	—	—
Home equity loans and lines of credit	114	138	—
Auto Loans	445	598	164
Other	17	25	—
Total Impaired Loans	$ 11,870	$ 15,014	$ 313

The following tables represent the average recorded investments in the impaired loans and the related amount of interest recognized during the time within the period that the impaired loans were impaired (in thousands):

	For the Three Months Ended December 31,			
	2018 Average Recorded Investment	2017 Average Recorded Investment	2018 Interest Income Recognized	2017 Interest Income Recognized
With no specific allowance recorded:				
Real estate loans				
Residential	$4,167	$ 4,429	$ 3	$ 10
Construction	—	—	—	—
Commercial	4,484	7,006	45	72
Commercial	84	1,289	—	27
Obligations of states and political subdivisions	—	—	—	—
Home equity loans and lines of credit	151	206	—	—
Auto loans	87	137	1	1
Other	17	10	—	—
Total	8,990	13,077	49	110
With an allowance recorded:				
Real estate loans				
Residential	815	1,527	—	—
Construction	—	—	—	—
Commercial	—	20	—	—
Commercial	—	—	—	—
Obligations of states and political subdivisions	—	—	—	—
Home equity loans and lines of credit	13	2	—	—
Auto loans	204	262	—	—
Other	—	—	—	—
Total	1,032	1,811	—	—
Total:				
Real estate loans				
Residential	4,982	5,956	3	10
Construction	—	—	—	—
Commercial	4,484	7,026	45	72
Commercial	84	1,289	—	27
Obligations of states and political subdivisions	—	—	—	—
Home equity loans and lines of credit	164	208	—	—
Auto loans	291	399	1	1
Other	17	10	—	—
Total Impaired Loans	$10,022	$ 14,888	$ 49	$ 110

The Company uses a ten-point internal risk-rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized and are aggregated as Pass-rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are fundamentally sound yet exhibit potentially unacceptable credit risk or deteriorating trends or characteristics which, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Company’s credit position at some future date. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans that are 90 or more days past due are considered Substandard. Loans in the Doubtful category have all the weaknesses inherent in loans classified as Substandard with the added characteristic that their weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Loans in the Loss category are considered uncollectible and of little value that their continuance as bankable assets is not warranted. Certain residential real estate loans, construction loans, home equity loans and lines of credit, auto loans and other consumer loans are underwritten and structured using standardized criteria and characteristics, primarily payment performance, and are normally risk rated and monitored collectively on a monthly basis. These are typically loans to individuals in the consumer categories and are delineated as either performing or non-performing.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. The Bank's Commercial Loan Officers are responsible for the timely and accurate risk rating recommendation for the loans in their portfolios at origination and on an ongoing basis. The Bank's Commercial Loan Officers perform an annual review of all commercial relationships $750,000 or greater. Confirmation of the appropriate risk grade is included in the review on an ongoing basis. The Bank engages an external consultant to conduct loan reviews on at least a semi-annual basis. Generally, the external consultant reviews commercial relationships greater than $1,000,000 and/or all criticized relationships. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The following tables present the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard, and Doubtful or Loss within the internal risk rating system at December 31, 2018 and September 30, 2018 (in thousands):

	Pass	Special Mention	Substandard	Doubtful or Loss	Total
December 31, 2018					
Commercial real estate loans	$414,214	$ 9,408	$ 10,805	$ —	$434,427
Commercial	56,347	6	1,028	—	57,381
Obligations of states and political subdivisions	75,041	—	—	—	75,041
Total	$545,602	$ 9,414	$ 11,833	$ —	$566,849

	Pass	Special Mention	Substandard	Doubtful or Loss	Total
September 30, 2018					
Commercial real estate loans	$392,915	$ 8,960	$ 14,698	$ —	$416,573
Commercial	48,137	8	1,334	—	49,479
Obligations of states and political subdivisions	73,362	—	—	—	73,362
Total	$514,414	$ 8,968	$ 16,032	$ —	$539,414

All other loans are underwritten and structured using standardized criteria and characteristics, primarily payment performance, and are normally risk rated and monitored collectively on a monthly basis. These are typically loans to individuals in the consumer categories and are delineated as either performing or non-performing. The following tables present the risk ratings in the consumer categories of performing and non-performing loans at December 31, 2018 and September 30, 2018 (in thousands):

Performing	Non-	Purchased	Total

		performing	Credit Impaired	
December 31, 2018				
Real estate loans:				
Residential	$ 594,896	$ 5,668	$ —	$ 600,564
Construction	4,755	—	—	4,755
Home equity loans and lines of credit	42,733	538	—	43,271
Auto loans	127,632	584	—	128,216
Other	2,853	17	—	2,870
Total	$ 772,869	$ 6,807	$ —	$ 779,676

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	Performing	Non-performing	Purchased Impaired Credit	Total
September 30, 2018				
Real estate loans:				
Residential	$ 575,244	$ 5,317	$ —	$ 580,561
Construction	3,920	—	—	3,920
Home equity loans and lines of credit	43,746	216	—	43,962
Auto loans	145,633	587	—	146,220
Other	2,664	18	—	2,682
Total	$ 771,207	$ 6,138	$ —	$ 777,345

The Company further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of December 31, 2018 and September 30, 2018 (in thousands):

							Purchased Credit Impaired		
	Current	31-60 Days Past Due	61-89 Days Past Due	90 + Days Past Due and Accruing	Non–accrual	Total Past Due	Accruing	Non–accrual	Total Loans
December 31, 2018									
Real estate loans:									
Residential	$ 592,486	$ 1,485	$ 925	$ —	$ 5,668	$ 8,078	$ —	$ —	$ 600,564
Construction	4,755	—	—	—	—	—	—	—	4,755
Commercial	431,140	—	—	—	1,977	1,977	253	1,057	434,427
Commercial	56,504	13	16	—	632	661	—	216	57,381
Obligations of states and political subdivisions	75,041	—	—	—	—	—	—	—	75,041
Home equity loans and lines of credit	42,621	65	47	—	538	650	—	—	43,271
Auto loans	125,573	1,981	78	—	584	2,643	—	—	128,216
Other	2,812	30	11	—	17	58	—	—	2,870
Total	$ 1,330,932	$ 3,574	$ 1,077	$ —	$ 9,416	$ 14,067	$ 253	$ 1,273	$ 1,346,525

	Current	31-60 Days Past Due	61-89 Days Past Due	90 + Days Past Due and Accruing	Non–accrual	Total Past Due	Purchased Credit Impaired Accruing	Purchased Credit Impaired Non–accrual	Total Loans
September 30, 2018									
Real estate loans:									
Residential	$572,236	$2,088	$ 920	$ —	$ 5,317	$8,325	$—	$ —	$580,561
Construction	3,920	—	—	—	—	—	—	—	3,920
Commercial	412,636	185	—	—	1,951	2,136	255	1,546	416,573
Commercial	48,567	25	11	—	875	911	—	1	49,479
Obligations of states and political subdivisions	73,362	—	—	—	—	—	—	—	73,362
Home equity loans and lines of credit	43,716	30	—	—	216	246	—	—	43,962
Auto loans	144,140	1,473	20	—	587	2,080	—	—	146,220
Other	2,647	17	—	—	18	35	—	—	2,682
Total	$1,301,224	$3,818	$ 951	$ —	$ 8,964	$13,733	$255	$ 1,547	$1,316,759

The allowance for loan losses is maintained at a level necessary to absorb loan losses that are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses inherent in its loan portfolio and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. The allowance for loan losses consists of two elements: (1) an allocated allowance, which comprises allowances established on specific loans and class allowances based on historical loss experience and current trends, and (2) an allocated allowance based on general economic conditions and other risk factors in our markets and portfolios. We maintain a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions, management’s judgment and losses which are probable and reasonably estimable. The allowance is increased through provisions charged against current earnings and recoveries of previously charged-off loans. Loans that are determined to be uncollectible are charged against the allowance. While management uses available information to recognize probable and reasonably estimable loan

losses, future loss provisions may be necessary, based on changing economic conditions. Payments received on impaired loans generally are either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. The allowance for loan losses as of December 31, 2018 was maintained at a level that represents management's best estimate of losses inherent in the loan portfolio, and such losses were both probable and reasonably estimable.

In addition, the FDIC and the Pennsylvania Department of Banking and Securities, as an integral part of their examination process, have periodically reviewed our allowance for loan losses. The banking regulators may require that we recognize additions to the allowance based on its analysis and review of information available to it at the time of its examination.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the allowance for loan losses ("ALL"). When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL.

The following table summarizes changes in the primary segments of the ALL for the three months period ended December 31, 2018 and 2017 (in thousands):

	Real Estate Loans			Commercial	Obligations of States and Political	Home Equity Loans and Lines of		Other		
	Residential	Construction	Commercial	Loans	Subdivisions	Credit	Auto Loans	Loans	Unallocated	Total
ALL balance at September 30, 2018	$3,605	$ 35	$ 3,458	$ 1,462	$ 323	$ 296	$ 1,859	$ 23	$ 627	$11,688
Charge-offs	(142)	—	—	(22)	—	—	(368)	—	—	(532)
Recoveries	6	—	—	—	—	1	181	1	—	189
Provision	276	8	38	264	(28)	1	22	2	293	876
ALL balance at December 31, 2018	$3,745	$ 43	$ 3,496	$ 1,704	$ 295	$ 298	$ 1,694	$ 26	$ 920	$12,221
ALL balance at September 30, 2017	$3,878	$ 23	$ 1,758	$ 987	$ 248	$ 470	$ 1,836	$ 21	$ 144	$9,365
Charge-offs	(43)	—	(1)	(133)	—	-	(536)	(6)	—	(719)
Recoveries	3	—	2	10	—	1	170	1	—	187
Provision	(69)	10	560	190	(35)	(22)	492	5	(131)	1,000
ALL balance at December 31, 2017	$3,769	$ 33	$ 2,319	$ 1,054	$ 213	$ 449	$ 1,962	$ 21	$ 13	$9,833

Acquired loans are recorded at fair value on their purchase date without a carryover of the related allowance for loan losses.

During the three months ended December 31, 2018 the Company recorded provision expense for the residential real estate, construction loans, commercial real estate, commercial, home equity loans and lines of credit, auto and other loan segments, due to either increased loan balances, changes in the loan mix within the pool, and/or charge-off activity in those segments. Credit provisions were recorded for loan loss for the obligations of states and political subdivisions segment.

During the three months ended December 31, 2017 the Company recorded provision expense for the construction loans, commercial real estate, commercial, auto and other loan segments, due to either increased loan balances, changes in the loan mix within the pool, and/or charge-off activity in those segments. Credit provisions were recorded for loan loss for the residential real estate, obligations of states and political subdivisions and home equity loans and lines of credit segments.

The following table summarizes the primary segments of the ALL, segregated into two categories, the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of December 31, 2018 and September 30, 2018 (in thousands):

	Real Estate Loans			Commercial	Obligations of States and Political	Home Equity Loans and Lines of		Other		
	Residential	Construction	Commercial	Loans	Subdivisions	Credit	Auto Loans	Loans	Unallocated	Total
Individually evaluated for impairment	$154	$ —	$ —	$ —	$ —	$ 8	$ 164	$ —	$ —	$326
Collectively evaluated for impairment	3,591	43	3,496	1,704	295	290	1,530	26	920	11,895
ALL balance at December 31, 2018	$3,745	$ 43	$ 3,496	$ 1,704	$ 295	$ 298	$ 1,694	$ 26	$ 920	$12,221
Individually evaluated for impairment	$149	$ —	$ —	$ —	$ —	$ —	$ 164	$ —	$ —	$313
Collectively evaluated for impairment	3,456	35	3,458	1,462	323	296	1,695	23	627	11,375
ALL balance at September 30, 2018	$3,605	$ 35	$ 3,458	$ 1,462	$ 323	$ 296	$ 1,859	$ 23	$ 627	$11,688

The allowance for loan losses is based on estimates, and actual losses will vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date. Despite the above allocations, the allowance for loan losses is general in nature and is available to absorb losses from any loan segment.

The following is a summary of troubled debt restructuring granted during the three months ended December 31, 2018 and 2017 (dollars in thousands):

	For the Three Months Ended December 31, 2018		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Real estate loans:			
Residential	2	$ 95	$ 95
Construction	—	—	—
Commercial	—	—	—
Commercial	—	—	—
Obligations of states and political subdivisions	—	—	—
Home equity loans and lines of credit	2	159	159
Auto loans	1	21	21
Other	—	—	—
Total	5	$ 275	$ 275

	For the Three Months Ended December 31, 2017		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Real estate loans:			
Residential	2	$ 243	$ 240
Construction	—	—	—
Commercial	—	—	—
Commercial	—	—	—
Obligations of states and political subdivisions	—	—	—
Home equity loans and lines of credit	—	—	—
Auto loans	—	—	—
Other	—	—	—
Total	2	$ 243	$ 240

Of the five new troubled debt restructurings granted for the three months ended December 31, 2018, one loan totaling $14,000 was granted terms concessions, one loan totaling $81,000 was granted an interest rate concession, and three loans totaling $180,000 were granted term and rate concessions.

The two new troubled debt restructurings granted for the three months ended December 31, 2017, totaled $240,000 and were granted interest rate and principal concessions.

For the three months ended December 31, 2018, no loans defaulted on a restructuring agreement within one year of modification.

For the three months ended December 31, 2017, two loans totaling $95,000 defaulted on a restructuring agreement within one year of modification.

Foreclosed assets acquired in settlement of loans are carried at fair value, less estimated costs to sell, and are included in the Consolidated Balance Sheet. As of December 31, 2018, included within the foreclosed assets is $795,000 of consumer residential mortgages that were foreclosed on or received via a deed in lieu of foreclosure transaction prior to the period end. As of December 31, 2018, the Company has initiated formal foreclosure proceedings on $2.5 million of consumer residential mortgages which have not yet been transferred into foreclosed assets.

7. Deposits

Deposits consist of the following major classifications (in thousands):

	December 31, 2018	September 30, 2018
Non-interest bearing demand accounts	$162,129	$158,340
Interest bearing demand accounts	198,320	221,327
Money market accounts	317,828	296,078
Savings and club accounts	135,837	135,862
Certificates of deposit	493,803	525,248
Total	$1,307,917	$1,336,855

8. Net Periodic Benefit Cost-Defined Benefit Plan

For a detailed disclosure on the Bank’s pension and employee benefits plans, please refer to Note 12 of the Company’s Consolidated Financial Statements for the year ended September 30, 2018 included in the Company’s Annual Report on Form 10-K.

The following table comprises the components of net periodic benefit cost for the three month period ended December 31, 2018 and 2017 (in thousands):

	For the Three Months Ended December 31,	
	2018	2017
Service Cost	$—	$—
Interest Cost	174	174
Expected return on plan assets	(293)	(298)
Amortization of unrecognized loss	—	—
Net periodic benefit cost	$(119)	$(124)

The Company's board of directors adopted resolutions to freeze the status of the Defined Benefit Plan ("the plan") effective February 28, 2017 ("the freeze date"). Accordingly, no additional participants will enter the plan after February 28, 2017; no additional years of service for benefit accrual purposes will be credited after the freeze date under the plan; and compensation earned by participants after the freeze date will not be taken into account under the plan.

9. Equity Incentive Plan

The Company previously maintained the ESSA Bancorp, Inc. 2007 Equity Incentive Plan (the "Plan"). The Plan provided for a total of 2,377,326 shares of common stock for issuance upon the grant or exercise of awards. Of the shares that were available under the Plan, 1,698,090 were available to be issued in connection with the exercise of stock options and 679,236 were available to be issued as restricted stock. The Plan allowed for the granting of non-qualified stock options ("NSOs"), incentive stock options ("ISOs"), and restricted stock. Options granted under the plan were granted at no less than the fair value of the Company's common stock on the date of the grant. As of the effective date of the 2016 Equity Incentive Plan (detailed below), no further grants will be made under the Plan and forfeitures of outstanding awards under the Plan will be added to the shares available under the 2016 Equity Incentive Plan.

The Company replaced the 2007 Equity Incentive Plan with the ESSA Bancorp, Inc. 2016 Equity Incentive Plan (the "2016 Plan") which was approved by shareholders on March 3, 2016. The 2016 Plan provides for a total of 250,000 shares of common stock for issuance upon the grant or exercise of awards. The 2016 Plan allows for the granting of restricted stock, restricted stock units, ISOs and NSOs.

The Company classifies share-based compensation for employees and outside directors within "Compensation and employee benefits" in the Consolidated Statement of Income to correspond with the same line item as compensation paid.

Restricted stock shares outstanding at December 31, 2018 vest over periods ranging from 18 to 45 months. The product of the number of shares granted and the grant date market price of the Company's common stock determines

the fair value of restricted shares under the Company's restricted stock plan. The Company expenses the fair value of all share based compensation grants over the requisite service period.

For the three months ended December 31, 2018 and 2017, the Company recorded $252,000 and $80,000 of share-based compensation expense, respectively, comprised of restricted stock expense. Expected future compensation expense relating to the restricted shares outstanding at December 31, 2018 is $840,000 over the remaining vesting period of 3.75 years.

The following is a summary of the status of the Company's restricted stock as of December 31, 2018, and changes therein during the three month period then ended:

	Number of Restricted Stock	Weighted-average Grant Date Fair Value
Nonvested at September 30, 2018	35,072	$ 15.37
Granted	37,236	16.23
Vested	(625)	15.00
Forfeited	(3,937)	15.87
Nonvested at December 31, 2018	67,746	$ 15.94

10. Fair Value

The following disclosures show the hierarchal disclosure framework associated within the level of pricing observations utilized in measuring assets and liabilities at fair value. The definition of fair value maintains the exchange price notion in earlier definitions of fair value but focuses on the exit price of the asset or liability. The exit price is the price that would be received to sell the asset or paid to transfer the liability adjusted for certain inherent risks and restrictions. Expanded disclosures are also required about the use of fair value to measure assets and liabilities.

Assets and Liabilities Required to be Measured and Reported at Fair Value on a Recurring Basis

The following tables provide the fair value for assets required to be measured and reported at fair value on a recurring basis on the Consolidated Balance Sheet as of December 31, 2018 and September 30, 2018 by level within the fair value hierarchy.

Recurring Fair Value Measurements at Reporting Date

	December 31, 2018			
	Level I	Level II	Level III	Total
Investment securities available for sale:				
Mortgage backed securities	$—	$267,993	$—	$267,993
Obligations of states and political subdivisions	—	32,924	—	32,924
U.S. government agencies	—	9,789	—	9,789
Corporate obligations	—	39,202	7,642	46,844
Other debt securities	—	18,504	—	18,504
Total Debt Securities	$—	$368,412	$7,642	$376,054
Equity securities- financial services	$18	$—	$—	$18
Derivatives and hedging activities:	—	1,511	—	1,511

	September 30, 2018			
	Level I	Level II	Level III	Total
Investment securities available for sale:				
Mortgage backed securities	$—	$258,123	$—	$258,123
Obligations of states and political subdivisions	—	40,949	—	40,949
U.S. government agencies	—	5,558	—	5,558
Corporate obligations	—	39,677	7,738	47,415
Other debt securities	—	19,373	—	19,373
Equity securities-financial services	20	—	—	20
Total Securities	$20	$363,680	$7,738	$371,438
Derivatives and hedging activities:	—	2,452	—	2,452

The following tables present a summary of changes in the fair value of the Company's Level III investments for the three month periods ended December 31, 2018 and 2017 (in thousands).

	Fair Value Measurement Using Significant Unobservable Inputs (Level III) Three Months Ended	
	December 31, 2018	December 31, 2017
Beginning balance	$7,738	$ 7,224
Purchases, sales, issuances, settlements, net	—	500
Total unrealized gain (loss):		
Included in other comprehensive (loss) income	(96)	102
Transfers in and/or out of Level III	—	—
	$7,642	$ 7,826

Each financial asset and liability is identified as having been valued according to a specified level of input, 1, 2 or 3. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset, either directly or indirectly. Level 2 inputs include quoted prices for similar assets in active markets, and inputs other than quoted prices that are observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset, and include situations where there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy, within which the fair value measurement in its entirety falls, has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset.

The measurement of fair value should be consistent with one of the following valuation techniques: market approach, income approach, and/or cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparable. Multiples might lie in ranges with a different multiple for each comparable. The selection of where within the range the appropriate multiple falls requires judgment, considering factors specific to the measurement (qualitative and quantitative). Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on a security's relationship to other benchmark quoted securities. Most of the securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quoted market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Securities reported at fair value utilizing Level 1 inputs are limited to actively traded equity securities whose market price is readily available from the New York Stock Exchange or the NASDAQ exchange. A few securities are valued using Level 3 inputs, all of these are classified as available for sale and are reported at fair value using Level 3 inputs.

Assets and Liabilities Required to be Measured and Reported on a Non-Recurring Basis

The following tables provide the fair value for assets required to be measured and reported at fair value on a non recurring basis on the Consolidated Balance Sheet as of December 31, 2018 and September 30, 2018 by level within the fair value hierarchy:

Non-Recurring Fair Value Measurements at Reporting Date (in thousands)

	December 31, 2018			
	Level I	Level II	Level III	Total
Foreclosed real estate	$—	$ —	$876	$876
Impaired loans	—	—	7,570	7,570

	September 30, 2018			
				Total

	Level I	Level II	Level III	
Foreclosed real estate	$—	$ —	$1,141	$1,141
Impaired loans	—	—	11,557	11,557

The following tables present additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

	Quantitative Information about Level 3 Fair Value Measurements			
(in thousands)	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range
December 31, 2018				
Impaired loans	$7,570	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to 35% (21.0%)
Foreclosed real estate owned	876	Appraisal of collateral (1), (3)	Appraisal adjustments (2)	20% to 46% (26.1%)

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	Quantitative Information about Level 3 Fair Value Measurements			
(in thousands)	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range
September 30, 2018				
Impaired loans	$ 11,557	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to 35% (25.3%)
Foreclosed real estate owned	1,141	Appraisal of collateral (1), (3)	Appraisal adjustments (2)	20% to 46% (22.1%)

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level 3 inputs which are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

Foreclosed real estate is measured at fair value, less cost to sell at the date of foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value, less cost to sell. Income and expenses from operations and changes in valuation allowance are included in the net expenses from foreclosed real estate. Impaired loans are reported at fair value utilizing level three inputs. For these loans, a review of the collateral is conducted and an appropriate allowance for loan losses is allocated to the loan. At December 31, 2018, 137 impaired loans with a carrying value of $7.9 million were reduced by specific valuation allowance totaling $326,000 resulting in a net fair value of $7.6 million based on Level 3 inputs. At September 30, 2018, 133 impaired loans with a carrying value of $11.9 million were reduced by a specific valuation totaling $313,000 resulting in a net fair value of $11.6 million based on Level 3 inputs.

Assets and Liabilities not Required to be Measured and Reported at Fair Value

The methods and assumptions used by the Company in estimating fair values of financial instruments at December 31, 2018 is in accordance with ASC Topic 825, Financial Instruments, as amended by ASU 2016-01 which requires public entities to use exit pricing in the calculations of the tables below. Prior period fair value calculations were run on the assumption of entry pricing and therefore the comparability between the periods below are diminished.

	December 31, 2018				
	Carrying Value	Level I	Level II	Level III	Total Fair Value

Financial assets:					
Cash and cash equivalents	$39,650	$39,650	$ —	$—	$39,650
Certificates of deposit	500	—	—	500	500
Loans receivable, net	1,334,304	—	—	1,297,473	1,297,473
Accrued interest receivable	6,261	6,261	—	—	6,261
Regulatory stock	15,121	15,121	—	—	15,121
Mortgage servicing rights	200	—	—	336	336
Bank owned life insurance	38,874	38,874	—	—	38,874
Financial liabilities:					
Deposits	$1,307,917	$814,114	$ —	$490,194	$1,304,308
Short-term borrowings	239,824	239,824	—	—	239,824
Other borrowings	112,373	—	—	111,904	111,904
Advances by borrowers for taxes and insurance	8,435	8,435	—	—	8,435
Accrued interest payable	1,488	1,488	—	—	1,488

	September 30, 2018				
	Carrying Value	Level I	Level II	Level III	Total Fair Value
Financial assets:					
Cash and cash equivalents	$43,539	$43,539	$ —	$—	$43,539
Certificates of deposit	500	—	—	505	505
Loans receivable, net	1,305,071	—	—	1,269,127	1,269,127
Accrued interest receivable	6,640	6,640	—	—	6,640
Regulatory stock	12,973	12,973	—	—	12,973
Mortgage servicing rights	206	—	—	340	340
Bank owned life insurance	38,630	38,630	—	—	38,630
Financial liabilities:					
Deposits	$1,336,855	$811,607	$ —	$520,861	$1,332,468
Short-term borrowings	179,773	179,773	—	—	179,773
Other borrowings	118,723	—	—	117,920	117,920
Advances by borrowers for taxes and insurance	6,826	6,826	—	—	6,826
Accrued interest payable	1,369	1,369	—	—	1,369

11. Accumulated Other Comprehensive Loss

The activity in accumulated other comprehensive loss for the three month periods ended December 31, 2018 and 2017 is as follows (in thousands):

	Accumulated Other Comprehensive Loss			
	Defined Benefit Pension Plan	Unrealized Gains (Losses) on Securities Available for Sale	Derivatives	Total
Balance at September 30, 2018	$(477)	$ (11,369)	$ 1,936	(9,910)
Other comprehensive income (loss) before reclassifications	—	3,991	(573)	3,418
Amounts reclassified from accumulated other comprehensive loss	—	(3)	(171)	(174)
Change in accounting principal for adoption of ASU 2016-01	—	4	—	4
Period change	—	3,992	(744)	3,248
Balance at December 31, 2018	$(477)	$ (7,377)	$ 1,192	$(6,662)
Balance at September 30, 2017	$(628)	$ (927)	$ 801	$(754)

Other comprehensive (loss) income before reclassifications	—	(1,288)	301	(987)
Amounts reclassified from accumulated other comprehensive loss, net of tax	—	—	(15)	(15)
Period change	—	(1,288)	286	(1,002)
Balance at December 31, 2017	$(628)	$ (2,215)	$ 1,087	$(1,756)

The following table presents significant amounts reclassified out of each component of accumulated other comprehensive loss for the three month periods ended December 31, 2018 and 2017 (in thousands):

Details About Accumulated Other Comprehensive Loss Components	Amount Reclassified from Accumulated Other Comprehensive Loss Accumulated Other Comprehensive Loss for the Three Months Ended December 31, 2018		Affected Line Item in the Consolidated Statement of Income
	2018	2017	
Securities available for sale			
Net securities gains reclassified into earnings	$4	$ —	Gain on sale of investments, net
Related income tax expense	(1)	—	Income taxes
Net effect on accumulated other comprehensive loss for the period	3	—	
Derivatives and hedging activities:			
Interest expense, effective portion	217	23	Interest expense
Related income tax expense	(46)	(8)	Income taxes
Net effect on accumulated other comprehensive loss for the period	171	15	
Total reclassification for the period	$174	$ 15	

12. Derivatives and Hedging Activities

Risk Management Objective of Using Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources, and duration of its assets and liabilities and through the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company’s derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company’s known or expected cash receipts and its known or expected cash payments principally related to certain variable rate borrowings.

Fair Values of Derivative Instruments on the Consolidated Balance Sheet

The table below presents the fair value of the Company’s derivative financial instruments as well as their classification on the Consolidated Balance Sheet as of December 31, 2018 and September 30, 2017 (in thousands).

		Fair Values of Derivative Instruments Asset Derivatives					Fair Values of Derivative Instruments Liability Derivatives			
		As of December 31, 2018		As of September 30, 2018			As of December 31, 2018		As of Septenber 30, 2018	
	Notional Amount	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value		Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments						Derivatives designated as hedging instruments				
Interest Rate Products	$ 100,000	Other Assets	$ 1,832	Other Assets	$ 2,595	Interest Rate Products	Other Liabilities	$ 145	Other Liabilities	$ -
Total derivatives designated as hedging instruments			$ 1,832		$ 2,595	Total derivatives designated as hedging instruments		$ 145		$ -

Cash Flow Hedges of Interest Rate Risk

The Company’s objectives in using interest rate derivatives are to add stability to interest income and expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company has entered into interest rate swaps as part of its interest rate risk management strategy. These interest rate swaps are designated as cash flow hedges and involve the receipt of variable rate amounts from a counterparty in exchange for the Company making fixed payments. As of December 31, 2018, the Company had four interest rate swaps with a notional principal amount of $100.0 million associated with the Company’s cash outflows associated with various FHLB advances.

For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income (outside of earnings), net of tax, and subsequently reclassified to earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings. The Company assesses the effectiveness of each hedging relationship by comparing the changes in cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged transactions. The Company did not recognize any hedge ineffectiveness in earnings during the periods ended December 31, 2018 and September 30, 2018.

Amounts reported in accumulated other comprehensive loss related to derivatives that will be reclassified to interest income/expense as interest payments are made/received on the Company's variable-rate assets/liabilities. During the three months ended December 31, 2018 and 2017, the Company had $217,000 and $23,000 respectively, of gains reclassified to interest expense. During the next twelve months, the Company estimates that $967,000 will be reclassified as a decrease in interest expense.

The tables below presents the effect of the Company's cash flow hedge accounting on Accumulated Other Comprehensive Income for the three month period ended December 31, 2018 and 2017 (in thousands).

The Effect of Fair Value and Cash Flow Hedge Accounting on Accumulated Other Comprehensive Income

Derivatives in Hedging Relationships	Amount of (Loss) Gain Recognized in OCI on Derivative		Location of Gain Reclassified from Accumulated OCI into Income	Amount of Gain Reclassified from Accumulated OCI into Income	
Derivatives in Cash Flow Hedging Relationships	2018	2017		2018	2017
Interest Rate Products	$(941)	$457	Interest expense	$ 217	$ 23
Total	$(941)	$457		$ 217	$ 23

The table below presents the effect of the Company's derivative financial instruments on Consolidated Statement of Operations for the three months ended December 31, 2018 and 2017.

	Location and Amount of Gain Recognized in Income on Fair Value and Cash Flow Hedging Relationships			
	Three months ended December 31, 2018		Three months ended December 31, 2017	
	Interest Income (Expense)	Other Income (Expense)	Interest Income (Expense)	Other Income (Expense)
Total amounts of income and expense line items presented in the statement of financial performance in which the effects of fair value or cash flow hedges are recorded	$217	$ -	$ 23	$ -
The effects of fair value and cash flow hedging:				
Gain in cash flow hedging relationships				
Interest contracts				
Amount of gain reclassified from accumulated other comprehensive income into income	$217	$ -	$ 23	$ -

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The table below presents a gross presentation, the effects of offsetting, and a net presentation of the Company's derivatives for the periods ended December 31, 2018 and 2017. The net amounts of derivative assets or liabilities can be reconciled on the tabular disclosure of fair value. The tabular disclosure of fair value provides the location the derivative assets and liabilities are presented on the Consolidated Balance Sheet. There were no derivative liabilities for the periods ended December 31, 2018 and September 30, 2018.

Offsetting of Derivative Assets as of December 31, 2018

				Gross Amounts Not Offset in the Statement of Financial Position		
	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets presented in the Statement of Financial Position	Financial Instruments	Cash Collateral Received	Net Amount
Derivatives	$ 1,832	$ -	$ 1,832	$ (145)	$ 1,687	$ -

Offsetting of Derivative Liabilities as of December 31, 2018

				Gross Amounts Not Offset in the Statement of Financial Position		
	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities presented in the Statement of	Financial Instruments	Cash Collateral Received	Net Amount

			Financial Position			
Derivatives	$ 145	$ -	$ 145	$(145)	$ -	$ -

Offsetting of Derivative Assets
as of September 30, 2018

				Gross Amounts Not Offset in the Statement of Financial Position		
	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets presented in the Statement of Financial Position	Financial Instruments	Cash Collateral Received	Net Amount
Derivatives	$ 2,595	$ -	$ 2,595	$-	$ 2,540	$ 55

Credit-risk-related Contingent Features

The Company has agreements with its derivative counterparties that contain a provision where if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations.

The Company also has agreements with certain of its derivative counterparties that contain a provision where if the Company fails to maintain its status as a well / adequately capitalized institution, then the counterparty could terminate the derivative positions and the Company would be required to settle its obligations under the agreements.

As of December 31, 2018 and September 30, 2018, the Company had no derivatives in a net liability position and was not required to post collateral against its obligations under these agreements. If the Company had breached any of these provisions at December 31, 2018, it could have been required to settle its obligations under the agreements at the termination value.

13. Contingent Liabilities
Legal Proceedings

The Company and its subsidiaries are subject to various legal actions arising in the normal course of business. In the opinion of Management, the resolution of these legal actions is not expected to have a material adverse effect on the Company's results of operations.

The Bank was named as a defendant in an action commenced on December 8, 2016 by one plaintiff who will also seek to pursue this action as a class action on behalf of the entire class of people similarly situated. The plaintiff alleges that a bank previously acquired by ESSA Bancorp in the process of making loans, received unearned fees and kickbacks in violation of the Real Estate Settlement Procedures Act. In an order dated January 29, 2018, the court granted the Bank's motion to dismiss the case. The plaintiff appealed the court's ruling. The plaintiff submitted her brief in support of her appeal in May 2018, and the Bank submitted its opposition brief in July 2018. The appellate court heard oral arguments in December 2018. To the extent that pending or threatened litigation could result in exposure to the Bank, the amount of such exposure is not currently estimable.

14. Revenue Recognition

Effective October 1, 2018, the Company adopted ASU 2014-09 Revenue from Contracts with Customers- Topic 606 and all subsequent ASC's that modified ASC 606. The Company has elected to apply the standard utilizing the modified retrospective approach with a cumulative effect of adoption for the impact from uncompleted contracts as of the date of adoption. The implementation of the new standard had no material impact on the measurement or recognition of revenue of prior periods.

Management determined that since the guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other GAAP, the new guidance did not have a material impact on revenue most closely associated with financial instruments including interest income and expense along with non interest revenue resulting from non interest security gains, loan servicing, commitment fees and fees from financial guarantees. As a result, no changes were made during the period related to these sources of revenue which cumulatively comprise 90.3% of the total revenue of the Company.

The main types of non interest income within the scope of the standard are:

Trust and Investment Fees

Trust and asset management income is primarily comprised of fees earned from the management and administration of trusts and other customer assets. The Company's performance obligation is generally satisfied over time and the resulting fees are recognized monthly, based upon the month-end market value of the assets under management and the applicable fee rate. Payment is generally received a few days after month end through a direct charge to customer's accounts. The Company does not earn performance-based incentives. Optional services such as real estate sales and tax return preparation services are also available to existing trust and asset management customers. The Company's performance obligation for these transactional-based services is generally satisfied, and related revenue recognized, at a point in time (i.e. as incurred). Payment is received shortly after services are rendered.

Service Charges on Deposit Accounts

Service charges on deposit accounts consist of account analysis fees (i.e. net fees earned on analyzed business and public checking accounts), monthly service fees, check orders, and other deposit account related fees. The Company's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Check orders and other deposit account related fees are largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

Fees, Exchange, and Other Service Charges

Fees, interchange, and other service charges are primarily comprised of debit card income, ATM fees, cash management income, and other services charges. Debit card income is primarily comprised of interchange fees earned whenever the Company's debit cards are processed through card payment networks such as Mastercard. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a company ATM. Other service charges include revenue from processing wire transfers, bill pay service, cashier's checks, and other services. The Company's performance obligation for fees, exchange, and other service charges are largely satisfied, and related revenue recognized when the services are rendered or upon completion., Payment is typically received immediately or in the following month.

Insurance Commissions

Insurance income primarily consists of commissions received on product sales. The Company acts as an intermediary between the Company's customer and the insurance carrier. The Company's performance obligation is generally satisfied upon the issuance of the policy. Shortly after the policy is issued, the carrier remits the commission payment to the Company, and the Company recognizes the revenue.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations
Forward Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements, which can be identified by the use of such words as estimate, project, believe, intend, anticipate, plan, seek, expect and similar expressions. These forward-looking statements include:

- statements of our goals, intentions and expectations;
- statements regarding our business plans and prospects and growth and operating strategies;
- statements regarding the asset quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

By identifying these forward-looking statements for you in this manner, we are alerting you to the possibility that our actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these forward-looking statements. Important factors that could cause our actual results and financial condition to differ from those indicated in the forward-looking statements include, among others, those discussed under “Risk Factors” in Part I, Item 1A of the Company’s Annual Report on Form 10-K and Part II, Item 1A of this Quarterly Report on Form 10-Q, as well as the following factors:

- significantly increased competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;
- general economic conditions, either nationally or in our market areas, that are worse than expected;
- adverse changes in the securities markets;
- legislative or regulatory changes that adversely affect our business;
- our ability to enter new markets successfully and take advantage of growth opportunities, and the possible short-term dilutive effect of potential acquisitions or de novo branches, if any;
- changes in consumer spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies and the FASB; and
- changes in our organization, compensation and benefit plans.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

Comparison of Financial Condition at December 31, 2018 and September 30, 2018

Total Assets. Total assets increased by $29.1 million, or 1.6%, to $1.86 billion at December 31, 2018 from $1.83 billion at September 30, 2018 due primarily to growth in loans receivable.

Total Cash and Cash Equivalents. Total cash and cash equivalents decreased $3.9 million, or 8.9%, to $39.7 million at December 31, 2018 from $43.5 million at September 30, 2018. Decreases in interest bearing deposits with other institutions of $541,000, and cash and due from banks of $3.3 million, were the reasons for the net decrease.

Net Loans. Net loans increased $29.2 million, or 2.2%, to $1.33 billion at December 31, 2018 from $1.31 billion at September 30, 2018. During this period, residential loans increased $20.0 million to $600.6 million, construction loans increased $835,000 to $4.8 million, commercial real estate loans increased $17.9 million to $434.4 million, commercial loans increased $7.9 million to $57.4 million, obligations of states and political subdivisions increased $1.7 million to $75.0 million, home equity loans and lines of credit decreased $691,000 to $43.3 million, auto loans decreased $18.0 million to $128.2 million, and other loans increased $188,000 to $2.9 million.

Investment Securities Available for Sale. Investment securities available for sale increased $4.7 million, or 1.3%, to $376.1 million at December 31, 2018 from $371.4 million at September 30, 2018. The increase was due primarily to increases in mortgage backed securities of $7.8 million and U.S. government securities of $4.2 million, which were partially offset by decreases in obligations of states and political subdivisions of $8.0 million, corporate obligations of $571,000 and other debt securities of $869,000. The Company realized a net gain of $4,000 on the sale of investment securities totaling $9.9 million for the three months ended December 31, 2018.

Deposits. Deposits decreased $28.9 million, or 2.2%, to $1.31 billion at December 31, 2018 from $1.34 billion at September 30, 2018 due primarily to a decrease in municipal deposits. A decrease in interest bearing demand accounts of $23.0 million was offset in part by increases in non interest bearing demand accounts of $3.8 million and money market accounts of $21.8 million. The decrease in certificates of deposit, which decreased to $493.8 million at December 31, 2018, included a decrease in brokered certificates of deposit of $10.1 million to $158.6 million.

Borrowed Funds. Borrowed funds increased by $53.7 million, or 18.0%, to $352.2 million at December 31, 2018, from $298.5 million at September 30, 2018. The increase in borrowed funds was due to an increase in short term borrowings of $60.1 million offset in part by a decrease in other borrowings of $6.4 million. Short term borrowings increased due to asset growth and the decline in deposits. All borrowings at December 31, 2018 represent advances from the Federal Home Loan Bank of Pittsburgh (the “FHLB”).

Stockholders’ Equity. Stockholders’ equity increased by $5.0 million, or 3.1%, to $184.8 million at December 31, 2018 from $179.2 million at September 30, 2018. The increase in stockholders’ equity was primarily due to a decrease in accumulated other comprehensive loss of $3.2 million together with net income of $3.0 million.

Average Balance Sheets for the Three Months Ended December 31, 2018 and 2017

The following tables set forth average balance sheets, average yields and costs, and certain other information for the periods indicated. All average balances are daily average balances, the yields set forth below include the effect of deferred fees and discounts and premiums that are amortized or accreted to interest income.

	For the Three Months Ended December 31,					
	2018			2017		
		Interest Income/			Interest Income/	
	Average Balance	Expense	Yield/Cost	Average Balance	Expense	Yield/Cost
	(dollars in thousands)					
Interest-earning assets:						
Loans[1]	$1,320,053	$ 13,907	4.18 %	$1,267,613	$ 12,783	4.00 %
Investment Securities						
Taxable[2]	68,190	676	3.93 %	80,745	656	3.22 %
Exempt from federal income tax[2][3]	25,377	136	2.69 %	50,017	288	3.02 %
Total investment securities	93,567	812	3.60 %	130,762	944	3.14 %
Mortgage-backed securities	278,425	1,806	2.57 %	258,354	1,403	2.15 %
Federal Home Loan Bank stock	13,464	222	6.54 %	14,258	175	4.87 %
Other	24,386	122	1.98 %	5,742	71	4.91 %
Total interest-earning assets	1,729,895	16,869	3.88 %	1,676,729	15,376	3.66 %
Allowance for loan losses	(11,864)			(9,505)		
Noninterest-earning assets	114,591			135,157		
Total assets	$1,832,622			$1,802,381		
Interest-bearing liabilities:						
NOW accounts	$209,035	$ 188	0.36 %	$205,532	$ 139	0.27 %
Money market accounts	315,439	821	1.03 %	249,639	332	0.53 %
Savings and club accounts	131,181	18	0.05 %	135,086	18	0.05 %
Certificates of deposit	512,533	2,361	1.83 %	526,263	1,888	1.42 %
Borrowed funds	307,102	1,596	2.06 %	328,465	1,231	1.49 %
Total interest-bearing liabilities	1,475,290	4,984	1.34 %	1,444,985	3,608	0.99 %
Non-interest-bearing NOW accounts	157,993			152,596		
Non-interest-bearing liabilities	18,171			20,612		
Total liabilities	1,651,454			1,618,193		
Equity	181,168			184,188		
Total liabilities and equity	$1,832,622			$1,802,381		
Net interest income		$ 11,885			$ 11,767	
Interest rate spread			2.54 %			2.67 %
Net interest-earning assets	$254,605			$231,744		
Net interest margin[4]			2.73 %			2.78 %
Average interest-earning assets to		117.26 %			116.04 %	

average interest-bearing liabilities

(1) Non-accruing loans are included in the outstanding loan balances.
(2) Available for sale securities are reported at fair value.
(3) Yields on tax exempt securities have been calculated on a fully tax equivalent basis assuming a tax rate of 21.00% for the three months ended December 31, 2018 and 24.25% for the three months ended December 31, 2017.
(4) Represents the difference between interest earned and interest paid, divided by average total interest earning assets.

Comparison of Operating Results for the Three Months Ended December 31, 2018 and December 31, 2017

Net Income. Net income increased $4.6 million, or 283.7%, to $3.0 million for the three months ended December 31, 2018 compared to a net loss of $1.6 million for the comparable period in 2017. The increase was due to an increase in net interest income and non interest income combined with a decrease in noninterest expenses, loan loss provision and income taxes. The net loss for the three month period ended December 31, 2017 was primarily a result of a one time charge to income tax expense of $3.7 million related to the reduction in the carrying value of the Company's deferred tax assets, which resulted from the reduction in the federal corporate income tax rate under the Tax Cuts and Jobs Act of 2017.

Net Interest Income. Net interest income increased $117,000, or 1.0%, to $11.9 million for the three months ended December 31, 2018 from $11.8 million for the comparable period in 2017. The increase was primarily attributable to a $22.9 million increase in the average balance of the Company's net interest earning assets for the three months ended December 31, 2018 partially offset by a decrease of thirteen basis points in the Company's interest rate spread to 2.54% for the three months ended December 31, 2018 from 2.67% for the comparable period in 2017.

Interest Income. Interest income increased $1.5 million, or 9.7%, to $16.9 million for the three months ended December 31, 2018 from $15.4 million for the comparable 2017 period. The increase resulted primarily from an increase in the average yield on interest earning assets of 22 basis points to 3.88% for the three months ended December 31, 2018 from 3.66% in the comparable 2017 period and an increase in the average balance of interest earning assets of $53.2 million. The average balance of loans increased $52.4 million between the two periods. In addition between the two periods, the average balance of investment securities decreased $37.2 million, mortgage-backed securities increased $20.1 million, FHLB stock decreased $794,000 and other interest earning assets increased $18.6 million.

Interest Expense. Interest expense increased $1.4 million, or 38.1%, to $5.0 million for the three months ended December 31, 2018 from $3.6 million for the comparable 2017 period. The increase resulted from an increase in the cost of interest bearing liabilities of 35 basis points and an increase in the average balance of interest bearing liabilities of $30.3 million between the two periods. The Federal Reserve increased the Fed Funds interest rate by a total of 100 basis points between December 31, 2017 and December 31, 2018. This increase was the primary reason for increases in the Company's cost of borrowed funds to 2.06% for the three months ended December 31, 2018 from 1.49% for the comparable period in 2017 and cost of certificates of deposit to 1.83% from 1.42% for the same comparative periods. For the three months ended December 31, 2018 and 2017 the average cost of interest bearing liabilities was 1.34% and 0.99%, respectively.

Provision for Loan Losses. In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of any underlying collateral, peer group information and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are subject to interpretation and revision as more information becomes available or as future events occur. After an evaluation of these factors, management made a provision for loan losses of $876,000 for the three month period ended December 31, 2018 compared to $1.0 million for the three month period ended December 31, 2017. The allowance for loan losses was $12.2 million, or 0.91% of loans outstanding, at December 31, 2018, compared to $11.7 million, or 0.89% of loans outstanding, at September 30, 2018.

Non-interest Income. Non-interest income increased $157,000, or 8.0%, to $2.1 million for the three months ended December 31, 2018 from $2.0 million for the comparable period in 2017. Increases in other income of $195,000, gain on sale of investments, net of $4,000 and insurance commissions of $30,000 were partially offset by decreases in service fees on deposit accounts of $20,000, service charges and fees on loans of $39,000, trusted investment fees of

$1,000 and earnings on bank owned life insurance of $11,000. Other income increased primarily due to a recovery of $226,000 of previously expensed professional fees related to the settlement of a non-performing loan.

Non-interest Expense. Non-interest expense decreased $630,000, or 6.1%, to $9.7 million for the three months ended December 31, 2018 from $10.3 million for the comparable period in 2017. The primary reasons for the decrease were decreases in professional fees of $42,000, occupancy and equipment expenses of $159,000, data processing expenses of $26,000, amortization of intangible assets of $60,000, other expense of $375,000 and an increase in gain on foreclosed real estate of $79,000 which were offset in part by an increase of $116,000 in compensation and employee benefits.

Income Taxes. Income tax expense decreased $3.6 million to $474,000 for the three months ended December 31, 2018 from $4.1 million for the comparable 2017 period. The decrease was primarily a result of a one time charge to income tax expense of $3.7 million in the three months ended December 31, 2017 related to the reduction in the carrying value of the Company's deferred tax assets, which resulted from the reduction in the federal corporate income tax rate under the Tax Cuts and Jobs Act of 2017. The effective tax rate for the three months ended December 31, 2018 was 13.6% compared to 166.7% for the 2017 period.

The following table provides information with respect to the Bank's non-performing assets at the dates indicated (dollars in thousands).

	December 31, 2018		September 30, 2018	
Non-performing assets:				
Non-accruing loans	$ 9,416		$ 8,964	
Non-accruing purchased credit impaired loans	1,273		1,547	
Total non-performing loans	10,689		10,511	
Foreclosed real estate	876		1,141	
Other repossessed assets	16		16	
Total non-performing assets	$ 11,581		$ 11,668	
Ratio of non-performing loans to total loans	0.79	%	0.80	%
Ratio of non-performing loans to total assets	0.57	%	0.57	%
Ratio of non-performing assets to total assets	0.62	%	0.64	%
Ratio of allowance for loan losses to total loans	0.91	%	0.85	%

Loans are reviewed on a regular basis and are placed on non-accrual status when they become more than 90 days delinquent. When loans are placed on non-accrual status, unpaid accrued interest is fully reserved, and further income is recognized only to the extent received. Non-performing assets decreased $88,000 from September 30, 2018 to December 31, 2018. The number of nonperforming residential loans was 59 at December 31, 2018 compared to 58 at September 30, 2018. The $10.7 million of non-accruing loans at December 31, 2018 included 59 residential loans with an aggregate outstanding balance of $5.7 million, 23 commercial and commercial real estate loans with aggregate outstanding balances of $3.9 million and 90 consumer loans with aggregate balances of $1.1 million. Within the residential loan balance are $3.0 million of loans less than 90 days past due. In the quarter ended December 31, 2018, the Company identified 28 residential loans which, although paying as agreed, have a high probability of default. Foreclosed real estate decreased $265,000 to $876,000 at December 31, 2018. Foreclosed real estate consists of 13 residential properties, one building lot and two commercial properties.

At December 31, 2018, the principal balance of troubled debt restructures ("TDRs") was $4.5 million compared to $4.4 million at September 30, 2018. Of the $4.5 million of troubled debt restructures at December 31, 2018, $192,000 are performing loans and $4.3 million are non-accrual loans.

As of December 31, 2018, TDRs were comprised of 30 residential loans totaling $3.3 million, six commercial and commercial real estate loans totaling $937,000 and eight consumer (home equity loans, home equity lines and credit, indirect auto and other) loans totaling $270,000.

For the three month period ended December 31, 2018, three loans were removed from non-performing TDR status.

Liquidity and Capital Resources

We maintain liquid assets at levels we consider adequate to meet both our short-term and long-term liquidity needs. We adjust our liquidity levels to fund deposit outflows, repay our borrowings and to fund loan commitments. We also adjust liquidity as appropriate to meet asset and liability management objectives.

Our primary sources of liquidity are deposits, prepayment and repayment of loans and mortgage-backed securities, maturities of investment securities and other short-term investments, and earnings and funds provided from operations, as well as access to FHLB advances and other borrowing sources. While scheduled principal repayments on loans and mortgage-backed securities are a relatively predictable source of funds, deposit flows and loan prepayments are greatly influenced by market interest rates, economic conditions, and rates offered by our competition. We set the interest rates on our deposits to maintain a desired level of total deposits.

A portion of our liquidity consists of cash and cash equivalents and borrowings, which are a product of our operating, investing and financing activities. At December 31, 2018, $39.7 million of our assets were invested in cash and cash equivalents. Our primary sources of cash are principal repayments on loans, proceeds from the maturities of investment securities, principal repayments of mortgage-backed securities and increases in deposit accounts. As of December 31, 2018, we had $352.2 million in borrowings outstanding from the Pittsburgh FHLB. We have access to total FHLB advances of up to approximately $650.2 million.

At December 31, 2018, we had $208.2 million in loan commitments outstanding, which included, in part, $57.0 million in undisbursed construction loans and land development loans, $37.3 million in unused home equity lines of credit, $106.1 million in commercial lines of credit and commitments to originate commercial loans, $4.8 million in performance standby letters of credit and $3.0 million in other unused commitments which are primarily to originate residential mortgage loans and multifamily loans. Certificates of deposit due within one year of December 31, 2018 totaled $338.7 million, or 68.6% of certificates of deposit. If these maturing deposits do not remain with us, we will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before December 31, 2019. We believe, however, based on past experience that a significant portion of our certificates of deposit will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

As reported in the Consolidated Statements of Cash Flow, our cash flows are classified for financial reporting purposes as operating, investing or financing cash flows. Net cash provided by operating activities was $3.2 million and $5.9 million for the three months ended December 31, 2018 and 2017, respectively. These amounts differ from our net income because of a variety of cash receipts and disbursements that did not affect net income for the respective periods. Net cash used for investing activities was $32.4 million and $47.4 million for the three months ended December 31, 2018 and 2017, respectively, principally reflecting our loan and investment security activities. Deposit and borrowing cash flows have comprised most of our financing activities, which resulted in net cash provided by $25.3 million and $38.6 million for the three months ended December 31, 2018 and 2017, respectively.

Critical Accounting Policies

We consider accounting policies that require management to exercise significant judgment or discretion or make significant assumptions that have, or could have, a material impact on the carrying value of certain assets or on income, to be critical accounting policies. We consider the following to be our critical accounting policies:

Allowance for Loan Losses. The allowance for loan losses is the estimated amount considered necessary to cover credit losses inherent in the loan portfolio at the balance sheet date. The allowance is established through the provision for loan losses which is charged against income. In determining the allowance for loan losses, management makes significant estimates and has identified this policy as one of our most critical. The methodology for determining the allowance for loan losses is considered a critical accounting policy by management due to the high degree of judgment involved, the subjectivity of the assumptions utilized and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses.

As a substantial amount of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans and discounted cash flow valuations of properties are critical in determining the amount of the allowance required for specific loans. Assumptions for appraisals and discounted cash flow valuations are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly impact the valuation of a property securing a loan and the related allowance determined. The assumptions supporting such appraisals and discounted cash flow valuations are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable on the related loans.

Management performs a quarterly evaluation of the adequacy of the allowance for loan losses. Consideration is given to a variety of factors in establishing this estimate including, but not limited to, current economic conditions, delinquency statistics, geographic and industry concentrations, the adequacy of the underlying collateral, the financial strength of the borrower, results of internal and external loan reviews and other relevant factors. This evaluation is inherently subjective, as it requires material estimates that may be susceptible to significant revision based on changes in economic and real estate market conditions.

The analysis of the allowance for loan losses has two components: specific and general allocations. Specific allocations are made for loans that are determined to be impaired. Impairment is measured by determining the present value of expected future cash flows or, for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. The general allocation is determined by segregating the remaining loans by type of loan, risk weighting (if applicable) and payment history. We also analyze historical loss experience, delinquency trends, general economic conditions and geographic and industry concentrations. This analysis establishes factors that are applied to the loan groups to determine the amount of the general allocations. Actual loan losses may be significantly more than the allowance for loan losses we have established which could have a material negative effect on our financial results.

Goodwill and Intangible Assets. Goodwill is not amortized, but it is tested at least annually for impairment in the fourth quarter, or more frequently if indicators of impairment are present. If the estimated current fair value of a reporting unit exceeds its carrying value, no additional testing is required and an impairment loss is not recorded. The Company uses market capitalization and multiples of tangible book value methods to determine the estimated current fair value of its reporting unit. Based on this analysis, no impairment was recorded in 2018 or 2017.

The other intangibles assets are assigned useful lives, which are amortized on an accelerated basis over their weighted-average lives. The Company periodically reviews the intangible assets for impairment as events or changes in circumstances indicate that the carrying amount of such asset may not be recoverable. Based on these reviews, no impairment was recorded in 2018 and 2017.

Derivative Instruments and Hedging Activities. The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting.

Fair Value Measurements. We group our assets at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level I – Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level II – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level III – Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company's own estimates of assumptions that market participants would use in pricing the asset.

We base our fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is our policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements, in accordance with the fair value hierarchy in generally accepted accounting principles.

Fair value measurements for most of our assets are obtained from independent pricing services that we have engaged for this purpose. When available, we, or our independent pricing service, use quoted market prices to measure fair value. If market prices are not available, fair value measurement is based upon models that incorporate available trade, bid, and other market information. Subsequently, all of our financial instruments use either of the foregoing methodologies to determine fair value adjustments recorded to our financial statements. In certain cases, however, when market observable inputs for model-based valuation techniques may not be readily available, we are required to make judgments about assumptions market participants would use in estimating the fair value of financial instruments. The degree of management judgment involved in determining the fair value of a financial instrument is dependent upon the availability of quoted market prices or observable market parameters. For financial instruments that trade actively and have quoted market prices or observable market parameters, there is minimal subjectivity involved in measuring fair value. When observable market prices and parameters are not fully available, management judgment is necessary to estimate fair value. In addition, changes in the market conditions may reduce the availability of quoted prices or observable data. When market data is not available, we use valuation techniques requiring more management judgment to estimate the appropriate fair value measurement. Therefore, the results cannot be determined with

precision and may not be realized in an actual sale or immediate settlement of the asset. Additionally, there may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, that could significantly affect the results of current or future valuations.

Other-than-Temporary Investment Security Impairment. Securities are evaluated periodically to determine whether a decline in their value is other-than-temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reasons underlying the decline, to determine whether the loss in value is other-than-temporary. The term "other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospect for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

Deferred Income Taxes. We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. We consider the determination of this valuation allowance to be a critical accounting policy because of the need to exercise significant judgment in evaluating the amount and timing of recognition of deferred tax liabilities and assets, including projections of future taxable income. These judgments and estimates are reviewed on a continual basis as regulatory and business factors change. A valuation allowance for deferred tax assets may be required if the amount of taxes recoverable through loss carryback declines, or if we project lower levels of future taxable income. Such a valuation allowance would be established through a charge to income tax expense that would adversely affect our operating results.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements (as such term is defined in applicable Securities and Exchange Commission rules) that are reasonably likely to have a current or future material effect on our financial condition, results of operations, liquidity, capital expenditures or capital resources.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The majority of our assets and liabilities are monetary in nature. Consequently, our most significant form of market risk is interest rate risk. Our assets, consisting primarily of mortgage loans, have longer maturities than our liabilities, consisting primarily of deposits and borrowings. As a result, a principal part of our business strategy is to manage interest rate risk and reduce the exposure of our net interest income to changes in market interest rates. Accordingly, our Board of Directors has approved guidelines for managing the interest rate risk inherent in our assets and liabilities, given our business strategy, operating environment, capital, liquidity and performance objectives. Senior management monitors the level of interest rate risk on a regular basis and the asset/liability committee meets quarterly to review our asset/liability policies and interest rate risk position.

We have sought to manage our interest rate risk in order to minimize the exposure of our earnings and capital to changes in interest rates. The net proceeds from the Company’s stock offering increased our capital and provided management with greater flexibility to manage our interest rate risk. In particular, management used the majority of the capital we received to increase our interest-earning assets. There have been no material changes in our interest rate risk since September 30, 2018.

Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this Report. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that, as of the end of the period covered by this Report, our disclosure controls and procedures were effective.

There were no changes made in the Company’s internal controls over financial reporting (as defined by rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) or in other factors that have materially affected, or are reasonably likely to materially affect, the Company’s internal controls over financial reporting during the period covered by this Report.

Part II – Other Information

Item 1. Legal Proceedings

The Company and its subsidiaries are subject to various legal actions arising in the normal course of business. In the opinion of Management, the resolution of these legal actions is not expected to have a material adverse effect on the Company's results of operations.

The Bank was named as a defendant in an action commenced on December 8, 2016 by one plaintiff who will also seek to pursue this action as a class action on behalf of the entire class of people similarly situated. The plaintiff alleges that a bank previously acquired by ESSA Bancorp in the process of making loans, received unearned fees and kickbacks in violation of the Real Estate Settlement Procedures Act. In an order dated January 29, 2018, the court granted the Bank's motion to dismiss the case. The plaintiff appealed the court's ruling. The plaintiff submitted her brief in support of her appeal in May 2018, and the Bank submitted its opposition brief in July 2018. The appellate court heard oral arguments in December 2018. To the extent that pending or threatened litigation could result in exposure to the Bank, the amount of such exposure is not currently estimable.

Item 1A. Risk Factors

There have been no material changes in the "Risk Factors" as disclosed in the Company's response to Item 1A in Part 1 of its Annual Report on Form 10-K for the year ended September 30, 2018, filed on December 14, 2018.

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

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

The following exhibits are either filed as part of this Report or are incorporated herein by reference:

3.1	Articles of Incorporation of ESSA Bancorp, Inc. (incorporated by reference to the Registration Statement on Form S-1 of ESSA Bancorp, Inc. (file no. 333-139157), originally filed with the Securities and Exchange Commission on December 7, 2006)
3.2	Bylaws of ESSA Bancorp, Inc. (incorporated by reference to the Registration Statement on Form S-1 of ESSA Bancorp, Inc. (file no. 333-139157), originally filed with the Securities and Exchange Commission on December 7, 2006)
4	Form of Common Stock Certificate of ESSA Bancorp, Inc. (incorporated by reference to the Registration Statement on Form S-1 of ESSA Bancorp, Inc. (file no. 333-139157), originally filed with the Securities and Exchange Commission on December 7, 2006)
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	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Statements of Condition; (ii) the Consolidated Statement of Income; (iii) the Consolidated Statement of Changes in Stockholder Equity; the Consolidated Statement of Cash Flows; and (iv) the Notes to Consolidated Financial Statements.

SIGNATURES

Pursuant to the requirements 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.

	ESSA BANCORP, INC.
Date: February 11, 2019	/s/ Gary S. Olson Gary S. Olson President and Chief Executive Officer
Date: February 11, 2019	/s/ Allan A. Muto Allan A. Muto Executive Vice President and Chief Financial Officer