WASHINGTON FEDERAL INC
Form 10-Q
January 26, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2017
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 001-34654
WASHINGTON FEDERAL, INC.
(Exact name of registrant as specified in its charter)

Washington	91-1661606
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

425 Pike Street Seattle, Washington 98101
(Address of principal executive offices and zip code)
(206) 624-7930
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report.)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) Yes x No o
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 definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

Emerging growth company o
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. o

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

APPLICABLE ONLY TO CORPORATE ISSUERS

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

Title of class:	January 24, 2018
Common stock, $1.00 par value	85,973,665

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(UNAUDITED)

	December 31, 2017	September 30, 2017
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents	$309,713	$313,070
Available-for-sale securities, at fair value	1,245,855	1,266,209
Held-to-maturity securities, at amortized cost	1,765,886	1,646,856
Loans receivable, net of allowance for loan losses of $127,155 and $123,073	11,107,042	10,882,622
Interest receivable	42,146	41,643
Premises and equipment, net	264,643	263,694
Real estate owned	17,928	20,658
FHLB and FRB stock	130,590	122,990
Bank owned life insurance	211,833	211,330
Intangible assets, including goodwill of $300,288 and $293,153	310,578	298,682
Other assets	177,799	185,826
	$15,584,013	$15,253,580
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Customer accounts		
Transaction deposit accounts	$6,482,612	$6,361,158
Time deposit accounts	4,518,967	4,473,850
	11,001,579	10,835,008
FHLB advances	2,415,000	2,225,000
Advance payments by borrowers for taxes and insurance	23,924	56,631
Accrued expenses and other liabilities	133,892	131,253
	13,574,395	13,247,892
Stockholders' equity		
Common stock, $1.00 par value, 300,000,000 shares authorized; 135,274,618 and 134,957,511 shares issued; 86,363,099 and 87,193,362 shares outstanding	135,275	134,958
Additional paid-in capital	1,661,866	1,660,885
Accumulated other comprehensive income (loss), net of taxes	8,004	5,015
Treasury stock, at cost; 48,911,519 and 47,764,149 shares	(877,044)	(838,060)
Retained earnings	1,081,517	1,042,890
	2,009,618	2,005,688
	$15,584,013	$15,253,580

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended December 31,	
	2017	2016
	(In thousands, except share data)	
INTEREST INCOME		
Loans receivable	$ 124,511	$ 114,835
Mortgage-backed securities	16,899	12,789
Investment securities and cash equivalents	4,370	5,140
	145,780	132,764
INTEREST EXPENSE		
Customer accounts	14,638	13,017
FHLB advances	15,407	16,595
	30,045	29,612
Net interest income	115,735	103,152
Provision (release) for loan losses	—	—
Net interest income after provision (release) for loan losses	115,735	103,152
OTHER INCOME		
Gain on sale of investment securities	—	968
FDIC loss share valuation adjustments	(8,550)	—
Loan fee income	1,035	1,334
Deposit fee income	6,686	5,185
Other income	7,624	4,409
	6,795	11,896
OTHER EXPENSE		
Compensation and benefits	29,619	26,994
Occupancy	8,671	8,450
FDIC insurance premiums	2,820	2,839
Product delivery	3,956	3,361
Information technology	7,929	6,451
Other expense	8,946	6,246
	61,941	54,341
Gain (loss) on real estate owned, net	46	398
Income before income taxes	60,635	61,105
Income tax expense	8,965	19,859
NET INCOME	$ 51,670	$ 41,246
PER SHARE DATA		
Basic earnings per share	$ 0.59	$ 0.46
Diluted earnings per share	0.59	0.46
Dividends paid on common stock per share	0.15	0.14
Basic weighted average number of shares outstanding	86,938,095	89,310,958
Diluted weighted average number of shares outstanding	87,082,499	89,731,024

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended December 31,	
	2017	2016
	(In thousands)	
Net income	$51,670	$41,246
Other comprehensive income (loss) net of tax:		
Net unrealized gain (loss) on available-for-sale investment securities	(1,964)	(17,079)
Reclassification adjustment of net gain (loss) from sale of available-for-sale securities included in net income	—	968
Related tax benefit (expense)	722	5,921
	(1,242)	(10,190)
Net unrealized gain (loss) on cash flow hedges of borrowings	6,690	29,271
Related tax benefit (expense)	(2,459)	(10,757)
	4,231	18,514
Other comprehensive income (loss) net of tax	2,989	8,324
Comprehensive income	$54,659	$49,570

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(UNAUDITED)

(in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at October 1, 2017	$134,958	$1,660,885	$1,042,890	$ 5,015	$(838,060)	$2,005,688
Net income			51,670			51,670
Other comprehensive income (loss)				2,989		2,989
Dividends on common stock			(13,043)			(13,043)
Compensation expense related to common stock options						—
Proceeds from exercise of common stock options	14	272				286
Restricted stock expense	194	818				1,012
Exercise of stock warrants	109	(109)				—
Treasury stock acquired					(38,984)	(38,984)
Balance at December 31, 2017	$135,275	$1,661,866	$1,081,517	$ 8,004	$(877,044)	$2,009,618

(in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at October 1, 2016	$134,308	$1,648,388	$943,877	$ (11,156)	$(739,686)	$1,975,731
Net income			41,246			41,246
Other comprehensive income (loss)				8,324		8,324
Dividends on common stock			(12,422)			(12,422)
Proceeds from exercise of common stock options	190	4,172				4,362
Restricted stock expense	109	2,636				2,745
Exercise of stock warrants	50	(50)				—
Treasury stock acquired					(20,385)	(20,385)
Balance at December 31, 2016	$134,657	$1,655,146	$972,701	$ (2,832)	$(760,071)	$1,999,601

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended December 31, 2017	2016
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$51,670	$41,246
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization, and accretion expense, net	15,273	12,087
Stock based compensation expense	1,012	2,745
Loss (gain) on sale of investment securities	—	(968)
Decrease (increase) in accrued interest receivable	(503)	(449)
Decrease (increase) in federal and state income tax receivable	—	16,047
Decrease (increase) in cash surrender value of bank owned life insurance	(1,571)	(1,739)
Gain on bank owned life insurance	(2,416)	(649)
Net realized (gain) loss on sales of premises, equipment, and real estate owned	(241)	657
Decrease (increase) in other assets	(7,715)	14,153
Increase (decrease) in accrued expenses and other liabilities	2,595	(41,265)
Net cash provided by (used in) operating activities	58,104	41,865
CASH FLOWS FROM INVESTING ACTIVITIES		
Origination of loans and principal repayments, net	(80,089)	(226,080)
Loans purchased	(143,605)	—
FHLB & FRB stock purchased	(123,600)	(9)
FHLB & FRB stock redeemed	116,000	24
Available-for-sale securities purchased	(40,884)	—
Principal payments and maturities of available-for-sale securities	58,261	112,469
Proceeds from sales of available-for-sale securities	—	350,890
Held-to-maturity securities purchased	(170,836)	(415,729)
Principal payments and maturities of held-to-maturity securities	50,653	78,778
Proceeds from sales of real estate owned	3,440	6,457
Proceeds from settlement of bank owned life insurance	3,484	1,231
Proceeds from sales of premises and equipment	1	1,722
Premises and equipment purchased and REO improvements	(6,485)	(2,200)
Net cash provided by (used in) investing activities	(333,660)	(92,447)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in customer accounts	166,647	46,799
Proceeds from borrowings	3,090,000	—
Repayments of borrowings	(2,900,000)	—
Proceeds from exercise of common stock options and related tax benefit	286	4,362
Dividends paid on common stock	(13,043)	(12,422)
Treasury stock purchased	(38,984)	(20,385)
Increase (decrease) in borrower advances related to taxes and insurance, net	(32,707)	(19,302)
Net cash provided by (used in) financing activities	272,199	(948)
Increase (decrease) in cash and cash equivalents	(3,357)	(51,530)
Cash and cash equivalents at beginning of period	313,070	450,368
Cash and cash equivalents at end of period	$309,713	$398,838

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended December 31,	
	2017	2016
	(In thousands)	
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Non-cash investing activities		
Real estate acquired through foreclosure	$773	$1,589
Non-cash financing activities		
Stock issued upon exercise of warrants	3,761	1,523
Cash paid during the period for		
Interest	29,986	28,737
Income taxes	5,225	—

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE A – Summary of Significant Accounting Policies

Nature of Operations - Washington Federal, Inc. (the "Company") is a Washington corporation headquartered in Seattle, Washington. The Company is a bank holding company that conducts its operations through its national bank subsidiary, Washington Federal, National Association (the "Bank"). The Bank is principally engaged in the business of attracting deposits from businesses and the general public and investing these funds, together with borrowings and other funds, in one-to-four family residential mortgage and construction loans, home equity loans, lines of credit, commercial real estate loans, commercial and industrial loans, multi-family and other forms of real estate loans. As used throughout this document, the terms "Washington Federal" or the "Company" refer to Washington Federal, Inc. and its consolidated subsidiaries and the term "Bank" refers to the operating subsidiary Washington Federal, National Association.

Basis of Presentation - The Company has prepared the consolidated unaudited interim financial statements included in this report. All intercompany transactions and accounts have been eliminated in consolidation. The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America (“GAAP”), requires management to make estimates and assumptions that affect amounts reported in the financial statements. Actual results could differ from these estimates. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation are reflected in the interim financial statements. Certain amounts in the financial statements from prior periods have been reclassified to conform to the current financial statement presentation.

The information included in this Form 10-Q should be read in conjunction with the financial statements and related notes in the Company's 2017 Annual Report on Form 10-K (“2017 Annual Financial Statements”). Interim results are not necessarily indicative of results for a full year.

During the three months ended December 31, 2017, an immaterial correction was recorded related to acquisitions of insurance agency businesses in prior years. The balance sheet classification correction resulted in an increase in goodwill of $7,135,000 and finite-lived intangible assets of $5,106,000 and a corresponding decrease in other assets of $12,241,000.

Summary of Significant Accounting Policies - The significant accounting policies used in preparation of the Company's consolidated financial statements are disclosed in its 2017 Annual Financial Statements. There have not been any material changes in our significant accounting policies compared to those contained in our 2017 Annual Financial Statements for the year ended September 30, 2017.

Off-Balance-Sheet Credit Exposures – The only material off-balance-sheet credit exposures are loans in process and unused lines of credit, which had a combined balance of $2,088,669,000 and $1,992,905,000 at December 31, 2017 and September 30, 2017, respectively. The Company estimates losses on off-balance-sheet credit exposures by allocating a loss percentage derived from historical loss factors for each asset class.

NOTE B – New Accounting Pronouncements

In August 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The ASU expands and refines hedge accounting for both financial and non-financial risk components, aligns the recognition and presentation of the effects of hedging instruments and hedge items in the financial statements, and includes certain targeted improvements to ease the application of current guidance related to the assessment of hedge effectiveness. The effective date of the new standard for public companies is for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition with a cumulative effect adjustment recorded to opening retained earnings as of the initial adoption date. The Company does not anticipate that this guidance will have a material impact on its consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities. The ASU shortens 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. The ASU is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. If an entity early adopts in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments should be applied on a modified retrospective basis, with a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company does not anticipate that this guidance will have a material impact on its consolidated financial statements.

In February 2017, the FASB issued ASU 2017-05, Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets. The ASU clarifies that a financial asset is within the scope of Subtopic 610-20 if it meets the definition of an in substance nonfinancial asset. The amendments also define the term in substance nonfinancial asset. The amendments clarify that nonfinancial assets within the scope of Subtopic 610-20 may include nonfinancial assets transferred within a legal entity to a counterparty. A contract that includes the transfer of ownership interests in one or more consolidated subsidiaries is within the scope of Subtopic 610-20 if substantially all of the fair value of the assets that are promised to the counterparty in a contract is concentrated in nonfinancial assets. The amendments clarify that an entity should identify each distinct nonfinancial asset or in substance nonfinancial asset promised to a counterparty and derecognize each asset when a counterparty obtains control of it. The ASU is effective for public business entities for annual periods beginning after December 15, 2017, and interim periods therein. Entities may use either a full or modified approach to adopt the ASU. The Company does not anticipate that this guidance will have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which eliminates Step 2 from the goodwill impairment test. The ASU also eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The ASU is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019, with early adoption being permitted for annual or interim goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not anticipate that this guidance will have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, Business Combinations Clarifying the Definition of a Business (Topic 805), for determining whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017, with early adoption permitted for transactions that occurred before the issuance date or effective date of the standard if the transactions were not reported in financial statements that have been issued or made available for issuance. The ASU must be applied prospectively and upon adoption the standard will impact how we assess acquisitions (or disposals) of assets or businesses. The Company does not anticipate that this guidance will have a material impact on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash: a Consensus of the FASB Emerging Issues Task Force. This ASU requires a company’s cash flow statement to explain the changes during a reporting period of the totals for cash, cash equivalents, restricted cash, and restricted cash equivalents. Additionally, amounts for restricted cash and restricted cash equivalents are to be included with cash and cash equivalents if the cash flow statement includes a reconciliation of the total cash balances for a reporting period. This ASU is effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017, with early application permitted. The Company does not anticipate that this guidance will have a material impact on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments. The amendments in this ASU address eight specific cash flow issues with the objective of reducing diversity in practice. The specific issues identified include: debt prepayments or extinguishment costs; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (including bank-owned life insurance policies); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within that reporting period; however, early adoption is permitted. The Company is currently evaluating the guidance to determine its adoption method and does not expect this guidance to have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses. The amendments in this ASU were issued to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investments in leases and other commitments to extend credit held by a reporting entity at each reporting date. The amendments require that financial assets measured at amortized cost 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 ASU eliminates the current framework of recognizing probable incurred losses and instead requires an entity to use its current estimate of all expected credit losses over the contractual life. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the financial assets.

For purchased financial assets with a more-than-insignificant amount of credit deterioration since origination (“PCD assets”) that are measured at amortized cost, an allowance for expected credit losses is recorded as an adjustment to the cost basis of the asset. Subsequent changes in estimated cash flows would be recorded as an adjustment to the allowance and through the statement of income.

Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security's cost basis.

The amendments in this ASU are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For most debt securities, the transition approach requires a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period the guidance is effective. For other-than-temporarily impaired debt securities and PCD assets, the guidance will be applied prospectively. While the Company is currently in the process of evaluating the impact of the amended guidance on its consolidated financial statements, it currently expects the ALLL to increase upon adoption given that the allowance will be required to cover the full remaining expected life of the portfolio upon adoption, rather than the incurred loss model under current U.S. GAAP. The extent of this increase is still being evaluated and will depend on economic conditions and the composition of the Company’s loan and lease portfolio at the time of adoption.

In February 2016, the FASB issued ASU 2016-02, Leases. The amendments require lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. The guidance also simplifies the accounting for sale and leaseback transactions. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently in the process of accumulating the lease data necessary to apply the amended guidance. The Company is continuing to evaluate the impact of the amended guidance on its consolidated financial statements, but the effects of recognizing most operating leases is not expected to be material. The Company expects to recognize right-of-use assets and lease liabilities for substantially all of its operating lease commitments based on the present value of unpaid lease payments as of the date of adoption.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, to require all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). The amendments in this ASU also 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. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. The Company does not expect this guidance to have a material impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The guidance in this update supersedes the revenue recognition requirements in ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the industry topics of the codification. For public companies, this update was to be effective for interim and annual periods beginning after December 15, 2016. However, in August 2015, the FASB issued ASU 2015-14, which delayed the effective date of ASU 2014-09 by one year and permits companies to voluntarily adopt the new standard as of the original effective date. The Company does not expect this guidance to have a material impact on its consolidated financial statements.

NOTE C – Dividends and Share Repurchases

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On November 20, 2017, the Company paid a regular dividend on common stock of $0.15 per share, which represented the 139th consecutive quarterly cash dividend. Dividends per share were $0.15 and $0.14 for the quarters ended December 31, 2017 and 2016, respectively. On January 24, 2018, the Company declared a regular dividend on common stock of $0.17 per share, which represents its 140th consecutive quarterly cash dividend. This dividend will be paid on February 23, 2018 to common shareholders of record on February 9, 2018.

For the three months ended December 31, 2017, the Company repurchased 1,147,370 shares at an average price of $33.98. Additionally, 108,704 shares of common stock were issued during the three months ended December 31, 2017 to investors that exercised warrants previously issued as part of the 2008 Troubled Asset Relief Program ("TARP"). As of December 31, 2017, 112,649 such warrants remain outstanding. Net of warrant cash repurchase activity, there are 753,585 remaining shares authorized to be repurchased under the current Board approved share repurchase program. On January 24, 2018, the Board approved an additional 5,000,000 shares available under the repurchase program.

NOTE D – Loans Receivable

The following table is a summary of loans receivable.

	December 31, 2017		September 30, 2017	
	(In thousands)		(In thousands)	
Gross loans by category				
Single-family residential	$5,693,318	45.7%	$5,711,004	46.8%
Construction	1,710,418	13.7	1,597,996	13.1
Construction - custom	583,580	4.7	602,631	4.9
Land - acquisition & development	136,938	1.1	124,308	1.0
Land - consumer lot loans	105,086	0.8	104,405	0.9
Multi-family	1,312,695	10.5	1,303,148	10.7
Commercial real estate	1,436,508	11.5	1,434,610	11.8
Commercial & industrial	1,120,707	9.0	1,093,360	9.0
HELOC	136,995	1.1	144,850	1.2
Consumer	219,971	1.8	85,075	0.7
Total gross loans	12,456,216	100 %	12,201,387	100 %
Less:				
Allowance for loan losses	127,155		123,073	
Loans in process	1,175,642		1,149,934	
Net deferred fees, costs and discounts	46,377		45,758	
Total loan contra accounts	1,349,174		1,318,765	
Net loans	$11,107,042		$10,882,622	

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The following table sets forth information regarding non-accrual loans.

	December 31, 2017		September 30, 2017	
	(In thousands)			
Non-accrual loans:				
Single-family residential	$26,219	57.7%	$27,930	56.3%
Construction	364	0.8	—	—
Construction - custom	—	—	91	0.2
Land - acquisition & development	1,326	2.9	296	0.6
Land - consumer lot loans	976	2.1	605	1.2
Multi-family	250	0.5	139	0.3
Commercial real estate	8,241	18.1	11,815	23.8
Commercial & industrial	7,596	16.7	8,082	16.3
HELOC	476	1.0	531	1.1
Consumer	72	0.2	91	0.2
Total non-accrual loans	$45,520	100 %	$49,580	100 %
% of total net loans	0.41 %		0.46 %	

The Company recognized interest income on non-accrual loans of approximately $2,551,000 in the three months ended December 31, 2017. Had these loans been on accrual status and performed according to their original contract terms, the Company would have recognized interest income of approximately $489,000 for the three months ended December 31, 2017. Interest cash flows collected on non-accrual loans varies from period to period as those loans are brought current or are paid off.

The following tables provide details regarding delinquent loans.

December 31, 2017	Loans Receivable	Days Delinquent Based on $ Amount of Loans					% based on $
Type of Loan	Net of Loans In Process	Current	30	60	90	Total Delinquent	
	(In thousands)						
Single-family residential	$5,692,045	$5,655,873	$9,801	$6,073	$20,298	$ 36,172	0.64 %
Construction	852,164	847,793	1,500	2,507	364	4,371	0.51
Construction - custom	292,255	292,255	—	—	—	—	—
Land - acquisition & development	112,260	111,018	—	—	1,242	1,242	1.11
Land - consumer lot loans	104,996	104,246	107	153	490	750	0.71
Multi-family	1,312,673	1,312,423	—	—	250	250	0.02
Commercial real estate	1,436,508	1,436,064	129	—	315	444	0.03
Commercial & industrial	1,120,707	1,117,240	2,894	—	573	3,467	0.31
HELOC	136,995	136,004	439	147	405	991	0.72
Consumer	219,971	219,404	352	154	61	567	0.26
Total Loans	$11,280,574	$11,232,320	$15,222	$9,034	$23,998	$ 48,254	0.43 %
Delinquency %		99.57%	0.13%	0.08%	0.21%	0.43%	

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September 30, 2017	Loans Receivable	Days Delinquent Based on $ Amount of Loans					% based on $
Type of Loan	Net of Loans In Process	Current	30	60	90	Total Delinquent	
	(In thousands)						
Single-family residential	$5,709,690	$5,671,933	$10,925	$4,810	$22,022	$ 37,757	0.66 %
Construction	793,959	793,959	—	—	—	—	—
Construction - custom	277,599	277,508	—	—	91	91	0.03
Land - acquisition & development	104,856	104,526	—	—	330	330	0.31
Land - consumer lot loans	104,335	103,389	112	680	154	946	0.91
Multi-family	1,303,119	1,302,720	5	255	139	399	0.03
Commercial real estate	1,434,610	1,432,052	507	—	2,051	2,558	0.18
Commercial & industrial	1,093,360	1,092,735	—	51	574	625	0.06
HELOC	144,850	143,974	221	342	313	876	0.60
Consumer	85,075	84,644	245	107	79	431	0.51
Total Loans	$11,051,453	$11,007,440	$12,015	$6,245	$25,753	$ 44,013	0.40 %
Delinquency %		99.60%	0.11%	0.06%	0.23%	0.40%	

The percentage of total delinquent loans increased from 0.40% as of September 30, 2017 to 0.43% as of December 31, 2017 and there are no loans greater than 90 days delinquent and still accruing interest as of either date.

The following table provides information related to loans that were restructured in a troubled debt restructuring ("TDR") during the periods presented:

	Three Months Ended December 31,					
	2017			2016		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
		(In thousands)			(In thousands)	
Troubled Debt Restructurings:						
Single-family residential	8	$2,012	$ 2,012	12	$2,134	$ 2,134
Land - consumer lot loans	—	—	—	1	204	204
Commercial & Industrial	3	7,256	7,256	—	—	—
HELOC	—	—	—	1	228	228
	11	$9,268	$ 9,268	14	$2,566	$ 2,566

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The following table provides information on payment defaults occurring during the periods presented where the loan had been modified in a TDR within 12 months of the payment default.

	Three Months Ended December 31,			
	2017		2016	
	Number of Contracts	Recorded Investment (In thousands)	Number of Contracts	Recorded Investment (In thousands)
TDRs That Subsequently Defaulted:				
Single-family residential	1	$ 44	6	$ 1,993
Commercial real estate	—	—	2	267
	1	$ 44	8	$ 2,260

Most loans restructured in TDRs are accruing and performing loans where the borrower has proactively approached the Company about modification due to temporary financial difficulties. As of December 31, 2017, 97.6% of the Company's $199,175,000 in TDRs were classified as performing. Each request for modification is individually evaluated for merit and likelihood of success. The concession granted in a loan modification is typically a payment reduction through a rate reduction of between 100 to 200 basis points for a specific term, usually six to twenty four months. Interest-only payments may also be approved during the modification period. Principal forgiveness is not an available option for restructured loans. As of December 31, 2017, single-family residential loans comprised 85.7% of TDRs.

The Company reserves for restructured loans within its allowance for loan loss methodology by taking into account the following performance indicators: 1) time since modification, 2) current payment status and 3) geographic area.

The Company's remaining outstanding balance of assets subject to FDIC loss share agreements was $58,699,000 (including $54,865,000 of loans receivable) at December 31, 2017 compared to $67,914,000 (including $61,810,114 of loans receivable) as of September 30, 2017. As of December 31, 2017, the associated FDIC indemnification asset was $0 compared to a balance of $8,967,000 as of September 30, 2017. The FDIC clawback liability was $39,906,000 as of December 31, 2017 and $37,143,000 as of September 30, 2017. The Company has made a proposal to the FDIC to early terminate its remaining FDIC loss share agreements, which relate to the Horizon Bank and Home Valley Bank acquisitions. During the three months ended December 31, 2017, the Company recorded an $8,550,000 charge resulting from valuation adjustments related to the FDIC indemnification asset and FDIC clawback liability. The valuation adjustments were based on management's estimate of the amount that would be due to the FDIC to early terminate the loss share agreements.

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NOTE E – Allowance for Losses on Loans
The following tables summarize the activity in the allowance for loan losses.

Three Months Ended December 31, 2017	Beginning Allowance	Charge-offs	Recoveries	Provision & Transfers	Ending Allowance
	(In thousands)				
Single-family residential	$36,892	$ (461)	$ 121	$ (624)	$35,928
Construction	24,556	—	—	658	25,214
Construction - custom	1,944	(50)	—	158	2,052
Land - acquisition & development	6,829	—	3,372	(2,846)	7,355
Land - consumer lot loans	2,649	(47)	—	304	2,906
Multi-family	7,862	—	—	42	7,904
Commercial real estate	11,818	—	—	(193)	11,625
Commercial & industrial	28,524	(116)	55	805	29,268
HELOC	855	—	—	(47)	808
Consumer	1,144	(78)	286	2,743	4,095
	$123,073	$ (752)	$ 3,834	$ 1,000	$127,155

Three Months Ended December 31, 2016	Beginning Allowance	Charge-offs	Recoveries	Provision & Transfers	Ending Allowance
	(In thousands)				
Single-family residential	$37,796	$ (115)	$ 151	$ 374	$38,206
Construction	19,838	—	—	2,096	21,934
Construction - custom	1,080	—	—	30	1,110
Land - acquisition & development	6,023	(20)	4,018	(3,356)	6,665
Land - consumer lot loans	2,535	(17)	70	(87)	2,501
Multi-family	6,925	—	—	704	7,629
Commercial real estate	8,588	(11)	356	1,235	10,168
Commercial & industrial	28,008	(58)	725	(939)	27,736
HELOC	813	(37)	1	55	832
Consumer	1,888	(146)	379	(446)	1,675
	$113,494	$ (404)	$ 5,700	$ (334)	$118,456

The Company recorded no provision for loan losses during the three months ended December 31, 2017 or December 31, 2016. Reserving for new loan originations as the loan portfolio grows and the mix changes has been largely offset by recoveries of previously charged-off loans. Recoveries, net of charge-offs, totaled $3,082,000 for the three months ended December 31, 2017, compared with $5,296,000 of net recoveries for the same period one year ago.
Non-performing assets were $63,448,000, or 0.41%, of total assets at December 31, 2017, compared to $70,238,000, or 0.46%, of total assets at September 30, 2017. Non-accrual loans were $45,520,000 at December 31, 2017, compared to $49,580,000 at September 30, 2017. Delinquencies, as a percent of total loans, were 0.43% at December 31, 2017, compared to 0.40% at September 30, 2017.

The reserve for unfunded commitments was $6,750,000 as of December 31, 2017, which is a decrease from $7,750,000 at September 30, 2017.

Management believes the allowance for loan losses plus the reserve for unfunded commitments, totaling $133,905,000, or 1.08% of gross loans as of December 31, 2017, is sufficient to absorb estimated inherent losses.

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The following tables show loans collectively and individually evaluated for impairment and the related allocation of general and specific reserves.

December 31, 2017	Loans Collectively Evaluated for Impairment			Loans Individually Evaluated for Impairment		
	Allowance Allocation	Recorded Investment of Loans	Ratio	Allowance Allocation	Recorded Investment of Loans	Ratio
	(In thousands)			(In thousands)		
Single-family residential	$ 35,928	$ 5,676,565	0.6 %	$ —	$ 24,083	— %
Construction	25,214	851,800	3.0	—	364	—
Construction - custom	2,052	292,255	0.7	—	—	—
Land - acquisition & development	7,355	110,884	6.6	—	1,376	—
Land - consumer lot loans	2,906	97,291	3.0	—	416	—
Multi-family	7,899	1,311,943	0.6	5	730	0.7
Commercial real estate	11,519	1,389,749	0.8	106	27,535	0.4
Commercial & industrial	28,744	1,108,961	2.6	524	11,694	4.5
HELOC	808	134,320	0.6	—	620	—
Consumer	4,095	219,784	1.9	—	70	—
	$ 126,520	$ 11,193,552	1.1 %	$ 635	$ 66,888	0.9 %

September 30, 2017	Loans Collectively Evaluated for Impairment			Loans Individually Evaluated for Impairment		
	Allowance Allocation	Recorded Investment of Loans	Ratio	Allowance Allocation	Recorded Investment of Loans	Ratio
	(In thousands)			(In thousands)		
Single-family residential	$ 36,893	$ 5,713,576	0.7 %	$ —	$ 5,552	— %
Construction	24,556	793,958	3.1	—	—	—
Construction - custom	1,944	277,495	0.7	—	105	—
Land - acquisition & development	6,828	104,767	6.5	1	89	1.0
Land - consumer lot loans	2,649	96,337	2.8	—	171	—
Multi-family	7,857	1,302,625	0.6	5	493	1.0
Commercial real estate	11,697	1,391,668	0.8	120	21,765	0.6
Commercial & industrial	28,524	1,093,210	2.6	—	81	—
HELOC	855	141,689	0.6	—	215	—
Consumer	1,144	84,887	1.4	—	82	—
	$ 122,947	$ 11,000,212	1.1 %	$ 126	$ 28,553	0.4 %

As of December 31, 2017, $126,520,000 of the allowance was calculated under the formulas contained in our general allowance methodology and the remaining $635,000 was specific reserves on loans deemed to be individually impaired. As of September 30, 2017, $122,947,000 of the allowance was calculated under the formulas contained in our general allowance methodology and the remaining $126,000 was specific reserves on loans deemed to be individually impaired.

The Company has an asset quality review function that analyzes its loan portfolio and reports the results of the review to the Board of Directors on a quarterly basis. The single-family residential, HELOC and consumer portfolios are evaluated based on their performance as a pool of loans, since no single loan is individually significant or judged by its risk rating, size or potential risk of loss. The construction, land, multi-family, commercial real estate and commercial and industrial loans are risk rated on a loan by

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loan basis to determine the relative risk inherent in specific borrowers or loans. Based on that risk rating, the loans are assigned a grade and classified as follows:

- Pass – the credit does not meet one of the definitions below.

- Special mention – A special mention credit is considered to be currently protected from loss but is potentially weak. No loss of principal or interest is foreseen; however, proper supervision and Management attention is required to deter further deterioration in the credit. Assets in this category constitute some undue and unwarranted credit risk but not to the point of justifying a risk rating of substandard. The credit risk may be relatively minor yet constitutes an unwarranted risk in light of the circumstances surrounding a specific asset.

- Substandard – A substandard credit is an unacceptable credit. Additionally, repayment in the normal course is in jeopardy due to the existence of one or more well defined weaknesses. In these situations, loss of principal is likely if the weakness is not corrected. A substandard asset is inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral pledged, if any. Assets so classified will have a well defined weakness or weaknesses that jeopardize the collection or liquidation of the debt. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets risk rated substandard.

- Doubtful – A credit classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weakness makes collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The probability of loss is high, but because of certain important and reasonably specific pending factors that may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral, and refinancing plans.

- Loss – Credits classified loss are considered uncollectible and of such little value that their continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this asset even though partial recovery may be affected in the future. Losses should be taken in the period in which they are identified as uncollectible. Partial charge-off versus full charge-off may be taken if the collateral offers some identifiable protection.

The following tables provide information on loans based on risk rating categories as defined above.

December 31, 2017	Internally Assigned Grade					
	Pass	Special mention	Substandard	Doubtful	Loss	Total Gross Loans
	(In thousands)					
Loan type						
Single-family residential	$5,657,731	$ —	$35,587	$ —	$ —	$5,693,318
Construction	1,707,044	—	3,374	—	—	1,710,418
Construction - custom	583,580	—	—	—	—	583,580
Land - acquisition & development	134,625	—	2,313	—	—	136,938
Land - consumer lot loans	104,105	—	981	—	—	105,086
Multi-family	1,304,991	3,159	4,545	—	—	1,312,695
Commercial real estate	1,401,236	3,764	31,508	—	—	1,436,508
Commercial & industrial	1,077,207	10,423	33,077	—	—	1,120,707
HELOC	136,287	—	708	—	—	136,995
Consumer	219,899	—	72	—	—	219,971
Total gross loans	$12,326,705	$ 17,346	$112,165	$ —	$ —	$12,456,216
Total grade as a % of total gross loans	99.0 %	0.1 %	0.9 %	— %	—%	

September 30, 2017	Internally Assigned Grade					
	Pass	Special mention	Substandard	Doubtful	Loss	Total Gross Loans
	(In thousands)					
Loan type						
Single-family residential	$5,671,229	$ —	$39,775	$ —	$ —	$5,711,004
Construction	1,594,926	—	3,070	—	—	1,597,996
Construction - custom	602,540	—	91	—	—	602,631
Land - acquisition & development	123,028	207	1,073	—	—	124,308
Land - consumer lot loans	103,787	—	618	—	—	104,405
Multi-family	1,295,261	5,795	2,092	—	—	1,303,148
Commercial real estate	1,391,996	5,944	36,670	—	—	1,434,610
Commercial & industrial	1,054,972	14,814	23,574	—	—	1,093,360
HELOC	144,229	—	621	—	—	144,850
Consumer	84,984	—	91	—	—	85,075
Total gross loans	$12,066,952	$ 26,760	$107,675	$ —	$ —	$12,201,387
Total grade as a % of total gross loans	98.9 %	0.2 %	0.9 %	— %	—%	

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The following tables provide information on gross loans based on borrower payment activity.

December 31, 2017	Performing Loans		Non-Performing Loans	
	Amount	% of Total Gross Loans	Amount	% of Total Gross Loans
	(In thousands)			
Single-family residential	$5,667,099	99.5 %	$ 26,219	0.5 %
Construction	1,710,054	100.0	364	—
Construction - custom	583,580	100.0	—	—
Land - acquisition & development	135,612	99.0	1,326	1.0
Land - consumer lot loans	104,110	99.1	976	0.9
Multi-family	1,312,445	100.0	250	—
Commercial real estate	1,428,267	99.4	8,241	0.6
Commercial & industrial	1,113,111	99.3	7,596	0.7
HELOC	136,519	99.7	476	0.3
Consumer	219,899	100.0	72	—
	$12,410,696	99.6 %	$ 45,520	0.4 %

September 30, 2017	Performing Loans		Non-Performing Loans	
	Amount	% of Total Gross Loans	Amount	% of Total Gross Loans
	(In thousands)			
Single-family residential	$5,683,074	99.5 %	$ 27,930	0.5 %
Construction	1,597,996	100.0	—	—
Construction - custom	602,540	99.9	91	0.1
Land - acquisition & development	124,012	99.8	296	0.2
Land - consumer lot loans	103,800	99.4	605	0.6
Multi-family	1,303,009	99.9	139	0.1
Commercial real estate	1,422,795	99.2	11,815	0.8
Commercial & industrial	1,085,278	99.3	8,082	0.7
HELOC	144,319	99.6	531	0.4
Consumer	84,984	99.9	91	0.1
	$12,151,807	99.6 %	$ 49,580	0.4 %

The following tables provide information on impaired loan balances and the related allowances by loan types.

December 31, 2017	Recorded Investment	Unpaid Principal Balance	Related Allowance		Average Recorded Investment
	(In thousands)				
Impaired loans with no related allowance recorded:					
Single-family residential	$20,405	$21,860	$ —		$ 20,864
Construction	969	969	—		485
Construction - custom	—	—	—		74
Land - acquisition & development	1,376	1,405	—		853
Land - consumer lot loans	300	375	—		254
Multi-family	250	254	—		195
Commercial real estate	16,372	21,720	—		14,631
Commercial & industrial	4,439	4,506	—		6,359
HELOC	620	747	—		555
Consumer	70	134	—		79
	44,801	51,970	—		44,349
Impaired loans with an allowance recorded:					
Single-family residential	170,677	174,162	3,412		176,308
Land - acquisition & development	—	—	—		45
Land - consumer lot loans	7,405	7,776	—		7,677
Multi-family	480	480	5		487
Commercial real estate	11,910	12,755	106		13,495
Commercial & industrial	7,256	7,256	524		3,628
HELOC	1,356	1,435	—		1,542
Consumer	91	91	—		94
	199,175	203,955	4,047	(1)	203,276
Total impaired loans:					
Single-family residential	191,082	196,022	3,412		197,172
Construction	969	969	—		485
Construction - custom	—	—	—		74
Land - acquisition & development	1,376	1,405	—		898
Land - consumer lot loans	7,705	8,151	—		7,931
Multi-family	730	734	5		682
Commercial real estate	28,282	34,475	106		28,126
Commercial & industrial	11,695	11,762	524		9,987
HELOC	1,976	2,182	—		2,097
Consumer	161	225	—		173
	$243,976	$255,925	$ 4,047	(1)	$ 247,625

(1) Includes $635,000 of specific reserves and $3,412,000 included in the general reserves.

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September 30, 2017	Recorded Investment	Unpaid Principal Balance	Related Allowance		Average Recorded Investment
	(In thousands)				
Impaired loans with no related allowance recorded:					
Single-family residential	$21,325	$23,880	$ —		$ 19,371
Construction - custom	148	165	—		231
Land - acquisition & development	330	8,208	—		176
Land - consumer lot loans	208	330	—		431
Multi-family	139	3,231	—		748
Commercial real estate	12,890	22,487	—		11,466
Commercial & industrial	8,279	14,321	—		7,425
HELOC	490	1,212	—		487
Consumer	88	1,433	—		57
	43,897	75,267	—		40,392
Impaired loans with an allowance recorded:					
Single-family residential	181,941	186,167	4,030		204,723
Land - acquisition & development	90	90	1		576
Land - consumer lot loans	7,949	8,526	—		8,976
Multi-family	493	493	5		1,024
Commercial real estate	15,079	16,707	120		16,991
Commercial & industrial	—	—	—		297
HELOC	1,728	1,806	—		1,451
Consumer	97	284	—		100
	207,377	214,073	4,156	(1)	234,138
Total impaired loans:					
Single-family residential	203,266	210,047	4,030		224,094
Construction - custom	148	165	—		231
Land - acquisition & development	420	8,298	1		752
Land - consumer lot loans	8,157	8,856	—		9,407
Multi-family	632	3,724	5		1,772
Commercial real estate	27,969	39,194	120		28,457
Commercial & industrial	8,279	14,321	—		7,722
HELOC	2,218	3,018	—		1,938
Consumer	185	1,717	—		157
	$251,274	$289,340	$ 4,156	(1)	$ 274,530

(1) Includes $126,000 of specific reserves and $4,030,000 included in the general reserves.

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NOTE F – Fair Value Measurements

ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active exchange markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

We have established and documented the Company's process for determining the fair values of the Company's assets and liabilities, where applicable. Fair value is based on quoted market prices, when available, for identical or similar assets or liabilities. In the absence of quoted market prices, fair value is determined using valuation models or third-party appraisals. The following is a description of the valuation methodologies used to measure and report the fair value of financial assets and liabilities on a recurring or nonrecurring basis.

Measured on a Recurring Basis

Available-for-Sale Securities and Derivative Contracts

Securities available for sale are recorded at fair value on a recurring basis. The fair value of debt securities are priced using model pricing based on the securities' relationship to other benchmark quoted prices as provided by an independent third party, and under GAAP are considered a Level 2 input method. Securities that are traded on active exchanges, including the Company's equity securities, are measured using the closing price in an active market and are considered a Level 1 input method.

The Company offers interest rate swaps to its variable rate borrowers who want to manage their interest rate risk. At the same time, the Company enters into the opposite trade with a counter party to offset its interest rate risk. The Company has also entered into commercial loan hedges as well as borrowings hedges using interest rate swaps. The fair value of these interest rate swaps are estimated by a third party pricing service using a discounted cash flow technique. These are considered a Level 2 input method.

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The following tables present the balance of assets and liabilities measured at fair value on a recurring basis.

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Financial Assets				
Available-for-sale securities:				
Equity securities	$503	$—	$ —	$503
U.S. government and agency securities	—	194,869	—	194,869
Municipal bonds	—	26,212	—	26,212
Corporate debt securities	—	184,416	—	184,416
Mortgage-backed securities				
Agency pass-through certificates	—	831,489	—	831,489
Commercial MBS	—	8,366	—	8,366
Total available-for-sale securities	503	1,245,352	—	1,245,855
Interest rate contracts	—	7,587	—	7,587
Borrowings hedges	—	4,997	—	4,997
Total financial assets	$503	$1,257,936	$ —	$1,258,439
Financial Liabilities				
Interest rate contracts	$—	$7,587	$ —	$7,587
Commercial loan hedges	—	36	—	36
Total financial liabilities	$—	$7,623	$ —	$7,623

There were no transfers between, into and/or out of Levels 1, 2 or 3 during the three months ended December 31, 2017.

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	September 30, 2017			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Financial Assets				
Available-for-sale securities:				
Equity securities	$522	$—	$ —	$522
U.S. government and agency securities	—	211,077	—	211,077
Municipal bonds	—	26,624	—	26,624
Corporate debt securities	—	185,298	—	185,298
Mortgage-backed securities				
Agency pass-through certificates	—	834,297	—	834,297
Commercial MBS	—	8,391	—	8,391
Total available-for-sale securities	522	1,265,687	—	1,266,209
Interest rate contracts	—	1,139	—	1,139
Total financial assets	$522	$1,266,826	$ —	$1,267,348
Financial Liabilities				
Interest rate contracts	$—	$1,139	$ —	$1,139
Commercial loan hedges	—	174	—	174
Borrowings hedges	—	1,693	—	1,693
Total financial liabilities	$—	$3,006	$ —	$3,006

There were no transfers between, into and/or out of Levels 1, 2 or 3 during the fiscal year ended September 30, 2017.

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Measured on a Nonrecurring Basis
Impaired Loans & Real Estate Owned
Real estate owned ("REO") consists principally of properties acquired through foreclosure. From time to time, and on a nonrecurring basis, adjustments using fair value measurements are recorded to reflect increases or decreases based on the discounted cash flows, the current appraisal or estimated value of the collateral, but only up to the fair value of the real estate owned as of the initial transfer date less selling costs.

When management determines that the fair value of the collateral or the real estate owned requires additional adjustments, either as a result of an updated appraised value or when there is no observable market price, the Company classifies the impaired loan or real estate owned as Level 3. Level 3 assets recorded at fair value on a nonrecurring basis at December 31, 2017 included loans for which a specific reserve allowance was established or a partial charge-off was recorded based on the fair value of collateral, as well as real estate owned where the fair value of the property was less than the cost basis.

The following tables present the aggregated balance of assets that were measured at fair value on a nonrecurring basis at December 31, 2017 and December 31, 2016, and the total gains (losses) resulting from those fair value adjustments for the three months ended December 31, 2017 and December 31, 2016. The estimated fair value measurements are shown gross of estimated selling costs.

	December 31, 2017				Three Months Ended December 31, 2017
	Level 1	Level 2	Level 3	Total	Total Gains (Losses)
	(In thousands)				
Impaired loans (1)	$ —	$ —	$ 688	$ 688	$ (507)
Real estate owned (2)	—	—	2,055	2,055	(180)
Balance at end of period	$ —	$ —	$ 2,743	$ 2,743	$ (687)

(1) The gains (losses) represent remeasurements of collateral-dependent loans.
(2) The gains (losses) represent aggregate writedowns and charge-offs on REO.

	December 31, 2016				Three Months Ended December 31, 2016
	Level 1	Level 2	Level 3	Total	Total Gains (Losses)
	(In thousands)				
Impaired loans (1)	$ —	$ —	$ 3,353	$ 3,353	$ (422)

Real estate owned (2)	—	—	2,299	2,299	(241)
Balance at end of period	$—	$—	$5,652	$5,652	$ (663)

(1) The gains (losses) represent remeasurements of collateral-dependent loans.
(2) The gains (losses) represent aggregate writedowns and charge-offs on REO.

Impaired loans - The Company adjusts the carrying amount of impaired loans when there is evidence of probable loss and the expected fair value of the loan is less than its contractual amount. The amount of the impairment may be determined based on the estimated present value of future cash flows or the fair value of the underlying collateral. Impaired loans with a specific reserve allowance based on cash flow analysis or the value of the underlying collateral are classified as Level 3 assets.

The evaluations for impairment are prepared by the Problem Loan Review Committee, which is chaired by the Chief Credit Officer and includes the Loan Review manager and Special Credits manager, as well as senior credit officers, division managers and group executives, as applicable. These evaluations are performed in conjunction with the quarterly allowance for loan loss process.

Applicable loans that were included in the previous quarter's review are reevaluated and if their values are materially different from the prior quarter evaluation, the underlying information (loan balance and collateral value) are compared. Material differences are evaluated for reasonableness and discussions are held between the relationship manager and their division manager to understand the difference and determine if any adjustment is necessary.

The inputs are developed and substantiated on a quarterly basis, based on current borrower developments, market conditions and collateral values. The following methods are used to value impaired loans:

- The fair value of the collateral, which may take the form of real estate or personal property, is based on internal estimates, field observations, assessments provided by third-party appraisers and other valuation models. The Company performs or reaffirms valuations of collateral-dependent impaired loans at least annually. Adjustments are made if management believes that more recent information is available and relevant with respect to the fair value of the collateral.
- The present value of the expected future cash flows of the loans is used for measurement of non collateral-dependent loans to test for impairment.

Real estate owned - When a loan is reclassified from loan status to real estate owned due to the Company taking possession of the collateral, a special credits officer, along with the special credits manager, obtains a valuation, which may include appraisals or third-party price opinions, which is used to establish the fair value of the underlying collateral. The determined fair value, less selling costs, becomes the carrying value of the REO asset.

The fair value of REO assets is re-evaluated quarterly and the REO asset is adjusted to reflect the fair value as necessary. After foreclosure, the valuations are updated periodically and current market conditions may require the assets to be written down further or up to the cost basis established on the date of transfer. The carrying balance of REO assets are also written down once a bona fide offer is contractually accepted, through execution of a purchase and sale agreement, where the accepted price is lower than the cost established on the transfer date.

Fair Values of Financial Instruments

ASC 825 requires disclosure of fair value information about financial instruments, whether or not recognized on the statement of financial condition, for which it is practicable to estimate those values. Certain financial instruments and all non-financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value estimates presented do not reflect the underlying fair value of the Company. Although management is not aware of any factors that would materially affect the estimated fair value amounts presented below, such amounts have not been comprehensively revalued for purposes of these financial statements since the dates shown, and therefore, estimates of fair value subsequent to those dates may differ significantly from the amounts presented below.

	Level in Fair Value Hierarchy	December 31, 2017		September 30, 2017	
		Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
		(In thousands)			
Financial assets					
Cash and cash equivalents	1	$309,713	$309,713	$313,070	$313,070
Available-for-sale securities					
Equity securities	1	503	503	522	522
U.S. government and agency securities	2	194,869	194,869	211,077	211,077
Municipal bonds	2	26,212	26,212	26,624	26,624
Corporate debt securities	2	184,416	184,416	185,298	185,298
Mortgage-backed securities					
Agency pass-through certificates	2	831,489	831,489	834,297	834,297
Commercial MBS	2	8,366	8,366	8,391	8,391
Total available-for-sale securities		1,245,855	1,245,855	1,266,209	1,266,209
Held-to-maturity securities					
Mortgage-backed securities					
Agency pass-through certificates	2	1,750,886	1,738,337	1,646,856	1,635,913
Commercial MBS	2	15,000	15,005	—	