TFS Financial CORP
Form 10-Q
February 11, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended December 31, 2012

or

.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For transition period from to

Commission File Number 001-33390

TFS FINANCIAL CORPORATION
(Exact Name of Registrant as Specified in its Charter)

United States of America (State or Other Jurisdiction of Incorporation or Organization)	52-2054948 (I.R.S. Employer Identification No.)
7007 Broadway Avenue Cleveland, Ohio (Address of Principal Executive Offices)	44105 (Zip Code)

(216) 441-6000
Registrant’s telephone number, including area code:
Not Applicable
(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 filing requirements for the past 90 days. Yes x No ¨

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

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

Large accelerated filer ý Accelerated filer ¨

Non-accelerated filer ¨ (do not check if a smaller reporting company) Smaller Reporting Company ¨

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

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

As of February 1, 2013 there were 309,035,125 shares of the Registrant's common stock, par value $0.01 per share, outstanding, of which 227,119,132 shares, or 73.5% of the Registrant's common stock, were held by Third Federal Savings and Loan Association of Cleveland, MHC, the Registrant's mutual holding company.

Table of Contents

TFS Financial Corporation
INDEX

2

Table of Contents

Item 1. Financial Statements
TFS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CONDITION (unaudited)
(In thousands, except share data)

	December 31, 2012	September 30, 2012
ASSETS		
Cash and due from banks	$46,795	$38,914
Other interest-earning cash equivalents	286,759	269,348
Cash and cash equivalents	333,554	308,262
Investment securities:		
Available for sale (amortized cost $447,959 and $417,416, respectively)	450,880	421,430
Mortgage loans held for sale, at lower of cost or market ($3,107 measured at fair value, September 30, 2012)	324,322	124,528
Loans held for investment, net:		
Mortgage loans	9,960,370	10,339,402
Other loans	4,173	4,612
Deferred loan fees, net	(18,128)	(18,561)
Allowance for loan losses	(105,201)	(100,464)
Loans, net	9,841,214	10,224,989
Mortgage loan servicing assets, net	17,787	19,613
Federal Home Loan Bank stock, at cost	35,620	35,620
Real estate owned	18,605	19,647
Premises, equipment, and software, net	60,915	61,150
Accrued interest receivable	33,360	34,887
Bank owned life insurance contracts	178,882	177,279
Other assets	84,489	90,720
TOTAL ASSETS	$11,379,628	$11,518,125
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	$8,804,495	$8,981,419
Borrowed funds	468,000	488,191
Borrowers' advances for insurance and taxes	67,422	67,864
Principal, interest, and related escrow owed on loans serviced	129,036	127,539
Accrued expenses and other liabilities	90,631	46,262
Total liabilities	9,559,584	9,711,275
Commitments and contingent liabilities		
Preferred stock, $0.01 par value, 100,000,000 shares authorized, none issued and outstanding	—	—
Common stock, $0.01 par value, 700,000,000 shares authorized; 332,318,750 shares issued; 309,035,125 and 309,009,393 outstanding at December 31, 2012 and September 30, 2012, respectively	3,323	3,323
Paid-in capital	1,693,240	1,691,884
Treasury stock, at cost; 23,283,625 and 23,309,357 shares at December 31, 2012 and September 30, 2012, respectively	(280,622)	(280,937)
Unallocated ESOP shares	(73,668)	(74,751)
Retained earnings—substantially restricted	484,307	473,247
Accumulated other comprehensive loss	(6,536)	(5,916)

Total shareholders’ equity	1,820,044	1,806,850
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$11,379,628	$11,518,125

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

TFS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (unaudited)
(In thousands, except share and per share data)

	For the Three Months Ended December 31,	
	2012	2011
INTEREST INCOME:		
Loans, including fees	$98,689	$103,207
Investment securities available for sale	1,113	37
Investment securities held to maturity	—	1,734
Other interest and dividend earning assets	586	557
Total interest and dividend income	100,388	105,535
INTEREST EXPENSE:		
Deposits	31,135	40,706
Borrowed funds	837	574
Total interest expense	31,972	41,280
NET INTEREST INCOME	68,416	64,255
PROVISION FOR LOAN LOSSES	18,000	15,000
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	50,416	49,255
NON-INTEREST INCOME		
Fees and service charges, net of amortization	2,303	2,813
Net gain on the sale of loans	3,022	—
Increase in and death benefits from bank owned life insurance contracts	1,605	1,612
Other	1,317	1,284
Total non-interest income	8,247	5,709
NON-INTEREST EXPENSE		
Salaries and employee benefits	20,603	20,385
Marketing services	3,125	2,377
Office property, equipment and software	5,021	4,998
Federal insurance premium and assessments	3,714	3,877
State franchise tax	1,663	989
Real estate owned expense, net	1,165	2,335
Appraisal and other loan review expense	683	990
Other operating expenses	6,560	6,528
Total non-interest expense	42,534	42,479
INCOME BEFORE INCOME TAXES	16,129	12,485
INCOME TAX EXPENSE	4,976	4,026
NET INCOME	$11,153	$8,459
Earnings per share—basic and diluted	$0.04	$0.03
Weighted average shares outstanding		
Basic	301,576,327	301,044,732
Diluted	302,244,741	301,416,252

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

TFS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)
(In thousands)

	For the Three Months Ended December 31,	
	2012	2011
Net income	$ 11,153	$ 8,459
Other comprehensive (loss) income, net of tax		
Change in net unrealized gains on securities available for sale	(710)	(11)
Change in pension obligation	90	10,620
Total other comprehensive (loss) income	(620)	10,609
Total comprehensive income	$ 10,533	$ 19,068

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

TFS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (unaudited)
Three Months Ended December 31, 2012 and 2011
(In thousands)

	Common stock	Paid-in capital	Treasury stock	Unallocated common stock held by ESOP	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
Balance at September 30, 2011	$ 3,323	$ 1,686,216	$ (282,090)	$ (79,084)	$ 461,836	$ (16,277)	$ 1,773,924
Net income	—	—	—	—	8,459	—	8,459
Other comprehensive income, net of tax	—	—	—	—	—	10,609	10,609
ESOP shares allocated or committed to be released	—	(113)	—	1,083	—	—	970
Compensation costs for stock-based plans	—	1,998	—	—	—	—	1,998
Balance at December 31, 2011	$ 3,323	$ 1,688,101	$ (282,090)	$ (78,001)	$ 470,295	$ (5,668)	$ 1,795,960
Balance at September 30, 2012	$ 3,323	$ 1,691,884	$ (280,937)	$ (74,751)	$ 473,247	$ (5,916)	$ 1,806,850
Net income	—	—	—	—	11,153	—	11,153
Other comprehensive loss, net of tax	—	—	—	—	—	(620)	(620)
ESOP shares allocated or committed to be released	—	(137)	—	1,083	—	—	946
Compensation costs for stock-based plans	—	1,715	—	—	—	—	1,715
Treasury stock allocated to restricted stock plan	—	(222)	315	—	(93)	—	—
Balance at December 31, 2012	$ 3,323	$ 1,693,240	$ (280,622)	$ (73,668)	$ 484,307	$ (6,536)	$ 1,820,044

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

TFS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)
(In thousands)

	For the Three Months Ended December 31, 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$11,153	$8,459
Adjustments to reconcile net income to net cash provided by operating activities:		
ESOP and stock-based compensation expense	2,661	2,968
Depreciation and amortization	6,221	6,047
Provision for loan losses	18,000	15,000
Net gain on the sale of loans	(3,022)	—
Other net (gains) losses	(415)	415
Principal repayments on and proceeds from sales of loans held for sale	22,197	—
Loans originated for sale	(15,757)	—
Increase in bank owned life insurance contracts	(1,613)	(1,618)
Net decrease in interest receivable and other assets	7,998	4,811
Net increase in accrued expenses and other liabilities	44,751	55,006
Other	33	334
Net cash provided by operating activities	92,207	91,422
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans originated	(511,600)	(821,282)
Principal repayments on loans	606,535	539,416
Proceeds from principal repayments and maturities of:		
Securities available for sale	57,918	517
Securities held to maturity	—	55,523
Proceeds from sale of:		
Loans	61,231	—
Real estate owned	6,519	4,661
Purchases of:		
Securities available for sale	(90,305)	(9)
Securities held to maturity	—	(14,423)
Premises and equipment	(1,158)	(1,014)
Other	5	(11)
Net cash provided by (used in) investing activities	129,145	(236,622)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net decrease in deposits	(176,924)	(57,397)
Net (decrease) increase in borrowers' advances for insurance and taxes	(442)	3,218
Net increase in principal and interest owed on loans serviced	1,497	34,021
Net (decrease) increase in short term borrowed funds	(84,926)	124,633
Proceeds from long term borrowed funds	70,000	—
Repayment of long term borrowed funds	(5,265)	—
Net cash (used in) provided by financing activities	(196,060)	104,475
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	25,292	(40,725)
CASH AND CASH EQUIVALENTS—Beginning of period	308,262	294,846
CASH AND CASH EQUIVALENTS—End of period	$333,554	$254,121
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		

Cash paid for interest on deposits	$31,673	$41,464
Cash paid for interest on borrowed funds	763	564
Cash paid for income taxes	6,600	4,500
SUPPLEMENTAL SCHEDULES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Transfer of loans to real estate owned	4,992	4,109
Transfer of loans from held for investment to held for sale	264,908	—

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

TFS FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands unless otherwise indicated)

1. BASIS OF PRESENTATION

TFS Financial Corporation (the “Holding Company”), a federally chartered stock holding company, conducts its principal activities through its wholly owned subsidiaries. The principal line of business of the Holding Company and its subsidiaries (collectively, “TFS Financial” or the “Company”) is retail consumer banking, including mortgage lending, deposit gathering, and other insignificant financial services. On December 31, 2012, approximately 73% of the Holding Company’s outstanding shares were owned by a federally chartered mutual holding company, Third Federal Savings and Loan Association of Cleveland, MHC (“Third Federal Savings, MHC”). The thrift subsidiary of TFS Financial is Third Federal Savings and Loan Association of Cleveland (the “Association”).

The accounting and reporting policies followed by the Company conform in all material respects to accounting principles generally accepted in the United States of America (“U.S. GAAP”) and to general practices in the financial services industry. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. The allowance for loan losses, the valuation of mortgage loan servicing rights, the valuation of deferred tax assets, and the determination of pension obligations and stock-based compensation are particularly subject to change.

The unaudited interim consolidated financial statements were prepared without an audit and reflect all adjustments of a normal recurring nature which, in the opinion of management, are necessary to present fairly the consolidated financial condition of TFS Financial at December 31, 2012, and its results of operations and cash flows for the periods presented. In accordance with Regulation S-X for interim financial information, these statements do not include certain information and footnote disclosures required for complete audited financial statements. The Holding Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2012 contains consolidated financial statements and related notes, which should be read in conjunction with the accompanying interim consolidated financial statements. The results of operations for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2013.

2. EARNINGS PER SHARE

Basic earnings per share is the amount of earnings available to each share of common stock outstanding during the reporting period. Diluted earnings per share is the amount of earnings available to each share of common stock outstanding during the reporting period adjusted to include the effect of potentially dilutive common shares. For purposes of computing earnings per share amounts, outstanding shares include shares held by the public, shares held by the ESOP that have been allocated to participants or committed to be released for allocation to participants, the 227,119,132 shares held by Third Federal Savings, MHC, and, for purposes of computing dilutive earnings per share, stock options and restricted stock units with a dilutive impact. At December 31, 2012 and 2011, respectively, the ESOP held 7,366,775 and 7,800,115 shares that were neither allocated to participants nor committed to be released to participants.

Table of Contents

The following is a summary of the Company's earnings per share calculations.

	For the Three Months Ended December 31,					
	2012			2011		
	Income	Shares	Per share amount	Income	Shares	Per share amount
	(Dollars in thousands, except per share data)					
Net income	$11,153			$8,459		
Less: income allocated to restricted stock units	58			36		
Basic earnings per share:						
Income available to common shareholders	$11,095	301,576,327	$0.04	$8,423	301,044,732	$0.03
Diluted earnings per share:						
Effect of dilutive potential common shares		668,414			371,520	
Income available to common shareholders	$11,095	302,244,741	$0.04	$8,423	301,416,252	$0.03

Outstanding stock options and restricted stock units are excluded from the computation of diluted earnings per share when their inclusion would be anti-dilutive. The following is a summary of outstanding stock options and restricted stock units that are excluded from the computation of diluted earnings per share because their inclusion would be anti-dilutive.

	For the Three Months Ended December 31,	
	2012	2011
Options to purchase shares	6,654,525	6,283,425
Restricted stock units	226,500	140,000

3. INVESTMENT SECURITIES

Investments available for sale are summarized as follows:

	December 31, 2012			
	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
U.S. government and agency obligations	$2,000	$51	$—	$2,051
Freddie Mac certificates	916	61	—	977
Ginnie Mae certificates	15,147	600	—	15,747
Real estate mortgage investment conduits (REMICs)	415,643	2,113	(751)	417,005
Fannie Mae certificates	6,890	847	—	7,737
Money market accounts	7,363	—	—	7,363
Total	$447,959	$3,672	$(751)	$450,880

	September 30, 2012			
	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
U.S. government and agency obligations	$2,000	$56	$—	$2,056
Freddie Mac certificates	922	67	—	989
Ginnie Mae certificates	16,123	663	—	16,786
REMICs	383,545	2,772	(308)	386,009
Fannie Mae certificates	7,125	764	—	7,889
Money market accounts	7,701	—	—	7,701
Total	$417,416	$4,322	$(308)	$421,430

9

Table of Contents

Gross unrealized losses on securities and the estimated fair value of the related securities, aggregated by investment category and length of time the individual securities have been in a continuous loss position, at December 31, 2012 and September 30, 2012, were as follows:

	December 31, 2012					
	Less Than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Available for sale—						
REMICs	$168,251	$743	$4,103	$8	$172,354	$751
Total	$168,251	$743	$4,103	$8	$172,354	$751

	September 30, 2012					
	Less Than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Available for sale—						
REMICs	$80,219	$291	$6,550	$17	$86,769	$308
Total	$80,219	$291	$6,550	$17	$86,769	$308

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans held for investment consist of the following:

	December 31, 2012	September 30, 2012
Real estate loans:		
Residential non-Home Today	$7,649,508	$7,943,165
Residential Home Today	201,615	208,325
Home equity loans and lines of credit	2,078,406	2,155,496
Construction	61,670	69,152
Real estate loans	9,991,199	10,376,138
Consumer and other loans	4,173	4,612
Less:		
Deferred loan fees—net	(18,128)	(18,561)
Loans-in-process (“LIP”)	(30,829)	(36,736)
Allowance for loan losses	(105,201)	(100,464)
Loans held for investment, net	$9,841,214	$10,224,989

At December 31, 2012 and September 30, 2012, respectively, $324,322 and $124,528 of long-term loans were classified as mortgage loans held for sale.

A large concentration of the Company’s lending is in Ohio and Florida. As of December 31, 2012 and September 30, 2012, the percentages of residential real estate loans held in Ohio were both 77%, and the percentages held in Florida were both 17%, respectively. As of both December 31, 2012 and September 30, 2012, home equity loans and lines of credit were concentrated in the states of Ohio (39%), Florida (29%) and California (12%), respectively. The economic conditions and market for real estate in those states, including to a greater extent Florida, have impacted the ability of borrowers in those areas to repay their loans.

Home Today is an affordable housing program targeted to benefit low- and moderate-income home buyers. Through this program, prior to March 27, 2009, the Association provided loans to borrowers who would not otherwise qualify for the Association’s loan products, generally because of low credit scores. Although the credit profiles of borrowers in the Home Today program for loans originated prior to March 27, 2009 might be described as sub-prime, Home Today loans generally contain the same features as loans offered to our non-Home Today borrowers. Borrowers in the Home Today program must complete financial management education and counseling and must be referred to the Association by a sponsoring organization

10

Table of Contents

with which the Association has partnered as part of the program. Borrowers must also meet a minimum credit score threshold. Because prior to March 27, 2009 the Association applied less stringent underwriting and credit standards to Home Today loans, loans originated under the program prior to that date have greater credit risk than its traditional residential real estate mortgage loans. Effective March 27, 2009, the Home Today underwriting guidelines were changed to be substantially the same as the Association's traditional first mortgage product. As of December 31, 2012 and September 30, 2012, the principal balance of Home Today loans originated prior to March 27, 2009 was $197,751 and $204,733, respectively. The Association does not offer, and has not offered, loan products frequently considered to be designed to target sub-prime borrowers containing features such as higher fees or higher rates, negative amortization, a loan-to-value ratio greater than 100%, or pay option adjustable-rate mortgages.

The recorded investment of loan receivables in non-accrual status is summarized in the following table. Balances are net of deferred fees.

	December 31, 2012	September 30, 2012
Real estate loans:		
Residential non-Home Today	$101,933	$105,780
Residential Home Today	41,226	41,087
Home equity loans and lines of credit	36,096	35,316
Construction	356	377
Total real estate loans	179,611	182,560
Consumer and other loans	—	—
Total non-accrual loans	$179,611	$182,560

Loans are placed in non-accrual status when they are contractually 90 days or more past due. Loans modified in troubled debt restructurings that were in non-accrual status prior to the restructurings remain in non-accrual status for a minimum of 6 months after restructuring. Beginning with the quarter ended March 31, 2012, home equity loans and lines of credit where the customer has a severely delinquent first mortgage are placed in non-accrual status. Beginning in the quarter ended September 30, 2012, loans in Chapter 7 bankruptcy status where all borrowers have been discharged of their obligation are also placed in non-accrual status. At December 31, 2012 and September 30, 2012, the recorded investment in non accrual loans includes $47,427 and $47,742, respectively, in troubled debt restructurings which are current according to the terms of their agreement of which $30,375 and $30,631 are performing loans in Chapter 7 bankruptcy status where all borrowers have been discharged of their obligations. Additionally, at December 31, 2012 and September 30, 2012, the recorded investment in non-accrual status loans includes $7,063 and $8,807, respectively, of performing second lien loans subordinate to first mortgages delinquent greater than 90 days. Interest on loans in accrual status, including certain loans individually reviewed for impairment, is recognized in interest income as it accrues, on a daily basis. Accrued interest on loans in non-accrual status is reversed by a charge to interest income and income is subsequently recognized only to the extent cash payments are received. Cash payments on loans in non-accrual status are applied to the oldest scheduled, unpaid payment first. Cash payments on loans with a partial charge-off are applied fully to principal, then to recovery of the charged off amount prior to interest income being recognized. A non-accrual loan is generally returned to accrual status when contractual payments are less than 90 days past due. However, a loan may remain in non-accrual status when collectability is uncertain, such as a troubled debt restructuring that has not met minimum payment requirements, a loan with a partial charge-off, an equity loan or line of credit with a delinquent first mortgage greater than 90 days, or a loan in Chapter 7 bankruptcy status where all borrowers have been discharged of their obligation. The number of days past due is determined by the number of scheduled payments that remain unpaid, assuming a period of 30 days between each scheduled payment.

Table of Contents

An age analysis of the recorded investment in loan receivables that are past due at December 31, 2012 and September 30, 2012 is summarized in the following tables. When a loan is more than one month past due on its scheduled payments, the loan is considered 30 days or more past due. Balances are net of deferred fees and any applicable loans-in-process.

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total
December 31, 2012						
Real estate loans:						
Residential non-Home Today	$10,529	$8,670	$72,406	$91,605	$7,535,068	$7,626,673
Residential Home Today	9,656	5,266	27,101	42,023	156,219	198,242
Home equity loans and lines of credit	6,697	3,849	16,661	27,207	2,059,796	2,087,003
Construction	—	—	356	356	29,968	30,324
Total real estate loans	26,882	17,785	116,524	161,191	9,781,051	9,942,242
Consumer and other loans	—	—	—	—	4,173	4,173
Total	$26,882	$17,785	$116,524	$161,191	$9,785,224	$9,946,415

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total
September 30, 2012						
Real estate loans:						
Residential non-Home Today	$15,015	$10,661	$74,807	$100,483	$7,818,927	$7,919,410
Residential Home Today	10,874	4,736	27,517	43,127	161,743	204,870
Home equity loans and lines of credit	8,676	3,210	16,587	28,473	2,136,255	2,164,728
Construction	—	—	377	377	31,456	31,833
Total real estate loans	34,565	18,607	119,288	172,460	10,148,381	10,320,841
Consumer and other loans	—	—	—	—	4,612	4,612
Total	$34,565	$18,607	$119,288	$172,460	$10,152,993	$10,325,453

In an October 2011 directive, the OCC required all specific valuation allowances (“SVA”) on collateral-dependent loans (SVAs established when the recorded investment in an impaired loan exceeded the measured value of the collateral) maintained by savings institutions to be charged off by March 31, 2012. As permitted, the Company elected to early-adopt this methodology effective for the quarter ended December 31, 2011. As a result, reported loan charge-offs for the quarter ended December 31, 2011 included the charge-off of specific valuation allowances, which had a balance of $55,507 at September 30, 2011. The one-time SVA related charge-off did not impact the provision for loan losses for the quarter ended December 31, 2011; however, reported loan charge-offs during the three months ended December 31, 2011 increased and the allowance for loan losses decreased accordingly.

Activity in the allowance for loan losses is summarized as follows:

	For the Three Months Ended December 31, 2012				
	Beginning Balance	Provisions	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
Residential non-Home Today	$31,618	$5,777	$(4,635)	$331	$33,091
Residential Home Today	22,588	5,238	(3,534)	91	24,383
Home equity loans and lines of credit	45,508	7,259	(6,308)	787	47,246

Construction	750	(274)	(5)	10	481
Total real estate loans	100,464	18,000	(14,482)	1,219	105,201
Consumer and other loans	—	—	—	—	—
Total	$100,464	$18,000	$(14,482)	$1,219	$105,201

Table of Contents

	For the Three Months Ended December 31, 2011				
	Beginning Balance	Provisions	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
Residential non-Home Today	$49,484	$7,178	$(27,538)	$103	$29,227
Residential Home Today	31,025	12,903	(23,888)	52	20,092
Home equity loans and lines of credit	74,071	(4,897)	(23,224)	485	46,435
Construction	2,398	(184)	(1,086)	1	1,129
Total real estate loans	156,978	15,000	(75,736)	641	96,883
Consumer and other loans	—	—	—	—	—
Total	$156,978	$15,000	$(75,736)	$641	$96,883

The recorded investment in loan receivables at December 31, 2012 and September 30, 2012 is summarized in the following table. The table provides details of the recorded balances according to the method of evaluation used for determining the allowance for loan losses, distinguishing between determinations made by evaluating individual loans and determinations made by evaluating groups of loans not individually evaluated. Balances of recorded investments are net of deferred fees and any applicable loans-in-process.

	December 31, 2012			September 30, 2012		
	Individually	Collectively	Total	Individually	Collectively	Total
Real estate loans:						
Residential non-Home Today	$161,067	$7,465,606	$7,626,673	$165,121	$7,754,289	$7,919,410
Residential Home Today	91,630	106,612	198,242	95,355	109,515	204,870
Home equity loans and lines of credit	38,295	2,048,708	2,087,003	37,016	2,127,712	2,164,728
Construction	1,184	29,140	30,324	1,378	30,455	31,833
Total real estate loans	292,176	9,650,066	9,942,242	298,870	10,021,971	10,320,841
Consumer and other loans	—	4,173	4,173	—	4,612	4,612
Total	$292,176	$9,654,239	$9,946,415	$298,870	$10,026,583	$10,325,453

An analysis of the allowance for loan losses at December 31, 2012 and September 30, 2012 is summarized in the following table. The analysis provides details of the allowance for loan losses according to the method of evaluation, distinguishing between allowances for loan losses determined by evaluating individual loans and allowances for loan losses determined by evaluating groups of loans not individually evaluated.

	December 31, 2012			September 30, 2012		
	Individually	Collectively	Total	Individually	Collectively	Total
Real estate loans:						
Residential non-Home Today	$7,048	$26,043	$33,091	$6,220	$25,398	$31,618
Residential Home Today	8,532	15,851	24,383	9,747	12,841	22,588
Home equity loans and lines of credit	2,941	44,305	47,246	3,928	41,580	45,508
Construction	37	444	481	41	709	750
Total real estate loans	18,558	86,643	105,201	19,936	80,528	100,464
Consumer and other loans	—	—	—	—	—	—
Total	$18,558	$86,643	$105,201	$19,936	$80,528	$100,464

At December 31, 2012, individually evaluated loans that required an allowance were comprised only of loans evaluated for impairment based on the present value of cash flows, such as performing troubled debt restructurings, performing second liens subordinate to first mortgages delinquent greater than 90 days and loans with a further deterioration in the fair value of collateral not yet identified as uncollectible. All other individually evaluated loans received a charge-off if applicable.

Table of Contents

Because many variables are considered in determining the appropriate level of general valuation allowances, directional changes in individual considerations do not always align with the directional change in the balance of a particular component of the general valuation allowance. At December 31, 2012 and September 30, 2012, respectively, allowances on individually reviewed loans evaluated for impairment based on the present value of cash flows, such as performing troubled debt restructurings were $16,671 and $17,720; allowances on performing second liens subordinate to first mortgages delinquent greater than 90 days were $1,499 and $1,550; and allowances on loans with further deteriorations in the fair value of collateral not yet identified as uncollectible were $388 and $666.
Residential non-Home Today mortgage loans represent the largest portion of the residential real estate portfolio. The Company believes overall credit risk is low based on the nature, composition, collateral, products, lien position and performance of the portfolio. The portfolio does not include loan types or structures that have experienced severe performance problems at other financial institutions (e.g., sub-prime, no documentation or pay option adjustable rate mortgages).
As described earlier in this footnote, Home Today loans, particularly those originated prior to March 27, 2009, have greater credit risk than traditional residential real estate mortgage loans. At December 31, 2012 and September 30, 2012, respectively, approximately 53% and 54% of Home Today loans include private mortgage insurance coverage. The majority of the coverage on these loans was provided by PMI Mortgage Insurance Co. (“PMIC”), which the Arizona Department of Insurance seized in 2011 and indicated that all claims payments would be reduced by 50%. Appropriate adjustments have been made to all of the Association’s affected valuation allowances and charge-offs, and estimated loss severity factors were increased for loans evaluated collectively. The amount of loans in our owned portfolio covered by mortgage insurance provided by PMIC as of December 31, 2012 and September 30, 2012, respectively, was $283,033 and $303,621 of which $253,031 and $273,225 was current. The amount of loans in our owned portfolio covered by mortgage insurance provided by Mortgage Guaranty Insurance Corporation ("MGIC") as of December 31, 2012 and September 30, 2012, respectively, was $111,745 and $118,055 of which $109,580 and $116,132 was current. As of December 31, 2012, MGIC's long-term debt rating, as published by the major credit rating agencies, did not meet the requirements to qualify as "investment grade"; however, MGIC continues to make claims payments in accordance with its contractual obligations and the Association has not increased its estimated loss severity factors related to MGIC's claim paying ability. No other loans were covered by mortgage insurers that were deferring claim payments or which we assessed as being non-investment grade.
Home equity lines of credit represent a significant portion of the residential real estate portfolio. The state of the economy and low housing prices continue to have an adverse impact on this portfolio since the home equity lines generally are in a second lien position. Between June 28, 2010 and March 20, 2012, due to the deterioration in overall housing conditions including concerns for loans and lines in a second lien position, home equity lines of credit and home equity loans were not offered by the Association. Beginning March 20, 2012, the Association offers new home equity lines of credit to qualifying existing home equity customers, subject to certain property and credit performance conditions.
Construction loans generally have greater credit risk than traditional residential real estate mortgage loans. The repayment of these loans depends upon the sale of the property to third parties or the availability of permanent financing upon completion of all improvements. In the event we make a loan on property that is not yet approved for the planned development, there is the risk that approvals will not be granted or will be delayed. These events may adversely affect the borrower and the collateral value of the property. Construction loans also expose the Association to the risk that improvements will not be completed on time in accordance with specifications and projected costs. In addition, the ultimate sale or rental of the property may not occur as anticipated. Effective August 30, 2011, the Association made the strategic decision to exit the commercial construction loan business and ceased accepting new builder relationships. Builder commitments in place at that time, to provide additional financing were honored for a limited period, giving our customers the ability to secure new borrowing relationships.
Reflective of the much publicized foreclosure and mortgage servicing problems that have confronted the industry, the Company has generally experienced longer foreclosure timelines than those experienced in the past, particularly in Florida. The longer foreclosure timelines in Florida generally have a greater impact on the Association’s first position

liens as opposed to subordinate liens primarily because the significant property value decline in Florida since 2008, when coupled with the subordinate lien position of home equity lending products, generally results in a high percentage of full charge-offs on the date of initial evaluation. Once a home equity loan or line of credit has been fully charged off, foreclosure timing is no longer relevant. Longer foreclosure timelines generally result in greater loss experience rates on first position liens where full charge-offs are not as prevalent, particularly to the extent that property values continue to decline during the foreclosure process. These expected higher loss experience rates are factored into the determination of collateral fair value and are considered in making charge-off decisions.

Table of Contents

The recorded investment and the unpaid principal balance of impaired loans, including those whose terms have been modified in troubled debt restructurings, as of December 31, 2012 and September 30, 2012 are summarized as follows. Balances of recorded investments are net of deferred fees.

	December 31, 2012			September 30, 2012		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Residential non-Home Today	$93,660	$122,930	$—	$96,227	$126,806	$—
Residential Home Today	36,334	69,033	—	36,578	68,390	—
Home equity loans and lines of credit	29,608	47,932	—	24,397	41,974	—
Construction	780	1,080	—	970	1,349	—
Consumer and other loans	—	—	—	—	—	—
Total	$160,382	$240,975	$—	$158,172	$238,519	$—
With an allowance recorded:						
Residential non-Home Today	$67,407	$69,036	$7,048	$68,894	$70,577	$6,220
Residential Home Today	55,296	56,444	8,532	58,777	60,104	9,747
Home equity loans and lines of credit	8,687	9,294	2,941	12,619	13,554	3,928
Construction	404	404	37	408	408	41
Consumer and other loans	—	—	—	—	—	—
Total	$131,794	$135,178	$18,558	$140,698	$144,643	$19,936
Total impaired loans:						
Residential non-Home Today	$161,067	$191,966	$7,048	$165,121	$197,383	$6,220
Residential Home Today	91,630	125,477	8,532	95,355	128,494	9,747
Home equity loans and lines of credit	38,295	57,226	2,941	37,016	55,528	3,928
Construction	1,184	1,484	37	1,378	1,757	41
Consumer and other loans	—	—	—	—	—	—
Total	$292,176	$376,153	$18,558	$298,870	$383,162	$19,936

At December 31, 2012 and September 30, 2012, respectively, the recorded investment in impaired loans includes $214,037 and $221,399 of loans modified in troubled debt restructurings of which $40,104 and $39,127 are 90 days or more past due.

For all classes of loans, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal and interest according to the contractual terms of the loan agreement. Factors considered in determining that a loan is impaired may include the deteriorating financial condition of the borrower indicated by missed or delinquent payments, a pending legal action, such as bankruptcy or foreclosure, or the absence of adequate security for the loan. Impairment is measured based on the fair value of the collateral less costs to dispose when it is probable that the sole source of repayment for the loan is the underlying collateral. The fair value less estimated cost to dispose of the underlying property is compared to the recorded investment in the loan, net of anticipated mortgage insurance claims, to estimate a loss recorded as a charge-off in the allowance for credit losses. This applies to all mortgage loans and lines of credit. Equity loans, bridge loans, and loans modified in troubled debt restructurings are included in loans individually evaluated based on the fair value of the collateral at 90 or more days past due. Also, loans in Chapter 7 bankruptcy, where all borrowers' obligations related to the loan have been discharged, regardless of delinquency, are evaluated based on collateral. Collateral-based evaluations on all other loans are performed at 180 more days past due. An individual impairment evaluation may be performed on a loan in any portfolio prior to the guidelines established when it becomes evident that a loss is probable. A loan in any portfolio that is identified for individual evaluation based on a failure to make timely payments will continue to be reported as impaired until it is less than 30 days past due and does not have a prior charge-off. A loan in any portfolio that has a partial charge-off consequent to impairment evaluation will continue to be individually evaluated for impairment until, at a minimum, the impairment has been recovered. Loans are charged off when less than the full payment is accepted as satisfaction for a loan; a foreclosure action is completed and the fair value of the collateral received is insufficient to satisfy the loan; management concludes the costs of

Table of Contents

foreclosure exceed the potential recovery; or, in the case of equity loans and lines of credit, management determines the collateral is not sufficient to satisfy the loan.

Loans modified in troubled debt restructurings that are not evaluated based on collateral are separately evaluated for impairment on a loan by loan basis at the time of restructuring and at each subsequent reporting date for as long as they are reported as troubled debt restructurings. The impairment evaluation is based on the present value of expected future cash flows discounted at the effective interest rate of the original loan. Expected future cash flows include a discount factor representing a potential for default. Valuation allowances are recorded for the excess of the recorded investments over the result of the cash flow analysis. Loans in Chapter 7 bankruptcy and less than 30 days past due, where at least one borrower has not had the debt discharged, are evaluated based on the expected future cash flows. Consumer loans are not considered for restructuring. A loan modified in a troubled debt restructuring is classified as an impaired loan for a minimum of one year. After one year, a loan is no longer included in the balance of impaired loans if the loan was modified to yield a market rate for loans of similar credit risk at the time of restructuring and the loan is not impaired based on the terms of restructuring agreement. No troubled debt restructurings were reclassified from impaired loans during the quarter ended December 31, 2012.

The average recorded investment in impaired loans and the amount of interest income recognized during the period that the loans were impaired are summarized below.

	For the Three Months Ended December 31,			
	2012		2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Residential non-Home Today	$94,944	$ 399	$54,855	$ 221
Residential Home Today	36,456	68	25,677	265
Home equity loans and lines of credit	27,003	182	16,779	54
Construction	875	4	824	12
Consumer and other loans	—	—	—	—
Total	$159,278	$ 653	$98,135	$ 552
With an allowance recorded:				
Residential non-Home Today	$68,151	$ 842	$93,117	$ 721
Residential Home Today	57,037	642	96,572	619
Home equity loans and lines of credit	10,653	74	15,400	39
Construction	406	4	3,322	20
Consumer and other loans	—	—	—	—
Total	$136,247	$ 1,562	$208,411	$ 1,399
Total impaired loans:				
Residential non-Home Today	$163,095	$ 1,241	$147,972	$ 942
Residential Home Today	93,493	710	122,249	884
Home equity loans and lines of credit	37,656	256	32,179	93
Construction	1,281	8	4,146	32
Consumer and other loans	—	—	—	—
Total	$295,525	$ 2,215	$306,546	$ 1,951

The amounts of interest income on impaired loans recognized using a cash-basis method was $599 for the quarter ended December 31, 2012, and $566 for the quarter ended December 31, 2011.

Table of Contents

The recorded investment in total troubled debt restructurings as of December 31, 2012 and September 30, 2012 is shown in the tables below.

December 31, 2012	Reduction in Interest Rates	Payment Extensions	Forbearance or Other Actions	Multiple Concessions	Multiple Modifications	Bankruptcy	Total
Residential non-Home Today	$ 20,423	$2,500	$ 14,632	$ 19,602	$ 15,701	$41,917	$114,775
Residential Home Today	19,833	358	11,912	23,386	18,011	5,631	79,131
Home equity loans and lines of credit	88	733	855	181	485	17,084	19,426
Construction	—	607	—	—	—	98	705
Total	$ 40,344	$4,198	$ 27,399	$ 43,169	$ 34,197	$64,730	$214,037
September 30, 2012	**Reduction in Interest Rates**	**Payment Extensions**	**Forbearance or Other Actions**	**Multiple Concessions**	**Multiple Modifications**	**Bankruptcy**	**Total**
Residential non-Home Today	$ 22,039	$2,802	$ 17,106	$ 20,787	$ 9,438	$45,861	$118,033
Residential Home Today	21,977	360	13,991	27,058	11,960	6,548	81,894
Home equity loans and lines of credit	105	646	960	257	384	18,334	20,686
Construction	—	634	—	—	—	152	786
Total	$ 44,121	$4,442	$ 32,057	$ 48,102	$ 21,782	$70,895	$221,399

For all loans modified during the quarter ended December 31, 2012 and December 31, 2011(set forth in the table below), the pre-modification outstanding recorded investment was not materially different from the post-modification outstanding recorded investment.

The following table sets forth the recorded investment in troubled debt restructured loans modified during the period, by the types of concessions granted. Reported values for the prior year have not been adjusted for Chapter 7 bankruptcies that were reclassified as troubled debt restructurings per the OCC interpretive guidance issued in July 2012.

	For the Three Months Ended December 31, 2012						
	Reduction in Interest Rates	Payment Extensions	Forbearance or Other Actions	Multiple Concessions	Multiple Modifications	Bankruptcy	Total
Residential non-Home Today	$1,594	$—	$—	$1,291	$ 1,414	3,414	$7,713
Residential Home Today	152	—	—	351	3,326	774	4,603
Home equity loans and lines of credit	14	100	—	—	—	1,116	1,230
Total	$1,760	$100	$—	$1,642	$ 4,740	$5,304	$13,546

	For the Three Months Ended December 31, 2011					
	Reduction in Interest Rates	Payment Extensions	Forbearance or Other Actions	Multiple Concessions	Multiple Modifications	Total
Residential non-Home Today	$2,936	$ —	$ 1,247	$ 2,735	$ 1,256	$8,174
Residential Home Today	1,174	—	1,203	923	1,806	5,106
Home equity loans and lines of credit	—	—	—	—	155	155
Total	$4,110	$ —	$ 2,450	$ 3,658	$ 3,217	$13,435

Troubled debt restructured loans may be modified more than once. Among other requirements, a re-modification may be available for a borrower upon the expiration of temporary modification terms if the borrower cannot return to regular loan payments. If the borrower is experiencing an income curtailment that temporarily has reduced his/her capacity to repay, such as loss of employment, reduction of hours, non-paid leave or short term disability, a temporary modification is considered. If the borrower lacks the capacity to repay the loan at the current terms due to a permanent condition, a permanent modification is considered. In evaluating the need for a re-modification, the borrower's ability to repay is generally assessed utilizing a debt to income and cash flow analysis. As the economy remains sluggish and high unemployment persists, the need for re-

Table of Contents

modifications continues to linger. Beginning with the quarter ended December 31, 2012, loans discharged in Chapter 7 bankruptcy are classified as multiple modifications if the loan's original terms had also been modified by the Association.

The following table provides information on troubled debt restructured loans modified within the previous 12 months that defaulted, or were at least 30 days past due on one scheduled payment, during the period presented. Reported values for the
quarter ended December 31, 2012 include loans in Chapter 7 bankruptcy status, where at least one borrower has been discharged of their obligation, that were not in Chapter 7 bankruptcy status at December 31, 2011. Prior year activity has not been adjusted for Chapter 7 bankruptcies.

	For the Three Months Ended December 31, 2012	
Troubled Debt Restructurings That Subsequently Defaulted	Number of Contracts	Recorded Investment
	(Dollars in thousands)	
Residential non-Home Today	72	$8,595
Residential Home Today	32	1,526
Home equity loans and lines of credit	35	1,739
Construction	2	$98
Total	141	$11,958

	For the Three Months Ended December 31, 2011	
Troubled Debt Restructurings That Subsequently Defaulted	Number of Contracts	Recorded Investment
	(Dollars in thousands)	
Residential non-Home Today	13	$1,312
Residential Home Today	59	4,176
Home equity loans and lines of credit	1	22
Total	73	$5,510

The following tables provide information about the credit quality of residential loan receivables by an internally assigned grade. Balances are net of deferred fees and any applicable LIP.

	Pass	Special Mention	Substandard	Loss	Total
December 31, 2012					
Real Estate Loans:					
Residential non-Home Today	$7,520,494	$—	$106,179	$—	$7,626,673
Residential Home Today	156,442	—	41,800	—	198,242
Home equity loans and lines of credit	2,038,586	8,834	39,583	—	2,087,003
Construction	29,543	—	781	—	30,324
Total	$9,745,065	$8,834	$188,343	$—	$9,942,242

	Pass	Special Mention	Substandard	Loss	Total
September 30, 2012					
Real Estate Loans:					
Residential non-Home Today	$7,812,028	$—	$107,382	$—	$7,919,410
Residential Home Today	163,332	—	41,538	—	204,870
Home equity loans and lines of credit	2,118,926	9,868	35,934	—	2,164,728
Construction	30,850	—	983	—	31,833

Total	$10,125,136	$9,868	$185,837	$—	$10,320,841

Residential loans are internally assigned a grade that complies with the guidelines outlined in the OCC's Handbook for Rating Credit Risk. Pass loans are assets well protected by the current paying capacity of the borrower. Special Mention loans have a potential weakness that the Association feels deserve management's attention and may result in further deterioration in their repayment prospects and/or the Association's credit position. Substandard loans are inadequately protected by the current payment capacity of the borrower or the collateral pledged with a defined weakness that jeopardizes the liquidation of the debt. Also included in Substandard are performing home equity loans and lines of credit where the customer has a severely delinquent subordinate first mortgage and loans in Chapter 7 bankruptcy status where all borrowers have had their obligations discharged, and have not reaffirmed the debt. Loss loans are considered uncollectible and are charged off when identified.

At December 31, 2012 and September 30, 2012, respectively, the recorded investment of impaired loans includes $124,312 and $133,508 of troubled debt restructurings that are individually evaluated for impairment, but have adequately performed under the terms of the restructuring and are classified as pass loans. At December 31, 2012 and September 30, 2012, respectively, there were $20,513 and $20,475 of loans classified substandard and $8,800 and $9,868 of loans designated special mention that are not included in the recorded investment of impaired loans; rather, they are included in loans collectively evaluated for impairment.

The following table provides information about the credit quality of consumer loan receivables by payment activity.

	December 31, 2012	September 30, 2012
Performing	$4,173	$4,612
Nonperforming	—	—
Total	$4,173	$4,612

Consumer loans are internally assigned a grade of nonperforming when they become 90 days or more past due.

5. DEPOSITS

Deposit account balances are summarized as follows:

	December 31, 2012	September 30, 2012
Negotiable order of withdrawal accounts	$1,042,386	$1,006,125
Savings accounts	1,809,011	1,777,295
Certificates of deposit	5,952,955	6,197,319
	8,804,352	8,980,739
Accrued interest	143	680
Total deposits	$8,804,495	$8,981,419

6. INCOME TAXES

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and city jurisdictions. With few exceptions, the Company is no longer subject to federal tax examinations for tax years prior to 2011 and state tax examinations for tax years prior to 2009. The State of Ohio Department of Taxation is currently conducting an audit of the Association's Ohio Franchise Tax Returns for fiscal years ended September 30, 2009, 2010 and 2011.

The Company recognizes interest and penalties on income tax assessments or income tax refunds, where applicable, in the financial statements as a component of its provision for income taxes.

7. DEFINED BENEFIT PLAN

The Third Federal Savings Retirement Plan (the "Plan") is a defined benefit pension plan. Effective December 31, 2002, the Plan was amended to limit participation to employees who met the Plan's eligibility requirements on that date. Effective December 31, 2011, the Plan was amended to freeze future benefit accruals for participants in the Plan. After December 31, 2011, employees not participating in the Plan, upon meeting the applicable eligibility requirements, and those eligible participants who no longer receive service credits under the Plan, participate in a separate tier of the Company's defined contribution 401(k) Savings Plan. Benefits under the Plan are based on years of service and the employee's average annual compensation (as defined in the Plan) through December 31, 2011. The funding policy of the Plan is consistent with the funding requirements of U.S. federal and other governmental laws and regulations.

Table of Contents

The components of net periodic benefit cost (income) recognized in the statements of income are as follows:

	Three Months Ended December 31,	
	2012	2011
Service cost	$—	$1,005
Interest cost	734	917
Expected return on plan assets	(1,029)	(892)
Amortization of net loss	139	400
Amortization of prior service cost	—	(15)
Recognized net gain due to curtailment	—	(267)
Net periodic benefit cost	$(156)	$1,148

There were no minimum employer contributions paid during the three months ended December 31, 2012. No minimum employer contributions are expected during the remainder of the fiscal year.

8. EQUITY INCENTIVE PLAN

On December 28, 2012, 583,500 options to purchase our common stock and 116,500 restricted stock units were granted to certain officers and employees of the Company. The awards were made pursuant to the shareholder-approved 2008 Equity Incentive Plan.

During the quarter ended December 31, 2012 and 2011, the Company recorded $1,715 and $1,998, respectively, of stock-based compensation expense, comprised of stock option expense of $847 and $1,012, respectively, and restricted stock units expense of $868 and $986, respectively.

At December 31, 2012, 6,766,425 shares were subject to options, with a weighted average exercise price of $11.12 per share and a weighted average grant date fair value of $2.92 per share. Expected future expense related to the 4,381,170 non-vested options outstanding as of December 31, 2012 is $7,181 over a weighted average of 2.3 years. At December 31, 2012, 1,372,198 restricted stock units, with a weighted average grant date fair value of $10.62 per unit, are unvested. Expected future compensation expense relating to the 1,670,281 restricted stock units outstanding as of December 31, 2012 is $8,607 over a weighted average period of 2.7 years. Each unit is equivalent to one share of common stock.

9. COMMITMENTS AND CONTINGENT LIABILITIES

In the normal course of business, the Company enters into commitments with off-balance sheet risk to meet the financing needs of its customers. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments to originate loans generally have fixed expiration dates of 60 to 360 days or other termination clauses and may require payment of a fee. Unfunded commitments related to home equity lines of credit generally expire 10 years following the date that the line of credit was established, subject to various conditions, which include compliance with payment obligations, adequacy of collateral securing the line and maintenance of a satisfactory credit profile by the borrower. Since some of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Off-balance sheet commitments to extend credit involve elements of credit risk and interest rate risk in excess of the amount recognized in the consolidated statements of condition. The Company’s exposure to credit loss in the event of nonperformance by the other party to the commitment is represented by the contractual amount of the commitment. The
Company generally uses the same credit policies in making commitments as it does for on-balance-sheet instruments. Interest rate risk on commitments to extend credit results from the possibility that interest rates may have moved unfavorably from the position of the Company since the time the commitment was made.

At December 31, 2012, the Company had commitments to originate loans as follows:

Fixed-rate mortgage loans	$123,775
Adjustable-rate mortgage loans	171,544
Equity and bridge loans	4,737

Total	$300,056

20

Table of Contents

At December 31, 2012, the Company had unfunded commitments outstanding as follows:

Home equity lines of credit (excluding commitments for suspended accounts)	$1,280,327
Construction loans	30,829
Private equity investments	13,813
Total	$1,324,969

At December 31, 2012, the unfunded commitment on home equity lines of credit, including commitments for accounts suspended as a result of material default or a decline in equity, is $1,495,790.

The Company assumes a portion of the mortgage guaranty insurance on an excess of loss basis for the mortgage guaranty risks of certain mortgage loans in its own portfolio, including Home Today loans and loans in its servicing portfolio, through reinsurance contracts with two primary mortgage insurance companies. Under these contracts, the Company absorbs mortgage insurance losses in a range of 5% to 12% in excess of the initial 5% loss layer of a given pool of loans, in exchange for a portion of the pool's mortgage insurance premiums. The first 5% layer of loss must be exceeded before the Company assumes any liability. At December 31, 2012, the maximum losses under the reinsurance contracts were limited to $14,067. The Company has paid $4,537 of losses under these reinsurance contracts and has provided a liability for the remaining estimated losses totaling $2,621 as of December 31, 2012. When evaluating whether or not the reserves provide a reasonable provision for unpaid loss and loss adjustment expenses, it is necessary to project future loss and loss adjustment expense emergence and payments for loan delinquencies occurring through the balance sheet date. The actual future loss and loss adjustment expense may not develop as actuarially projected. They may in fact vary materially from the projections as mortgage insurance results are influenced by a number of factors such as unemployment, housing market conditions and loan repayment rates. Management believes it has made adequate provision for estimated losses. Based upon notice from the Company's two primary mortgage insurance companies, no new contracts have been added to the Company's risk exposure since December 31, 2008. The Company's insurance partners have retained all new mortgage insurance premiums and all new risk after that date.

The following table summarizes the activity in the liability for unpaid losses and loss adjustment expenses:

	Three Months Ended December 31,	
	2012	2011
Balance, beginning of period	$3,351	$4,023
Incurred (decrease) increase	(251)	171
Paid claims	(479)	(215)
Balance, end of period	$2,621	$3,979

At December 31, 2012 and 2011, the Company had no commitments to securitize and sell mortgage loans.

Management expects that the above commitments will be funded through normal operations.

10. FAIR VALUE

Under U.S. GAAP, fair value is defined as 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. A fair value framework is established whereby assets and liabilities measured at fair value are grouped into three levels of a fair value hierarchy, based on the transparency of inputs and the reliability of assumptions used to estimate fair value. The Company's policy is to recognize transfers between levels of the hierarchy as of the end of the reporting period in which the transfer occurs. The three levels of inputs are defined as follows:

Level 1 –	quoted prices (unadjusted) for identical assets or liabilities in active markets.
Level 2 –	quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets with few transactions, or model-based valuation techniques using assumptions that are observable in the market.
Level 3 –	a company's own assumptions about how market participants would price an asset or liability.

As permitted under the fair value guidance in U.S. GAAP, the Company elects to measure at fair value mortgage loans classified as held for sale that are subject to pending agency contracts to securitize and sell loans. This election is expected to reduce volatility in earnings related to timing issues on these contracts. At December 31, 2012 and September 30, 2012,

Table of Contents

respectively, there were $0 and $3,017 loans held for sale, with unpaid principal balances of $0 and $2,830, subject to pending agency contracts for which the fair value option was elected. For the three months ending December 31, 2012 and 2011, respectively, net gain (loss) on the sale of loans includes $(210) and $0, related to changes during the period in the fair value of loans held for sale subject to pending agency contracts.

Presented below is a discussion of the methods and significant assumptions used by the Company to estimate fair value.

Investment Securities Available for Sale – Investment securities available for sale are recorded at fair value on a recurring basis. At December 31, 2012 and September 30, 2012, respectively, this includes $443,517 and $413,729 of investments in U.S. government and agency obligations including U.S. Treasury notes and sequentially structured, highly liquid collateralized mortgage obligations ("CMOs") issued by Fannie Mae, Freddie Mac, and Ginnie Mae and $7,363 and $7,701 of secured institutional money market deposits insured by the FDIC up to the current coverage limits, with any excess collateralized by the holding institution. Both are measured using the market approach. The fair values of treasury notes and CMOs represent unadjusted price estimates obtained from third party independent nationally recognized pricing services using pricing models or quoted prices of securities with similar characteristics and are included in Level 2 of the hierarchy. At the time of initial measurement and, subsequently, when changes in methodologies occur, management obtains and reviews documentation of pricing methodologies used by third party pricing services to verify that prices are determined in accordance with fair value guidance in U.S. GAAP and to ensure that assets are properly classified in the fair value hierarchy. Additionally, third party pricing is reviewed on a monthly basis for reasonableness based on the market knowledge and experience of company personnel that interact daily with the markets for these types of securities. The carrying amount of the money market deposit accounts is considered a reasonable estimate of their fair value because they are cash deposits in interest bearing accounts valued at par. These accounts are included in Level 1 of the hierarchy.

Mortgage Loans Held for Sale – The fair value of mortgage loans held for sale is estimated using a market approach based on quoted secondary market pricing for loan portfolios with similar characteristics. Loans held for sale are carried at the lower of cost or fair value except, as described above, the Company elects the fair value measurement option for mortgage loans held for sale subject to pending agency contracts to securitize and sell loans. Loans held for sale are included in Level 2 of the hierarchy. At December 31, 2012 and September 30, 2012 there were $0 and $3,017, respectively, of loans held for sale measured at fair value and $324,322 and $121,511, respectively, of loans held for sale carried at cost.

Impaired Loans – Impaired loans represent certain loans held for investment that are subject to a fair value measurement under U.S. GAAP because they are individually evaluated for impairment and that impairment is measured using a fair value measurement, such as the observable market price of the loan or the fair value of the collateral less estimated costs to sell. Impairment is measured using the market approach based on the fair value of the collateral less estimated costs to sell for loans the Company considers to be collateral-dependent due to a delinquency status or other adverse condition severe enough to indicate that the borrower can no longer be relied upon as the continued source of repayment. These conditions are described more fully in Note 4, Loans and Allowance for Loan Losses.

The fair value of the collateral for a collateral-dependent loan is estimated using an exterior appraisal in the majority of instances. Only if supporting market data is unavailable or the appraiser is unable to complete the assignment will an alternative valuation method be used. Typically that would entail obtaining a Broker Price Opinion ("BPO"). If neither of these methods is available, a commercially available automated valuation model ("AVM") will be used to estimate value. These models are independently developed and regularly updated. The Association has engaged an independent firm to assist with the validation of automated valuation models.

Updated property valuations are obtained for all collateral-dependent impaired loans that become contractually 180 days past due, except that updated appraisals are obtained for home equity lines of credit, home equity loans, bridge loans, and loans modified in troubled debt restructurings that become contractually 90 days past due. Subsequently, updated appraisals are obtained at least annually for all loans that remain delinquent.

To calculate impairment of collateral-dependent loans, the fair market values of the collateral are generally reduced by a calculated cost to sell derived from historical experience and recent market conditions to reflect average net proceeds. A valuation allowance is recorded by a charge to income for any indicated impairment loss. When no impairment loss is indicated, the carrying amount is considered to approximate the fair value of that loan to the Company because contractually that is the maximum recovery the Company can expect. Loans individually evaluated for impairment based on the fair value of the collateral are included in Level 3 of the hierarchy with assets measured at fair value on a non-recurring basis.

Loans held for investment that have been restructured in troubled debt restructurings and are performing according to the modified terms of the loan agreement are individually evaluated for impairment using the present value of expected future cash flows based on the loan's original effective interest rate, which is not a fair value measurement. At December 31, 2012 and

Table of Contents

September 30, 2012, respectively, this included $129,573 and $137,468 in recorded investment of troubled debt restructurings with related allowances for loss of $16,671 and $17,602.

Real Estate Owned – Real estate owned includes real estate acquired as a result of foreclosure or by deed in lieu of foreclosure and is carried at the lower of acquisition cost basis or fair value less estimated costs to sell. Fair value is estimated under the market approach using independent third party appraisals. As these properties are actively marketed, estimated fair values may be adjusted by management to reflect current economic and market conditions. At December 31, 2012 and September 30, 2012, these adjustments were not significant to reported fair values. At December 31, 2012 and September 30, 2012, respectively, there was $14,812 and $16,131 of real estate owned included in Level 3 of the hierarchy with assets measured at fair value on a non-recurring basis where the acquisition costs exceeded the fair values less estimated costs to sell these properties. Real estate owned, as reported in the Consolidated Statements of Condition, includes estimated costs to sell of $1,358 and $1,383 related to properties measured at fair value and $5,151 and $4,899 of properties carried at their original or adjusted cost basis at December 31, 2012 and September 30, 2012, respectively.

Derivatives – Derivative instruments include interest rate locks on commitments to originate loans for the held for sale portfolio and forward commitments on contracts to deliver mortgage loans. Derivatives are reported at fair value in other assets or other liabilities on the Consolidated Statement of Condition with changes in value recorded in current earnings. Fair value is estimated using a market approach based on quoted secondary market pricing for loan portfolios with characteristics similar to loans underlying the derivative contracts. The fair value of interest rate lock commitments is adjusted by a closure rate based on the estimated percentage of commitments that will result in closed loans. A significant change in the closure rate may result in a significant change in the ending fair value measurement of these derivatives relative to their total fair value. Because the closure rate is a significantly unobservable assumption, interest rate lock commitments are included in Level 3 of the hierarchy. Forward commitments on contracts to deliver mortgage loans are included in Level 2 of the hierarchy.

Assets and liabilities carried at fair value on a recurring basis in the Consolidated Statements of Condition at December 31, 2012 and September 30, 2012 are summarized below. There were no liabilities carried at fair value on a recurring basis at December 31, 2102.

		Recurring Fair Value Measurements at Reporting Date Using		
	December 31, 2012	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
		(Level 1)	(Level 2)	(Level 3)
Assets				
Investment securities available for sale:				
U.S. government and agency obligations	$2,051	$ —	$ 2,051	$ —
Freddie Mac certificates	977	—	977	—
Ginnie Mae certificates	15,747	—	15,747	—
REMICs	417,005	—	417,005	—
Fannie Mae certificates	7,737	—	7,737	—
Money market accounts	7,363	7,363	—	—
Derivatives:				
Interest rate lock commitments	342	—	—	342
Total	$451,222	$ 7,363	$ 443,517	$ 342

Table of Contents

	September 30, 2012	Recurring Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Investment securities available for sale:				
U.S. government and agency obligations	$2,056	$ —	$ 2,056	$ —
Freddie Mac certificates	989	—	989	—
Ginnie Mae certificates	16,786	—	16,786	—
REMICs	386,009	—	386,009	—
Fannie Mae certificates	7,889	—	7,889	—
Money market accounts	7,701	7,701	—	—
Mortgage loans held for sale	3,017	—	3,017	—
Derivatives:				
Interest rate lock commitments	404	—	—	404
Total	$424,851	$ 7,701	$ 416,746	$ 404
Liabilities				
Derivatives:				
Forward commitments for the sale of mortgage loans	$243	$ —	$ 243	$ —
Total	$243	$ —	$ 243	$ —

The table below presents a reconciliation of the beginning and ending balances of interest rate lock commitments which are measured at fair value on a recurring basis using significant unobservable inputs (Level 3).

	Three Months Ended December 31, 2012	2011
Beginning balance	$404	$—
Total (losses) for the period:		
Included in earnings	(62)	—
Ending balance	$342	$—
Change in unrealized gains for the period included in earnings for assets held at end of the reporting date	$342	$—

The table below summarizes the classification of gains and losses recorded in earnings due to changes in fair value for interest rate lock commitments which are measured at fair value on a recurring basis using significant unobservable inputs.

	Three Months Ended December 31, 2012	2011
Classification of (losses) in earnings:		
Other income	$(62)	$—
Total (losses)	$(62)	$—

Table of Contents

Summarized in the tables below are those assets measured at fair value on a nonrecurring basis. This includes loans held for investment that are individually evaluated for impairment excluding performing troubled debt restructurings valued using the present value of cash flow method, and properties included in real estate owned that are carried at fair value less estimated costs to sell at the reporting date.

	December 31, 2012	Nonrecurring Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans, net of allowance	$ 160,716	$ —	$ —	$ 160,716
Real estate owned[1]	14,812	—	—	14,812
Total	$ 175,528	$ —	$ —	$ 175,528

[1] Amounts represent fair value measurements of properties before deducting estimated costs to sell.

	September 30, 2012	Nonrecurring Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans, net of allowance	$ 159,069	$ —	$ —	$ 159,069
Real estate owned[1]	16,131	—	—	16,131
Total	$ 175,200	$ —	$ —	$ 175,200

[1]