Eagle Bancorp Montana, Inc.
Form 10-K
September 20, 2010

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

(Mark One)

FORM 10-K

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

For the fiscal year ended June 30, 2010

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 1-34682

Eagle Bancorp Montana, Inc.
(Exact name of registrant as specified in its charter)

Delaware State or other jurisdiction of incorporation or organization	27-1449820 (I.R.S. Employer Identification No.)

1400 Prospect Avenue, Helena, MT (Address of principal executive offices)	59601 (Zip Code)

Registrant's telephone number, including area code 406-442-3080
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common stock, par value $0.01	The NASDAQ Stock Market LLC

Securities registered pursuant to section 12(g) of the Act:

(Title of Class)

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

o Yes x No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

o Yes x No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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).

o Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

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

The aggregate market value of the common stock held by non-affiliates of Eagle, computed by reference to the closing price at which the stock was sold as of December 31, 2009 was $11,481,000. The outstanding number of shares of common stock of Eagle as of August 31, 2010, was 4,083,127.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's definitive Proxy Statement to be filed with the Securities and Exchange Commission within 120 days after the Company's fiscal year end is incorporated by reference into Part III of this Form 10-K.

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CAUTIONARY LANGUAGE ABOUT FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K includes forward-looking statements within the meaning and protections of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. All statements other than statements of historical fact are statements that could be forward-looking statements. You can identify these forward-looking statements through our use of words such as may, will, anticipate, assume, should, indicate, would, believe, expect, estimate, continue, plan, project, could, intend, target and other similar words and expressions of the future. These for statements include, but are not limited to: (i) statements of our goals, intentions and expectations; (ii) statements regarding our business plans, prospects, growth and operating strategies; (iii) statements regarding the asset quality of our loan and investment portfolios; and (iv) estimates of our risks and future costs and benefits.

These forward-looking statements are based on current beliefs and expectations of our management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
- general economic conditions, either nationally or in our market areas, that are worse than expected;
- competition among depository and other financial institutions;
- changes in the prices, values and sales volume of residential and commercial real estate in Montana;
- inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;
- adverse changes in the securities markets;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- our ability to successfully integrate acquired entities, if any;
- changes in consumer spending, borrowing and savings habits;
- changes in our organization, compensation and benefit plans;
- our ability to continue to increase and manage our commercial and residential real estate, multi-family, and commercial business loans;
- possible impairments of securities held by us, including those issued by government entities and government sponsored enterprises;
- the level of future deposit premium assessments;
- the impact of the current recession on our loan portfolio (including cash flow and collateral values), investment portfolio, customers and capital market activities;
- the impact of the current restructuring of the U.S. financial and regulatory system;
- the failure of assumptions underlying the establishment of allowance for possible loan losses and other estimates;
- changes in the financial performance and/or condition of our borrowers and their ability to repay their loans when due; and
- the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Securities and Exchange Commission, the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters.

Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. For a further list and description of various risks, relevant factors and uncertainties that could cause future results or events to differ materially from those expressed or implied in our forward-looking statements, see the Item 1A, Risk Factors and Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations sections contained elsewhere in this report, as well as other reports that we file with the SEC.

PART I

ITEM 1. DESCRIPTION OF BUSINESS.

General

Eagle Bancorp Montana, Inc. (Eagle or the Company), is a Delaware corporation that holds 100% of the capital stock of American Federal Savings Bank (American Federal or the Bank), a federally chartered stock savings bank headquartered in Helena, Montana. Eagle s principal business is to hold the capital stock of American Federal. On April 5, 2010, Eagle completed a second-step conversion from the partially-public mutual holding company structure to the fully publicly-owned stock holding company structure. As part of that transaction it also completed a related stock offering. As a result of the conversion and offering, the Company became the stock holding company for American Federal Savings Bank, and Eagle Financial MHC and Eagle Bancorp ceased to exist. The Company sold a total of 2,464,274 shares of common stock at a purchase price of $10.00 per share in the offering for gross proceeds of $24.6 million. Concurrent with the completion of the offering, each share of Eagle Bancorp common stock owned by the public was exchanged for 3.800 shares of the Company s common stock owned immediately prior to completion of the transaction.

American Federal was founded in 1922 as a Montana chartered building and loan association and has conducted operations in Helena since that time. In 1975, the Bank adopted a federal thrift charter. The Bank currently has six full service offices. We also have six automated teller machines located in our market area and we participate in the CashCard® and Money Pass® ATM networks. The Bank s website can be found at www.americanfederalsavingsbank.com.

Business Strategy

Our strategy is to continue our profitability through building a diversified loan portfolio and positioning the Bank as a full-service community bank that offers both retail and commercial loan and deposit products in all of its markets. We believe that this focus will enable us to continue to grow our franchise, while maintaining our commitment to customer service, high asset quality, and sustained net earnings. The following are the key elements of our business strategy:

- Continue to diversify our portfolio by emphasizing our recent growth in commercial real estate and commercial business loans as a complement to our traditional single family residential real estate lending;
- Continue to emphasize the attraction and retention of lower cost long-term core deposits;
- Seek opportunities where presented to acquire other institutions or expand our branch structure;
- Maintain our high asset quality levels; and
- Operate as a community-oriented independent financial institution that offers a broad array of financial services with high levels of customer service.

Our results of operations may be significantly affected by our ability to effectively implement our business strategy including our plans for expansion through strategic acquisitions. If we are unable to effectively integrate and manage acquired or merged businesses or attract significant new business through our branching efforts, our financial performance may be negatively affected.

Market Area

From our headquarters in Helena, Montana, we operate six full service retail banking offices, including our main office. Our other full service branches are located in Helena Neill (opened 1987), Helena - Skyway (opened 2009), Bozeman (opened 1980, relocated 2009), Butte (opened 1979) and Townsend (opened 1979), Montana. The original Bozeman branch opened in 1980 was closed August 1, 2010 due to reduced use by customers as a result of the new location opened in October 2009 approximately one mile away.

Montana is one of the largest states in terms of land mass but ranks as one of the least populated states. According to U.S. Census Bureau data for 2008, it had a population of 967,440. Helena, where we are headquartered, is the county seat of Lewis and Clark County, which has a population of approximately 59,300 and is located within 120 miles of four of Montana s other five largest cities: Missoula, Great Falls, Bozeman and Butte. It is approximately midway between Yellowstone and Glacier National Parks. Helena is also Montana s state capital. Its economy has shown moderate growth, in terms of both employment and income. State government and the numerous offices of the federal government comprise the largest employment sector. Helena also has significant employment in the service industries. Specifically, it has evolved into a central health care center with employment in the medical and the supporting professions as well as the medical insurance industry. The local economy is also dependent to a lesser extent upon ranching and agriculture. These have been more cyclical in nature and remain vulnerable to severe weather conditions, increased competition, both domestic and international, as well as commodity prices.

Bozeman is approximately 95 miles southeast of Helena. It is located in Gallatin County, which has a population of approximately 80,900. Bozeman is home to Montana State University and experienced fairly significant growth from 1990 to 2007, in part due to the growth of the University as well as the increased tourism for resort areas in and near Bozeman. Agriculture, however, remains an important part of Bozeman s economy. Bozeman has also become an attractive location for retirees, primarily from the West Coast, owing to its many winter and summer recreational opportunities and the presence of the University. Of our four communities that we serve, Bozeman has experienced the largest impact of the national and global economic downturn.

Butte, Montana is approximately 64 miles southwest of Helena. Butte and the surrounding Silver-Bow County have a population of approximately 32,800. Butte s economy is somewhat reliant on the mining industry. Butte s economy has been volatile from the fluctuations in metal and mineral commodity prices.

Townsend is the smallest community in which we operate. It has a population of about 2,000. Many of its residents commute to other Montana locations for work. Other employment in Townsend is primarily in agriculture and services. Townsend is approximately 32 miles southeast of Helena.

Competition

We face strong competition in our primary market area for the attraction of retail deposits and the origination of loans. Historically, Montana was a unit banking state. This means that the ability of Montana state banks to create branches was either prohibited or significantly restricted. As a result of unit banking, Montana has a significant number of independent financial institutions serving a single community in a single location. While the state s population is approximately 967,440 people, there are 62 credit unions in Montana as well as two federally chartered thrift institutions, and 75 commercial banks as of June 30, 2010. Our most direct competition for depositors has historically come from locally owned and out-of-state commercial banks, thrift institutions and credit unions operating in our primary market area. The number of such competitor locations has increased significantly in recent years. Our competition for loans also comes from banks, thrifts and credit unions in addition to mortgage bankers and brokers. Our principal market areas can be characterized as markets with moderately increasing incomes, relatively low unemployment, increasing wealth (particularly in the growing resort areas such as Bozeman), and moderate population growth.

Lending Activities

General.

American Federal Savings Bank primarily originates one- to four-family residential real estate loans and, to a lesser extent, commercial real estate loans, real estate construction loans, home equity loans, consumer loans and commercial business loans. Commercial real estate loans include loans on multi-family dwellings, loans on nonresidential property and loans on developed and undeveloped land. Home equity loans include loans secured by the borrower s primary residence. Typically, the property securing such loans is subject to a prior lien. Consumer loans consist of loans secured by collateral other than real estate, such as automobiles, recreational vehicles and boats. Personal loans and lines of credit are made on deposits held by the Bank and on an unsecured basis. Commercial business loans consist of business loans and lines of credit on a secured and unsecured basis.

Loan Portfolio Composition.

The following table analyzes the composition of the Bank s loan portfolio by loan category at the dates indicated:

	At June 30,			
	2010		2009	
	(Dollars in thousands)			
	Amount	Percent of Total	Amount	Percent of Total
Real estate loans:				
Residential mortgage (one- to four-family) [(1)]	$ 73,010	42.81%	$ 79,216	47.26%
Commercial real estate	41,677	24.44%	36,713	21.90%
Real estate construction	7,016	4.11%	4,642	2.77%
Total real estate loans	121,703	71.36%	120,571	71.93%
Other loans:				
Home equity	29,795	17.46%	28,676	17.11%
Consumer	9,613	5.64%	10,835	6.46%
Commercial	9,452	5.54%	7,541	4.50%
Total other loans	48,860	28.64%	47,052	28.07%
Total loans	170,563	100.00%	167,623	100.00%
Less:				
Deferred loan fees	(39)		(99)	
Allowance for loan losses	1,100		525	
Total loans, net	$ 169,502		$ 167,197	

(1) Excludes loans held for sale.

Fee Income.

American Federal Savings Bank receives lending related fee income from a variety of sources. Its principal source of this income is from the origination and servicing of sold mortgage loans. Fees generated from mortgage loan servicing, which generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and foreclosure processing for loans held by others, were $770,000 and $628,000 for the years ended June 30, 2010 and 2009, respectively. Other loan related fee income for contract collections, late charges, credit life commissions and credit card fees were $73,000 and $78,000 for the years ended June 30, 2010 and 2009, respectively.

Loan Maturity Schedule.

The following table sets forth the estimated maturity of the loan portfolio of the Bank at June 30, 2010. Balances exclude deferred loan fees and allowance for loan losses. Scheduled principal repayments of loans do not necessarily reflect the actual life of such assets. The average life of a loan is typically substantially less than its contractual terms because of prepayments. In addition, due on sale clauses on loans generally give American Federal Savings Bank the right to declare loans immediately due and payable in the event, among other things, that the borrower sells the real property, subject to the mortgage, and the loan is not paid off. All mortgage loans are shown to be maturing based on the date of the last payment required by the loan agreement, except as noted.

Loans having no stated maturity, those without a scheduled payment, demand loans and matured loans, are shown as due within six months.

	Within 6 Months	6 to 12 Months	More than 1 year to 2 years	More than 2 years to 5 years	Over 5 years	Total
	(In thousands)					
Residential mortgage (one- to four-family) (1)	$	$ 46	$ 253	$ 2,557	$ 73,615	$ 76,471
Commercial real estate and land (1)	429	6,582	2,278	5,665	30,957	45,911
Real estate construction	2,899	4,117				7,016
Home equity	334	3,881	3,666	11,671	10,243	29,795
Consumer	336	738	786	5,654	2,099	9,613
Commercial	235	4,793	204	2,014	2,206	9,452
Total loans (1)	$ 4,233	$ 20,157	$ 7,187	$ 27,561	$ 119,120	$ 178,258

(1) Includes loans held for sale.

The following table sets forth the dollar amount of all loans, at June 30, 2010, due after June 30, 2011, which have fixed interest rates and which have floating or adjustable interest rates:

	Fixed	Adjustable	Total
	(Dollars in thousands)		
Residential mortgage (one- to four-family)	$ 58,367	$ 18,058	$ 76,425
Commercial real estate and land	38,259	641	38,900
Home equity	21,469	4,111	25,580
Consumer	7,864	675	8,539
Commercial	3,999	425	4,424
Total loans (1)	$ 129,958	$ 23,910	$ 153,868
Percent of total	84.46%	15.54%	100.00%

(1) Due after June 30, 2011.

The following table sets forth information with respect to our loan originations, purchases and sales activity for the periods indicated:

	Ended June 30, 2010	2009
	(In thousands)	
Net loans receivable at beginning of period (1)	$ 172,546	$ 175,519
Loans originated:		
Residential mortgage (one- to four-family)	89,428	164,657
Commercial real estate and land	15,573	21,500
Real estate construction	9,193	4,672
Home equity	18,438	20,043
Consumer	6,685	8,341
Commercial	10,354	8,789
Total loans originated	149,671	228,002
Loans sold:		
Whole loans	76,925	125,232
Commercial construction		6,000
Total loans sold	76,925	131,232
Principal repayments and loan refinancings	67,440	99,509
Deferred loan fees decrease (increase)	60	(9)
Allowance for losses decrease (increase)	(715)	(225)
Net loan increase (decrease)	4,651	(2,973)
Net loans receivable at end of period (1)	$ 177,197	$ 172,546

(1) Includes loans held for sale.

Residential Lending.

The Bank s primary lending activity consists of the origination of one- to four-family residential mortgage loans secured by property located in the Bank s market area. Approximately 42.81% of the bank s loans as of June 30, 2010 were comprised of such loans. American Federal generally originates one- to four-family residential mortgage loans in amounts up to 80% of the lesser of the appraised value or the selling price of the mortgaged property without requiring private mortgage insurance. A mortgage loan originated by the Bank, whether fixed rate or adjustable rate, can have a term of up to 30 years. The Bank holds substantially all of its adjustable rate and its 8, 10 and 12-year fixed rate loans in portfolio. Adjustable rate loans limit the periodic interest rate adjustment and the minimum and maximum rates that may be charged over the term of the loan. The Bank s fixed rate 15-year and 20-year loans are held in portfolio or sold in the secondary market depending on market conditions. Generally, all 30-year fixed rate loans are sold in the secondary market. The volume of loan sales is dependent on the volume, type and term of loan originations.

The Bank obtains a significant portion of its noninterest income from servicing loans sold. The Bank offers many of the fixed rate loans it originates for sale in the secondary market on a servicing retained basis. This means that we process the borrower s payments and send them to the purchaser of the loan. This retention of servicing enables the Bank to increase fee income and maintain a relationship with the borrower. Servicing income was $770,000 for the year ended June 30, 2010. At June 30, 2010, American Federal Savings Bank had $285.51 million in residential mortgage loans and $11.91 million in commercial real estate loans sold with servicing retained. American Federal Savings Bank does not ordinarily purchase home mortgage loans from other financial institutions.

Property appraisals on real estate securing the Bank s single-family residential loans are made by state certified and licensed independent appraisers who are approved annually by the board of directors. Appraisals are performed in accordance with applicable regulations and policies. American Federal Savings Bank generally obtains title insurance policies on all first mortgage real estate loans originated. On occasion, refinancings of mortgage loans are approved using title reports instead of title insurance. Title reports are also allowed on home equity loans. Borrowers generally remit funds with each monthly payment of principal and interest, to a loan escrow account from which American Federal Savings Bank makes disbursements for such items as real estate taxes and hazard and mortgage insurance premiums as they become due.

Home Equity Loans.

American Federal Savings Bank also originates home equity loans. These loans are secured by the borrowers primary residence, but are typically subject to a prior lien, which may or may not be held by the Bank. At June 30, 2010, $29.80 million or 17.47% of our total loans were home equity loans. Borrowers may use the proceeds from the Bank s home equity loans for many purposes, including home improvement, debt consolidation, or other purchasing needs. The Bank offers fixed rate, fixed payment home equity loans as well as variable and fixed rate home equity lines of credit. Fixed rate home equity loans typically have terms of no longer than 15 years.

Although home equity loans are secured by real estate, they carry a greater risk than first lien residential mortgages because of the existence of a prior lien on the property securing the loan, as well as the flexibility the borrower has with respect to the loan proceeds. American Federal Savings Bank attempts to minimize this risk by maintaining conservative underwriting policies on such loans. We generally make home equity loans for up to only 85% of appraised value of the underlying real estate collateral, less the amount of any existing prior liens on the property securing the loan.

Commercial Real Estate and Land Loans.

American Federal Savings Bank originates commercial real estate mortgage and land loans, including both developed and undeveloped land loans, and loans on multi-family dwellings. Commercial real estate and land loans made up 24.44% of the Bank s total loan portfolio, or $41.68 million at June 30, 2010. The majority of these loans are non-residential commercial real estate loans. American Federal Savings Bank s commercial real estate mortgage loans are primarily permanent loans secured by improved property such as office buildings, retail stores, commercial warehouses and apartment buildings. The terms and conditions of each loan are tailored to the needs of the borrower and based on the financial strength of the project and any guarantors. Generally, commercial real estate loans originated by the Bank will not exceed 75% of the appraised value or the selling price of the property, whichever is less. The average loan size is approximately $196,000 and is typically made with fixed rates of interest and 5- to 15-year maturities. Upon maturity, the loan is repaid or the terms and conditions are renegotiated. Generally, all originated commercial real estate loans are within the market area of the Bank and all are within the state of Montana. American Federal Savings Bank s largest single commercial real estate loan had a balance of approximately $1.42 million (net of $5.68 million sold to the Montana Board of Investments) on June 30, 2010, and is secured by a professional office building.

Real Estate Construction Lending.

American Federal Savings Bank also lends funds for the construction of one- to-four-family homes and commercial real estate. Real estate construction loans are made both to individual homeowners for the construction of their primary residence and, to a lesser extent, to local builders for the construction of pre-sold houses or houses that are being built for sale in the future. Real estate construction loans accounted for $7.02 million or 4.11% of the Bank s loan portfolio at June 30, 2010.

Consumer Loans.

As part of its strategy to invest in higher yielding shorter term loans, American Federal Savings Bank emphasized growth of its consumer lending portfolio in recent years. This portfolio includes personal loans secured by collateral other than real estate, unsecured personal loans and lines of credit, and loans secured by deposits held by the Bank. As of June 30, 2010, consumer loans totaled $9.6 million or 5.64% of the Bank s total loan portfolio. These loans consist primarily of auto loans, RV loans, boat loans, personal loans and credit lines and deposit account loans. Consumer loans are originated in the Bank s market area and generally have maturities of up to 7 years. For loans secured by savings accounts, American

Federal Savings Bank will lend up to 90% of the account balance on single payment loans and up to 100% for monthly payment loans.

Consumer loans have a shorter term and generally provide higher interest rates than residential loans. Consumer loans can be helpful in improving the spread between average loan yield and cost of funds and at the same time improve the matching of the maturities of rate sensitive assets and liabilities. Increasing its consumer loans has been a major part of the Bank s strategy of operating more like a commercial bank than a traditional savings bank.

The underwriting standards employed by American Federal Savings Bank for consumer loans include a determination of the applicant s credit history and an assessment of the applicant s ability to meet existing obligations and payments on the proposed loan. The stability of the applicant s monthly income may be determined by verification of gross monthly income from primary employment, and additionally from any verifiable secondary income. Creditworthiness of the applicant is of primary consideration; however, the underwriting process also includes a comparison of the value of the collateral in relation to the proposed loan amount.

Commercial Business Loans.

Commercial business loans amounted to $9.45 million, or 5.54% of the Bank s total loan portfolio at June 30, 2010. American Federal Savings Bank s commercial business loans are traditional business loans and are not secured by real estate. Such loans may be structured as unsecured lines of credit or may be secured by inventory, accounts receivable or other business assets. While the commercial business loan portfolio amounted to only 5.54% of the total portfolio at June 30, 2010, American Federal Savings Bank intends to increase such lending by focusing on market segments which it has not previously emphasized, such as business loans to doctors, lawyers, architects and other professionals as well as to small businesses within its market area. Our management believes that this strategy provides opportunities for growth, without significant additional cost outlays for staff and infrastructure.

Commercial business loans of this nature usually involve greater credit risk than one- to four-family residential mortgage loans. The collateral we receive is typically related directly to the performance of the borrower s business which means that repayment of commercial business loans is dependent on the successful operations and income stream of the borrower s business. Such risks can be significantly affected by economic conditions. In addition, commercial lending generally requires substantially greater oversight efforts compared to residential real estate lending.

Loans to One Borrower.

Under federal law, savings institutions have, subject to certain exemptions, lending limits to one borrower in an amount equal to the greater of $500,000 or 15% of the institution s unimpaired capital and surplus. As of June 30, 2010, our largest aggregation of loans to one borrower was approximately $3.69 million. This consisted of one commercial real estate loan secured by a detention facility and one commercial real estate construction loan secured by a separate detention facility. The commercial real estate loan has a principal balance of $6.93 million, and 90%, or $6.23 million, of it was sold to the Montana Board of Investments, leaving the net balance to the Bank of $0.69 million. The commercial real estate construction loan is to the same borrower for the construction of another detention facility. As of June 30, 2010, the Bank s portion of the construction loan had a principal balance of $3.0 million, and the remaining $9.10 million of the loan was held by another bank. The construction was completed in August 2010, and the Bank refinanced the entire loan into $12.10 million of permanent financing with 90% of the loan guaranteed by the USDA Rural Development. Due to the USDA Rural Development guarantee, 90% of this loan, or $10.89 million, is not included in the limitations to a single borrower. The Bank entered into an interest rate swap with a third party to change the underlying cash flows to be a variable market rate tied to one-month LIBOR. At June 30, 2010, these loans were performing in accordance with their terms. The Bank maintains the servicing for both these loans.

Loan Solicitation and Processing.

Our customary sources of mortgage loan applications include repeat customers, walk-ins, and referrals from home builders and real estate brokers. We also advertise in local newspapers and on local radio and television. We currently have the ability to accept online mortgage loan applications and provide pre-approvals through our website. Our branch managers and loan officers located at our headquarters and in branches, have authority to approve certain types of loans when presented with a completed application. Other loans must be approved at our main offices as disclosed below. No loan consultants or loan brokers are currently used by us for either residential or commercial lending activities.

After receiving a loan application from a prospective borrower, a credit report and verifications are obtained to confirm specific information relating to the loan applicant s employment, income and credit standing. When required by our policies, an appraisal of the real estate intended to secure the proposed loan is undertaken by an independent fee appraiser. In connection with the loan approval process, our staff analyze the loan applications and the property involved. Officers and branch managers are granted lending authority based on the kind of loan types where they possess expertise and their level of experience. We have established a series of loan committees to approve any loans which may exceed the lending authority of particular officers or branch managers. A quorum (five directors) of the board of directors is required for approval of any loan, or aggregation of loans to a single borrower, that exceeds $1,250,000.

Loan applicants are promptly notified of the decision by a letter setting forth the terms and conditions of the decision. If approved, these terms and conditions include the amount of the loan, interest rate basis, amortization term, a brief description of real estate to be mortgaged, tax escrow and the notice of requirement of insurance coverage to be maintained. We generally require title insurance on first mortgage loans and fire and casualty insurance on all properties securing loans, which insurance must be maintained during the entire term of the loan.

Loan Commitments.

We generally provide commitments to fund fixed and adjustable-rate single-family mortgage loans for periods up to 60 days at a specified term and interest rate, and other loan categories for shorter time periods. The total amount of our commitments to extend credit as of June 30, 2010, was approximately $9.03 million, $5.58 million of which was for residential mortgage loans.

Nonperforming Loans and Problem Assets

Collection Procedures.

Generally, our collection procedures provide that when a loan is 15 or more days delinquent, the borrower is sent a past due notice. If the loan becomes 30 days delinquent, the borrower is sent a written delinquency notice requiring payment. If the delinquency continues, subsequent efforts are made to contact the delinquent borrower, including face to face meetings and counseling to resolve the delinquency. All collection actions are undertaken with the objective of compliance with the Fair Debt Collection Act.

For mortgage loans and home equity loans, if the borrower is unable to cure the delinquency or reach a payment agreement, we will institute foreclosure actions. If a foreclosure action is taken and the loan is not reinstated, paid in full or refinanced, the property is sold at judicial sale at which we may be the buyer if there are no adequate offers to satisfy the debt. Any property acquired as the result of foreclosure or by deed in lieu of foreclosure is classified as real estate owned until such time as it is sold or otherwise disposed of. When real estate owned is acquired, it is recorded at its fair market value less estimated selling costs. The initial recording of any loss is charged to the allowance for loan losses. As of June 30, 2010, American Federal Savings Bank had $618,000 of real estate owned.

Loans are reviewed on a quarterly basis and are placed on non-accrual status when they are more than 90 days delinquent. Loans may be placed on non-accrual status at any time if, in the opinion of management, the collection of additional interest is doubtful. Interest accrued and unpaid at the time a loan is placed on non-accrual status is charged against interest income. Subsequent payments are either applied to the outstanding principal balance or recorded as interest income, depending on the assessment of the ultimate collectibility of the loan. At June 30, 2010, we had $2.81 million ($2.40 million net of specific reserves for loan losses) of loans that were nonperforming and held on non-accrual status.

Delinquent Loans.

The following table provides information regarding the Bank s loans that are delinquent 30 to 89 days at June 30, 2010:

	Number	Amount	Percentage of Total Delinquent Loans
		(Dollars in thousands)	
Loan type:			
Residential mortgage (one- to four-family)	7	$ 596	41.85%
Real estate construction			
Commercial real estate and land	2	230	16.15%
Home equity	9	447	31.39%
Consumer	14	117	8.22%
Commercial business	2	34	2.39%
Total	34	$ 1,424	100.00%

Nonperforming Assets.

The following table sets forth information regarding American Federal Savings Bank s nonperforming assets as of the dates indicated. As of June 30, 2010, the Bank had no loans considered to be a troubled debt restructuring within the meaning of FASB ASC 310 *Receivables*.

	At June 30, 2010	2009
	(Dollars in thousands)	
Non-accrual loans		
Real estate loans:		
Residential mortgage (one- to four-family)	$ 754	$ 265
Real estate construction	650	
Commercial real estate and land	1,316	527
Home equity	40	
Consumer	12	26
Commercial business	10	184
Accuring loans delinquent 90 days or more	29	251
Total nonperforming loans	2,811	1,253
Real estate owned and other repossed property	619	
Total nonperforming assets	$ 3,430	$ 1,253
Total nonperforming loans to net loans	1.65%	0.75%
Total nonperforming loans to total assets	0.86%	0.43%
Total nonperforming assets to total assets	1.05%	0.43%

During the year ended June 30, 2010, the Bank had no foreclosed real estate resulting in a loss. During the year ended June 30, 2010, a minimal amount of interest was recorded on loans previously accounted for on a non-accrual basis.

Classified Assets.

Management, in compliance with regulatory guidelines, conducts an internal loan review program, whereby loans are placed or classified in categories depending upon the level of risk of nonpayment or loss. These categories are special mention, substandard, doubtful or loss. When a loan is classified as substandard or doubtful, management is required to establish an allowance for loan losses in an amount that is deemed prudent. When management classifies a loan as a loss asset, an allowance equal up to 100% of the loan balance is required to be established or the loan is required to be charged-off. The allowance for loan losses is composed of an allowance for both inherent risk associated with lending activities and specific problem assets.

Management s evaluation of the classification of assets and the adequacy of the allowance for loan losses is reviewed by the Board on a regular basis and by the regulatory agencies as part of their examination process. In addition, each loan that exceeds $500,000 and each group of loans that exceeds $500,000 is monitored more closely. The following table reflects our classified assets as of the dates indicated:

	At June 30,	
	2010	2009
	(Dollars in thousands)	
Residential mortgage (one- to four-family):		
Special Mention	$ 536	$
Substandard	782	392
Doubtful		
Loss	90	
Commercial Real Estate and Land:		
Special Mention		
Substandard	1,787	488
Doubtful		
Loss	311	
Home equity loans:		
Special Mention	84	
Substandard	214	131
Doubtful		
Loss	5	
Consumer loans:		
Special Mention		
Substandard	79	40
Doubtful		
Loss	10	12
Commercial loans:		
Special Mention		
Substandard	97	551
Doubtful		
Loss		
Real estate owned/repossessed property:		
Special Mention		
Substandard	619	
Doubtful		
Loss		
Total classified loans and real estate owned	$ 4,614	$ 1,614

Allowance for Loan Losses and Real Estate Owned.

The Bank segregates its loan portfolio for loan losses into the following broad categories: real estate loans (residential mortgages (one- to four-family), real estate construction, commercial real estate and land) home equity loans, consumer loans, and commercial business loans. The Bank provides for a general allowance for losses inherent in the portfolio by the above categories, which consists of two components. General loss percentages are calculated based on historical analyses and other factors such as volume and severity of delinquencies, local and national economy, underwriting standards, and other factors. A supplemental portion of the allowance is calculated for inherent losses which probably exist as of the evaluation date even though they might not have been identified by the more objective processes used. This is due to the risk of error and/or inherent imprecision in the process.

This portion of the allowance is particularly subjective and requires judgments based on qualitative factors which do not lend themselves to exact mathematical calculations such as: trends in delinquencies and non-accruals; trends in volume; terms and portfolio mix; new credit products; changes in lending policies and procedures; and changes in the outlook for the local, regional and national economy.

At least quarterly, the management of the Bank evaluates the need to establish an allowance against losses on loans and other assets based on estimated losses on specific loans and on any real estate owned when a finding is made that a loss is estimable and probable. Such evaluation includes a review of all loans for which full collectibility may not be reasonably assured and considers, among other matters: the estimated market value of the underlying collateral of problem loans; prior loss experience; economic conditions; and overall portfolio quality.

Provisions for, or adjustments to, estimated losses are included in earnings in the period they are established. We had $1,100,000 in allowances for loan losses at June 30, 2010.

While we believe we have established our existing allowance for loan losses in accordance with generally accepted accounting principles, there can be no assurance that bank regulators, in reviewing our loan portfolio, will not request that we significantly increase our allowance for loan losses, or that general economic conditions, a deteriorating real estate market, or other factors will not cause us to significantly increase our allowance for loan losses, therefore negatively affecting our financial condition and earnings.

In making loans, we recognize that credit losses will be experienced and that the risk of loss will vary with, among other things, the type of loan being made, the creditworthiness of the borrower over the term of the loan and, in the case of a secured loan, the quality of the security for the loan.

It is our policy to review our loan portfolio, in accordance with regulatory classification procedures, on at least a quarterly basis.

The following table sets forth information with respect to our allowance for loan losses at the dates and for the periods indicated:

	For the Years Ended June 30, 2010	2009
	(Dollars in thousands)	
Balance at beginning of period	$ 525	$ 300
Provision for loan losses	715	257
Loans charged-off		
Real estate loans	(50)	
Home equity		
Consumer	(71)	(47)
Commercial business loans	(22)	
Recoveries		
Real estate loans		
Home equity		
Consumer	3	15
Commercial business loans		
Net loans charged-off	(140)	(32)
Balance at end of period	$ 1,100	$ 525
Allowance for loan losses to total loans	0.64%	0.31%
Allowance for loan losses to total non-performing loans	32.09%	41.90%
Net recoveries (charge-offs) to average loans outstanding during the period	-0.08%	-0.02%

The following table presents our allocation of the allowance for loan losses by loan category and the percentage of loans in each category to total loans at the periods indicated:

	At June 30,					
	2010			2009		
	(Dollars in thousands)					
	Amount	Percentage of Allowance to Total Allowance	Loans Category to Total Loans	Amount	Percentage of Allowance to Total Allowance	Loans Category to Total Loans
Real estate loans:						
Residential mortgage (one- to four-family)	$ 391	35.55%	42.81%	$ 190	36.19%	47.26%
Commercial real estate and land	447	40.62%	24.43%	158	30.10%	21.90%
Real estate construction	110	10.00%	4.11%	10	1.90%	2.77%
Total real estate loans	948	86.17%	71.35%	358	68.19%	71.93%
Other loans:						
Home equity	6	0.55%	17.47%	67	12.76%	17.11%
Consumer	78	7.10%	5.64%	68	12.95%	6.46%
Commercial business	68	6.18%	5.54%	32	6.10%	4.50%
Total other loans	152	13.83%	28.65%	167	31.81%	28.07%
Total	$ 1,100	100.00%	100.00%	$ 525	100.00%	100.00%

INVESTMENT ACTIVITIES

General.

Federally chartered savings banks such as American Federal Savings Bank have the authority to invest in various types of investment securities, including United States Treasury obligations, securities of various Federal agencies (including securities collateralized by mortgages), certificates of deposits of insured banks and savings institutions, municipal securities, corporate debt securities and loans to other banking institutions.

Eagle maintains liquid assets that may be invested in specified short-term securities and other investments. Liquidity levels may be increased or decreased depending on the yields on investment alternatives. They may also be increased based on management s judgment as to the attractiveness of the yields then available in relation to other opportunities. Liquidity levels can also change based on management s expectation of future yield levels, as well as management s projections as to the short-term demand for funds to be used in the Bank s loan origination and other activities. Eagle maintains an investment securities portfolio and a mortgage-backed securities portfolio as part of its investment portfolio.

Investment Policies.

The investment policy of Eagle, which is established by the board of directors, is designed to foster earnings and liquidity within prudent interest rate risk guidelines, while complementing American Federal s lending activities. The policy provides for available-for-sale (including those accounted for under FASB ASC 825), held-to-maturity, and trading classifications. However, Eagle does not hold any securities for purposes of trading. The policy permits investments in high credit quality instruments with diversified cash flows while permitting us to maximize total return within the guidelines set forth in our interest rate risk and liquidity management policies. Permitted investments include but are not limited to U.S. government obligations, government agency or government-sponsored agency obligations, state, county and municipal obligations, and mortgage-backed securities. Collateralized mortgage obligations, investment grade corporate debt securities, and commercial paper are also included. We also invest in Federal Home Loan Bank (FHLB) overnight deposits and federal funds, but these instruments are not considered part of the investment portfolio.

Our investment policy also includes several specific guidelines and restrictions to insure adherence with safe and sound activities. The policy prohibits investments in high-risk mortgage derivative products (as defined within the policy) without prior approval from the board of directors. Management must demonstrate the business advantage of such investments.

We do not participate in the use of off-balance sheet derivative financial instruments, except interest rate caps and certain financial instruments designated as cash flow hedges related to loans committed to be sold in the secondary market. Further, Eagle does not invest in securities which are not rated investment grade.

The Board, through its asset liability committee, has charged the President and CEO to implement the investment policy. All transactions are reported to the board of directors monthly, as well as the current composition of the portfolio, including market values and unrealized gains and losses.

Investment Securities.

We maintain a portfolio of investment securities, classified as either available-for-sale (including those accounted for under FASB ASC 825) or held-to-maturity to enhance total return on investments. At June 30, 2010, our investment securities included U.S. government and agency obligations, Small Business Administration pools, municipal securities, mortgage-backed securities, collateralized mortgage obligations and corporate obligations, all with varying characteristics as to rate, maturity and call provisions. Investment securities held-to-maturity represented 0.11% of Eagle s total investment portfolio. Securities available-for-sale totaled 97.37% of Eagle s total investment portfolio. The remaining percentage is comprised of interest-bearing deposits in banks and stock in the FHLB of Seattle.

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

	At June 30, 2010		At June 30, 2009	
	(Dollars in Thousands)			
	Carrying Value	Percentage of Total	Carrying Value	Percentage of Total
Securities available-for-sale, at fair value:				
U.S. Government and agency obligations	$ 32,241	27.41%	$ 3,882	4.57%
Corporate obligations	7,451	6.33%	9,493	11.18%
Municipal obligations	35,412	30.11%	28,893	34.04%
Collateralized mortgage obligations	37,669	32.03%	31,551	37.17%
Mortgage-backed securities	1,755	1.49%	8,444	9.95%
Total securities available for sale	114,528	97.37%	82,263	96.91%
Securities held to maturity, at book value:				
Municipal obligations	125	0.11%	375	0.44%
Total securities held to maturity	125	0.11%	375	0.44%
Preferred stock - FASB ASC 825			25	0.03%
Total securities	114,653	97.48%	82,663	97.38%
Interest-bearing deposits	966	0.82%	224	0.26%
Federal Home Loan Bank capital stock, at cost	2,003	1.70%	2,000	2.36%
Total	$ 117,622	100.00%	$ 84,887	100.00%

The following table sets forth information regarding the carrying values, weighted average yields and maturities of our investment securities portfolio at June 30, 2010:

	At June 30, 2010									
	One Year or Less		One to Five Years		More than Five to Ten Years		More than Ten Years		Total Inv	
	Carrying Value	Annualized Weighted Average Yield	Carrying Value	Annualized Weighted Average Yield	Carrying Value	Annualized Weighted Average Yield	Carrying Value	Annualized Weighted Average Yield	Carrying Value	Ap
Securities available-for-sale:										
U.S. Government and agency obligations	$ 4,174	0.99%	$ 23,396	2.06%	$ 4,132	1.19%	$ 539	1.13%	$ 32,241	$
Corporate obligations	1,023	5.15	6,428	4.89					7,451	
Municipal obligations	1,117	1.32	2,694	4.59	7,974	5.56	23,627	6.49	35,412	
Private collateralized mortgage obligations							842	10.77	842	
Collateralized mortgage obligations					4,146	3.60	32,681	3.80	36,827	
Mortgage-backed securities	119	2.85	121	4.11	81	5.38	1,434	3.89	1,755	
Total securities available for sale	6,433	1.74	32,639	2.83	16,333	3.96	59,123	4.80	114,528	
Securities held to maturity:										
Municipal obligations	125	7.50							125	
Total securities held to maturity	125	7.50							125	
Total securities	6,558	1.85	32,639	2.83	16,333	3.96	59,123	4.80	114,653	

Interest-bearing deposits	966	1.56							966	
Federal Home Loan Bank capital stock					2,003				2,003	