TFS Financial CORP
Form 10-Q
August 09, 2011
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

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

**For the Quarterly Period ended June 30, 2011**

**or**

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

**For transition period from to**

**Commission File Number 001-33390**

# TFS FINANCIAL CORPORATION

**(Exact Name of Registrant as Specified in its Charter)**

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

**(216) 441-6000**

**Registrant s telephone number, including area code:**

**Not Applicable**

**(Former name or former address, if changed since last report)**

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

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

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

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

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

As of August 2, 2011 there were 308,442,143 shares of the Registrant s common stock, par value $0.01 per share, outstanding, of which 227,119,132 shares, or 73.63% of the Registrant s common stock, were held by Third Federal Savings and Loan Association of Cleveland, MHC, the Registrant s mutual holding company.

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

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**TFS Financial Corporation**

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**PART I FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**TFS FINANCIAL CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CONDITION (unaudited)**

**(In thousands, except share data)**

| | June 30, 2011 | September 30, 2010 |
|---|---|---|
| **ASSETS** | | |
| Cash and due from banks | $ 33,757 | $ 38,804 |
| Other interest-bearing cash equivalents | 243,812 | 704,936 |
| Cash and cash equivalents | 277,569 | 743,740 |
| Investment securities: | | |
| Available for sale (amortized cost $16,573 and $24,480, respectively) | 16,664 | 24,619 |
| Held to maturity (fair value $449,380 and $657,076, respectively) | 441,691 | 646,940 |
| | 458,355 | 671,559 |
| Mortgage loans held for sale (none measured at fair value) | 0 | 25,027 |
| Loans held for investment, net: | | |
| Mortgage loans | 9,863,637 | 9,323,073 |
| Other loans | 6,916 | 7,199 |
| Deferred loan fees, net | (19,020) | (15,283) |
| Allowance for loan losses | (153,305) | (133,240) |
| Loans, net | 9,698,228 | 9,181,749 |
| Mortgage loan servicing assets, net | 30,791 | 38,658 |
| Federal Home Loan Bank stock, at cost | 35,620 | 35,620 |
| Real estate owned | 20,126 | 15,912 |
| Premises, equipment, and software, net | 60,518 | 62,685 |
| Accrued interest receivable | 35,625 | 36,282 |
| Bank owned life insurance contracts | 169,172 | 164,334 |
| Other assets | 91,537 | 100,461 |
| TOTAL ASSETS | $ 10,877,541 | $ 11,076,027 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Deposits | $ 8,701,896 | $ 8,851,941 |
| Borrowed funds | 185,129 | 70,158 |
| Borrowers advances for insurance and taxes | 28,817 | 51,401 |
| Principal, interest, and related escrow owed on loans serviced | 89,430 | 284,425 |
| Accrued expenses and other liabilities | 105,882 | 65,205 |
| Total liabilities | 9,111,154 | 9,323,130 |
| Commitments and contingent liabilities | | |

| | | |
|---|---|---|
| Preferred stock, $0.01 par value, 100,000,000 shares authorized, none issued and outstanding | 0 | 0 |
| Common stock, $0.01 par value, 700,000,000 shares authorized; 332,318,750 shares issued; 308,442,143 and 308,395,000 outstanding at June 30, 2011 and September 30, 2010, respectively | 3,323 | 3,323 |
| Paid-in capital | 1,690,561 | 1,686,062 |
| Treasury stock, at cost; 23,876,607 and 23,923,750 shares at June 30, 2011 and September 30, 2010, respectively | (287,797) | (288,366) |
| Unallocated ESOP shares | (80,168) | (82,699) |
| Retained earnings substantially restricted | 453,503 | 452,633 |
| Accumulated other comprehensive loss | (13,035) | (18,056) |
| Total shareholders' equity | 1,766,387 | 1,752,897 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | $ 10,877,541 | $ 11,076,027 |

See accompanying notes to unaudited interim consolidated financial statements.

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**TFS Financial Corporation and Subsidiaries**

**CONSOLIDATED STATEMENTS OF INCOME (unaudited)**

**(In thousands, except share and per share data)**

| | For the Three Months Ended June 30, 2011 | For the Three Months Ended June 30, 2010 | For the Nine Months Ended June 30, 2011 | For the Nine Months Ended June 30, 2010 |
|---|---|---|---|---|
| INTEREST INCOME: | | | | |
| Loans, including fees | $ 103,845 | $ 103,902 | $ 309,439 | $ 315,713 |
| Investment securities available for sale | 43 | 150 | 198 | 416 |
| Investment securities held to maturity | 2,871 | 4,674 | 9,001 | 14,639 |
| Other interest and dividend earning assets | 527 | 664 | 1,822 | 1,813 |
| Total interest and dividend income | 107,286 | 109,390 | 320,460 | 332,581 |
| INTEREST EXPENSE: | | | | |
| Deposits | 43,723 | 51,446 | 135,387 | 158,779 |
| Borrowed funds | 518 | 480 | 1,441 | 1,439 |
| Total interest expense | 44,241 | 51,926 | 136,828 | 160,218 |
| NET INTEREST INCOME | 63,045 | 57,464 | 183,632 | 172,363 |
| PROVISION FOR LOAN LOSSES | 22,500 | 30,000 | 79,500 | 71,000 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 40,545 | 27,464 | 104,132 | 101,363 |
| NON-INTEREST INCOME | | | | |
| Fees and service charges, net of amortization | 4,507 | 5,626 | 11,829 | 16,658 |
| Net gain on the sale of loans | 201 | 19,716 | 490 | 25,510 |
| Increase in and death benefits from bank owned life insurance contracts | 1,621 | 1,623 | 4,840 | 4,820 |
| Income on private equity investments | 763 | 200 | 977 | 546 |
| Other | 1,667 | 1,363 | 5,709 | 4,276 |
| Total non-interest income | 8,759 | 28,528 | 23,845 | 51,810 |
| NON-INTEREST EXPENSE | | | | |
| Salaries and employee benefits | 19,694 | 22,223 | 56,994 | 63,879 |
| Marketing services | 2,102 | 920 | 6,306 | 4,971 |
| Office property, equipment and software | 4,986 | 5,046 | 14,983 | 15,661 |
| Federal insurance premium | 2,759 | 4,239 | 14,591 | 12,762 |
| State franchise tax | 1,459 | 1,329 | 3,826 | 3,709 |
| Real estate owned expense, net | 1,994 | 1,380 | 5,906 | 4,042 |
| Appraisal and other loan review expenses | 1,005 | 158 | 4,907 | 480 |
| Other operating expenses | 5,553 | 5,386 | 18,958 | 14,609 |
| Total non-interest expense | 39,552 | 40,681 | 126,471 | 120,113 |
| INCOME BEFORE INCOME TAXES | 9,752 | 15,311 | 1,506 | 33,060 |
| INCOME TAX EXPENSE | 3,767 | 5,074 | 645 | 10,975 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| NET INCOME | $ | 5,985 | $ | 10,237 | $ | 861 | $ | 22,085 |
| Earnings per share - basic and diluted | $ | 0.02 | $ | 0.03 | $ | 0.00 | $ | 0.07 |
| Weighted average shares outstanding | | | | | | | | |
| Basic | | 300,347,978 | | 299,826,025 | | 300,234,492 | | 299,725,977 |
| Diluted | | 301,147,673 | | 300,557,738 | | 300,918,065 | | 300,335,743 |

See accompanying notes to unaudited interim consolidated financial statements.

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**TFS FINANCIAL CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (unaudited)**

**Nine Months Ended June 30, 2011 and 2010**

**(In thousands)**

| | | | | | | Accumulated other comprehensive income (loss) | | |
|---|---|---|---|---|---|---|---|---|
| | Common stock | Paid-in capital | Treasury stock | Unallocated common stock held by ESOP | Retained earnings | Unrealized gains/(losses) on securities | Pension obligation | Total shareholders equity |
| Balance at September 30, 2009 | $ 3,323 | 1,679,000 | (287,514) | (87,896) | 456,875 | 240 | (18,163) | $ 1,745,865 |
| Comprehensive Income | | | | | | | | |
| Net income | | | | | 22,085 | | | 22,085 |
| Change in unrealized gains on securities available for sale | | | | | | (83) | | (83) |
| Change in pension obligation | | | | | | | 1,018 | 1,018 |
| Total comprehensive income | | | | | | | | 23,020 |
| Purchase of treasury stock (161,400 shares) | | | (1,810) | | | | | (1,810) |
| ESOP shares allocated or committed to be released | | 1,032 | | 3,874 | | | | 4,906 |
| Compensation costs for stock-based plans | | 4,984 | | | | | | 4,984 |
| Excess tax effect from stock-based compensation | | 123 | | | | | | 123 |
| Dividends paid to common shareholders ($0.21 per common share) | | | | | (15,561) | | | (15,561) |
| Balance at June 30, 2010 | $ 3,323 | 1,685,139 | (289,324) | (84,022) | 463,399 | 157 | (17,145) | $ 1,761,527 |
| Balance at September 30, 2010 | $ 3,323 | 1,686,062 | (288,366) | (82,699) | 452,633 | 90 | (18,146) | $ 1,752,897 |
| Comprehensive Income | | | | | | | | |
| Net income | | | | | 861 | | | 861 |
| Change in unrealized gains on securities available for sale | | | | | | (31) | | (31) |
| Change in pension obligation | | | | | | | 5,052 | 5,052 |
| Total comprehensive loss | | | | | | | | 5,882 |
| ESOP shares allocated or committed to be released | | (281) | | 2,531 | | | | 2,250 |
| Compensation costs for stock-based plans | | 5,397 | (3) | | | | | 5,394 |
| Excess tax effect from stock-based compensation | | (36) | | | | | | (36) |
| Treasury stock allocated to restricted stock plan | | (581) | 572 | | 9 | | | |
| Balance at June 30, 2011 | $ 3,323 | 1,690,561 | (287,797) | (80,168) | 453,503 | 59 | (13,094) | $ 1,766,387 |

See accompanying notes to unaudited iterim consolidated financial statements.

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**TFS FINANCIAL CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

**(In thousands)**

| | For the Nine Months Ended June 30, 2011 | 2010 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | $ 861 | $ 22,085 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| ESOP and stock-based compensation expense | 7,644 | 9,932 |
| Depreciation and amortization | 15,380 | 11,563 |
| Deferred income taxes | 400 | 0 |
| Provision for loan losses | 79,500 | 71,000 |
| Net gain on the sale of loans | (490) | (25,510) |
| Other net losses | 3,283 | 1,796 |
| Principal repayments on and proceeds from sales of loans held for sale | 0 | 151,536 |
| Loans originated for sale | 0 | (202,677) |
| Increase in bank owned life insurance contracts | (4,846) | (4,818) |
| Net decrease (increase) in interest receivable and other assets | 5,992 | (43,265) |
| Net increase in accrued expenses and other liabilities | 48,450 | 4,395 |
| Other | 662 | 2,502 |
| Net cash provided by (used in) operating activities | 156,836 | (1,461) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Loans originated | (1,993,393) | (1,807,187) |
| Principal repayments on loans | 1,371,213 | 1,403,028 |
| Proceeds from sales, principal repayments and maturities of: | | |
| Securities available for sale | 10,102 | 7,626 |
| Securities held to maturity | 214,681 | 230,801 |
| Proceeds from sale of: | | |
| Loans | 33,722 | 797,099 |
| Real estate owned | 11,201 | 14,223 |
| Purchases of: | | |
| Securities available for sale | (2,288) | (8,141) |
| Securities held to maturity | (12,424) | (295,564) |
| Premises and equipment | (2,279) | (3,100) |
| Other | (853) | 122 |
| Net cash (used in) provided by investing activities | (370,318) | 338,907 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net (decrease) increase in deposits | (150,045) | 337,703 |
| Net decrease in borrowers' advances for insurance and taxes | (22,584) | (17,586) |
| Net (decrease) increase in principal and interest owed on loans serviced | (194,995) | 2,236 |
| Net increase in short term borrowed funds | 100,016 | 0 |
| Proceeds from long term borrowed funds | 29,955 | 0 |
| Repayment of long term borrowed funds | (15,000) | 0 |
| Purchase of treasury shares | 0 | (1,810) |
| Excess tax (provision) benefit related to stock-based compensation | (36) | 81 |
| Dividends paid to common shareholders | 0 | (15,561) |

| | | |
|---|---|---|
| Net cash (used in) provided by financing activities | (252,689) | 305,063 |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (466,171) | 642,509 |
| CASH AND CASH EQUIVALENTS Beginning of period | 743,740 | 307,046 |
| CASH AND CASH EQUIVALENTS End of period | $ 277,569 | $ 949,555 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Cash paid for interest on deposits | $ 136,097 | $ 161,211 |
| Cash paid for interest on borrowed funds | 1,418 | 1,439 |
| Cash paid for income taxes | 4,500 | 11,900 |
| SUPPLEMENTAL SCHEDULES OF NONCASH INVESTING AND FINANCING ACTIVITIES: | | |
| Transfer of loans to real estate owned | 17,700 | 12,389 |
| Transfer of loans from held for sale to held for investment | 25,027 | 0 |

See accompanying notes to unaudited interim consolidated financial statements.

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**TFS FINANCIAL CORPORATION AND SUBSIDIARIES**

**NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**(Dollars in thousands unless otherwise indicated)**

## 1. BASIS OF PRESENTATION

TFS Financial Corporation (the Holding Company), a federally chartered stock holding company, conducts its principal activities through its wholly owned subsidiaries. The principal line of business of TFS Financial Corporation and its subsidiaries (collectively, TFS Financial or the Company) is retail consumer banking, including mortgage lending, deposit gathering, and other insignificant financial services. On June 30, 2011, approximately 74% of the Holding Company s outstanding shares were owned by a federally chartered mutual holding company, Third Federal Savings and Loan Association of Cleveland, MHC (Third Federal Savings, MHC). The thrift subsidiary of TFS Financial is Third Federal Savings and Loan Association of Cleveland (the Association).

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

The unaudited interim consolidated financial statements were prepared without an audit and reflect all adjustments of a normal recurring nature which, in the opinion of management, are necessary to present fairly the consolidated financial condition of TFS Financial at June 30, 2011, and its results of operations and cash flows for the periods presented. In accordance with Regulation S-X for interim financial information, these statements do not include certain information and footnote disclosures required for complete audited financial statements. The Holding Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2010 contains consolidated financial statements and related notes, which should be read in conjunction with the accompanying interim consolidated financial statements. The results of operations for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2011.

## 2. EARNINGS PER SHARE

The following is a summary of our earnings per share calculations.

| | For the Three Months Ended June 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2011 | | | 2010 | | |
| | Income | Shares | Per share amount | Income | Shares | Per share amount |
| | (Dollars in thousands, except per share data) | | | | | |
| Net income | $ 5,985 | | | $ 10,237 | | |
| Less: income allocated to restricted stock units | 33 | | | 154 | | |
| Basic earnings per share: | | | | | | |
| Income available to common shareholders | $ 5,952 | 300,347,978 | $ 0.02 | $ 10,083 | 299,826,025 | $ 0.03 |
| Diluted earnings per share: | | | | | | |
| Effect of dilutive potential common shares | | 799,695 | | | 731,713 | |
| Income available to common shareholders | $ 5,952 | 301,147,673 | $ 0.02 | $ 10,083 | 300,557,738 | $ 0.03 |

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| | For the Nine Months Ended June 30, 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | Income | Shares | Per share amount | Income | Shares | Per share amount |
| | (Dollars in thousands, except per share data) | | | | | |
| Net income | $ 861 | | | $ 22,085 | | |
| Less: income allocated to restricted stock units | 5 | | | 394 | | |
| Basic earnings per share: | | | | | | |
| Income available to common shareholders | $ 856 | 300,234,492 | $ 0.00 | $ 21,691 | 299,725,977 | $ 0.07 |
| Diluted earnings per share: | | | | | | |
| Effect of dilutive potential common shares | | 683,573 | | | 609,766 | |
| Income available to common shareholders | $ 856 | 300,918,065 | $ 0.00 | $ 21,691 | 300,335,743 | $ 0.07 |

Earnings per share is computed by dividing the income available to common stockholders by the weighted average number of shares outstanding for the period. Outstanding shares include shares held by Third Federal Savings, MHC, shares held by the Third Federal Foundation, shares held by the Employee Stock Ownership Plan ( ESOP ), stock options and restricted stock units with a dilutive impact granted under the Company s 2008 Equity Incentive Plan and shares held by the public, except that shares held by the ESOP that have not been allocated to participants or committed to be released for allocation to participants are excluded from the computations.

Outstanding stock options and restricted stock units are excluded from the computation of diluted earnings per share when their inclusion would be anti-dilutive. The diluted earnings per share calculation for the three months and nine months ended June 30, 2011 excludes 4,515,276 unvested outstanding stock options and 490,649 vested outstanding stock options and for the three and nine months ended June 30, 2010 excludes 3,503,200 unvested outstanding stock options and 135,800 restricted stock units because their inclusion would be anti-dilutive.

## 3. INVESTMENT SECURITIES

Investment securities available for sale are summarized as follows:

| | June 30, 2011 | | | |
|---|---|---|---|---|
| | Amortized | Gross Unrealized | | Fair |
| | Cost | Gains | Losses | Value |
| U.S. government and agency obligations | $ 2,000 | $ 0 | $ (17) | $ 1,983 |
| Real estate mortgage investment conduits (REMICs) | 5,830 | 108 | 0 | 5,938 |
| Money market accounts | 8,743 | 0 | 0 | 8,743 |
| | $ 16,573 | $ 108 | $ (17) | $ 16,664 |

| | September 30, 2010 | | | |
|---|---|---|---|---|
| | Amortized | Gross Unrealized | | Fair |
| | Cost | Gains | Losses | Value |
| U.S. government and agency obligations | $ 7,000 | $ 63 | $ 0 | $ 7,063 |
| REMICs | 8,718 | 90 | (14) | 8,794 |
| Money market accounts | 8,762 | 0 | 0 | 8,762 |
| | $ 24,480 | $ 153 | $ (14) | $ 24,619 |

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Investments held to maturity are summarized as follows:

| | June 30, 2011 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Freddie Mac certificates | $ 2,741 | $ 166 | $ 0 | $ 2,907 |
| Ginnie Mae certificates | 20,202 | 584 | 0 | 20,786 |
| REMICs | 410,695 | 6,202 | (81) | 416,816 |
| Fannie Mae certificates | 8,053 | 818 | 0 | 8,871 |
| | $ 441,691 | $ 7,770 | $ (81) | $ 449,380 |

| | September 30, 2010 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Freddie Mac certificates | $ 4,441 | $ 231 | $ 0 | $ 4,672 |
| Ginnie Mae certificates | 22,375 | 598 | 0 | 22,973 |
| REMICs | 611,000 | 8,754 | (268) | 619,486 |
| Fannie Mae certificates | 9,124 | 821 | 0 | 9,945 |
| | $ 646,940 | $ 10,404 | $ (268) | $ 657,076 |

**4. LOANS AND ALLOWANCE FOR LOAN LOSSES**

Loans held for investment consist of the following:

| | June 30, 2011 | September 30, 2010 |
|---|---|---|
| Real estate loans: | | |
| Residential non-Home Today | $ 6,988,085 | $ 6,138,454 |
| Residential Home Today | 267,627 | 280,533 |
| Home equity loans and lines of credit | 2,560,264 | 2,848,690 |
| Construction | 90,767 | 100,404 |
| Total real estate loans | 9,906,743 | 9,368,081 |
| Consumer and other loans | 6,916 | 7,199 |
| Less: | | |
| Deferred loan fees net | (19,020) | (15,283) |
| Loans-in-process (LIP) | (43,106) | (45,008) |
| Allowance for loan losses | (153,305) | (133,240) |
| Loans held for investment, net | $ 9,698,228 | $ 9,181,749 |

A large concentration of the Company s lending is in Ohio. As of June 30, 2011 and September 30, 2010, the percentages of residential real estate loans held in Ohio were 81% and 80%, respectively. As of June 30, 2011 and September 30, 2010, the percentage of residential real estate loans held in Florida was 17% and 18%, respectively. As of June 30, 2011 and September 30, 2010, the home equity loans and lines of credit held were concentrated in the states of Ohio, 39% and 40%, Florida, 28% and 28%, and California, 12% and 11%, respectively. The economic conditions and market for real estate in those states have a significant impact on the ability of borrowers in those areas to repay their loans.

Effective June 28, 2010, the Association suspended the acceptance of new equity line of credit applications.

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

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education and counseling and must be referred to the Association by a sponsoring organization with which the Association has partnered as part of the program. Borrowers must also meet a minimum credit score threshold. Because prior to March 27, 2009 the Association applied less stringent underwriting and credit standards to these loans, loans originated under the Home Today program prior to that date have greater credit risk than its traditional residential real estate mortgage loans. Effective March 27, 2009, the Home Today underwriting guidelines are substantially the same as our traditional first mortgage product. As of June 30, 2011, the balance of Home Today loans originated prior to March 27, 2009 was $265,496. The Association does not offer, and has not offered, loan products frequently considered to be designed to target sub-prime borrowers containing features such as higher fees or higher rates, negative amortization, a loan-to-value ratio greater than 100%, or option adjustable-rate mortgages.

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

| | June 30, 2011 | September 30, 2010 |
|---|---|---|
| Real estate loans: | | |
| Residential non-Home Today | $ 126,149 | $ 135,109 |
| Residential Home Today | 71,739 | 91,985 |
| Home equity loans and lines of credit | 38,288 | 54,481 |
| Construction | 3,886 | 4,994 |
| Total real estate loans | 240,062 | 286,569 |
| Consumer and other loans | 1 | 1 |
| Total non-accrual loans | $ 240,063 | $ 286,570 |

Loans are placed in nonaccrual status when they are contractually 90 days or more past due. Loans modified in troubled debt restructurings that were in nonaccrual status prior to the restructurings remain in nonaccrual status for a minimum of six months. Interest on loans in accrual status, including certain loans individually reviewed for impairment, is recognized in interest income as it accrues, on a daily basis. Accrued interest on loans in non-accrual status is reversed by a charge to interest income and income is subsequently recognized only to the extent cash payments are received. Cash payments on loans in non-accrual status are applied to the oldest scheduled, unpaid principal and interest payment first. A nonaccrual loan, other than a troubled debt restructuring, is returned to accrual status when contractual payments are less than 90 days past due. The number of days past due is determined by the number of days the oldest contractual principal and interest payment remains unpaid. Total nonaccrual loans at June 30, 2011 and September 30, 2010 includes $18,879 and $32,365, respectively, in troubled debt restructurings which are current but included with nonaccrual loans for a minimum period of six months from the restructuring date due to their nonaccrual status prior to restructuring.

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Age analysis of the recorded investment in loan receivables that are past due at June 30, 2011 and September 30, 2010 is summarized in the following tables. Balances are net of deferred fees and any applicable loans-in-process (LIP).

| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Current | Total |
|---|---|---|---|---|---|---|
| June 30, 2011 | | | | | | |
| Real estate loans: | | | | | | |
| Residential non-Home Today | $ 17,023 | $ 13,586 | $ 118,025 | $ 148,634 | $ 6,808,977 | $ 6,957,611 |
| Residential Home Today | 11,525 | 7,460 | 61,364 | 80,349 | 186,111 | 266,460 |
| Home equity loans and lines of credit | 11,091 | 6,336 | 37,988 | 55,415 | 2,518,238 | 2,573,653 |
| Construction | 704 | 40 | 3,886 | 4,630 | 42,263 | 46,893 |
| Total real estate loans | 40,343 | 27,422 | 221,263 | 289,028 | 9,555,589 | 9,844,617 |
| Consumer and other loans | 0 | 0 | 1 | 1 | 6,915 | 6,916 |
| Total | $ 40,343 | $ 27,422 | $ 221,264 | $ 289,029 | $ 9,562,504 | $ 9,851,533 |

| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Current | Total |
|---|---|---|---|---|---|---|
| September 30, 2010 | | | | | | |
| Real estate loans: | | | | | | |
| Residential non-Home Today | $ 20,748 | $ 9,933 | $ 121,601 | $ 152,282 | $ 5,955,965 | $ 6,108,247 |
| Residential Home Today | 12,836 | 8,970 | 74,831 | 96,637 | 182,515 | 279,152 |
| Home equity loans and lines of credit | 14,144 | 7,233 | 53,948 | 75,325 | 2,790,611 | 2,865,936 |
| Construction | 558 | 0 | 3,980 | 4,538 | 49,917 | 54,455 |
| Total real estate loans | 48,286 | 26,136 | 254,360 | 328,782 | 8,979,008 | 9,307,790 |
| Consumer and other loans | 0 | 0 | 1 | 1 | 7,198 | 7,199 |
| Total | $ 48,286 | $ 26,136 | $ 254,361 | $ 328,783 | $ 8,986,206 | $ 9,314,989 |

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

| | For the Three Months Ended June 30, 2011 | | | | |
|---|---|---|---|---|---|
| | Beginning Balance | Provisions | Charge-offs | Recoveries | Ending Balance |
| Real estate loans: | | | | | |
| Residential non-Home Today | $ 49,419 | $ 5,312 | $ (5,067) | $ 131 | $ 49,795 |
| Residential Home Today | 24,685 | 4,810 | (2,239) | 25 | 27,281 |
| Home equity loans and lines of credit | 72,510 | 11,830 | (12,970) | 484 | 71,854 |
| Construction | 4,132 | 548 | (308) | 2 | 4,374 |
| Total real estate loans | 150,746 | 22,500 | (20,584) | 642 | 153,304 |
| Consumer and other loans | 1 | 0 | 0 | 0 | 1 |
| Total | $ 150,747 | $ 22,500 | $ (20,584) | $ 642 | $ 153,305 |

| | For the Three Months Ended June 30, 2010 | | | | |
|---|---|---|---|---|---|
| | Beginning Balance | Provisions | Charge-offs | Recoveries | Ending Balance |
| Real estate loans: | | | | | |
| Residential non-Home Today | $ 27,211 | $ 7,850 | $ (3,565) | $ 189 | $ 31,685 |
| Residential Home Today | 8,414 | 2,574 | (836) | 0 | 10,152 |
| Home equity loans and lines of credit | 61,140 | 19,459 | (12,070) | 787 | 69,316 |
| Construction | 7,539 | 117 | (406) | 10 | 7,260 |
| Total real estate loans | 104,304 | 30,000 | (16,877) | 986 | 118,413 |
| Consumer and other loans | 1 | 0 | 0 | 0 | 1 |
| Total | $ 104,305 | $ 30,000 | $ (16,877) | $ 986 | $ 118,414 |

| | For the Nine Months Ended June 30, 2011 | | | | |
|---|---|---|---|---|---|
| | Beginning Balance | Provisions | Charge-offs | Recoveries | Ending Balance |
| Real estate loans: | | | | | |
| Residential non-Home Today | $ 41,246 | $ 21,281 | $ (13,027) | $ 295 | $ 49,795 |
| Residential Home Today | 13,331 | 19,451 | (5,586) | 85 | 27,281 |
| Home equity loans and lines of credit | 73,780 | 38,520 | (41,743) | 1,297 | 71,854 |
| Construction | 4,882 | 248 | (791) | 35 | 4,374 |
| Total real estate loans | 133,239 | 79,500 | (61,147) | 1,712 | 153,304 |
| Consumer and other loans | 1 | 0 | 0 | 0 | 1 |
| Total | $ 133,240 | $ 79,500 | $ (61,147) | $ 1,712 | $ 153,305 |

| | For the Nine Months Ended June 30, 2010 | | | | |
|---|---|---|---|---|---|
| | Beginning Balance | Provisions | Charge-offs | Recoveries | Ending Balance |
| Real estate loans: | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Residential non-Home Today | $ 22,678 | $ 16,730 | $ (8,107) | $ 384 | $ 31,685 |
| Residential Home Today | 9,232 | 4,159 | (3,262) | 23 | 10,152 |
| Home equity loans and lines of credit | 57,594 | 46,747 | (36,130) | 1,105 | 69,316 |
| Construction | 5,743 | 3,364 | (1,858) | 11 | 7,260 |
| Total real estate loans | 95,247 | 71,000 | (49,357) | 1,523 | 118,413 |
| Consumer and other loans | 1 | 0 | 0 | 0 | 1 |
| Total | $ 95,248 | $ 71,000 | $ (49,357) | $ 1,523 | $ 118,414 |

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The recorded investment in loan receivables at June 30, 2011 and September 30, 2010 is summarized in the following table. The table provides details of the recorded balances according to the method of evaluation used for determining the allowance for loan losses, distinguishing between determinations made by evaluating individual loans and determinations made by evaluating groups of loans not individually evaluated. Balances of recorded investments are net of deferred fees and any applicable LIP.

| | June 30, 2011 | | | September 30, 2010 | | |
|---|---|---|---|---|---|---|
| | Individually | Collectively | Total | Individually | Collectively | Total |
| Real estate loans: | | | | | | |
| Residential non-Home Today | $ 158,860 | $ 6,798,751 | $ 6,957,611 | $ 147,002 | $ 5,961,245 | $ 6,108,247 |
| Residential Home Today | 135,080 | 131,380 | 266,460 | 129,721 | 149,431 | 279,152 |
| Home equity loans and lines of credit | 41,666 | 2,531,987 | 2,573,653 | 56,108 | 2,809,828 | 2,865,936 |
| Construction | 6,602 | 40,291 | 46,893 | 7,881 | 46,574 | 54,455 |
| Total real estate loans | 342,208 | 9,502,409 | 9,844,617 | 340,712 | 8,967,078 | 9,307,790 |
| Consumer and other loans | 1 | 6,915 | 6,916 | 1 | 7,198 | 7,199 |
| Total | $ 342,209 | $ 9,509,324 | $ 9,851,533 | $ 340,713 | $ 8,974,276 | $ 9,314,989 |

An analysis of the allowance for loan losses at June 30, 2011 and September 30, 2010 is summarized in the following table. The analysis provides details of the allowance for loan losses according to the method of evaluation, distinguishing between allowances for loan losses determined by evaluating individual loans and allowances for loan losses determined by evaluating groups of loans not individually evaluated.

| | June 30, 2011 | | | September 30, 2010 | | |
|---|---|---|---|---|---|---|
| | Individually | Collectively | Total | Individually | Collectively | Total |
| Real estate loans: | | | | | | |
| Residential non-Home Today | $ 21,871 | $ 27,924 | $ 49,795 | $ 15,790 | $ 25,456 | $ 41,246 |
| Residential Home Today | 17,685 | 9,596 | 27,281 | 9,752 | 3,579 | 13,331 |
| Home equity loans and lines of credit | 13,738 | 58,116 | 71,854 | 18,508 | 55,272 | 73,780 |
| Construction | 1,615 | 2,759 | 4,374 | 1,988 | 2,894 | 4,882 |
| Total real estate loans | 54,909 | 98,395 | 153,304 | 46,038 | 87,201 | 133,239 |
| Consumer and other loans | 1 | 0 | 1 | 1 | 0 | 1 |
| Total | $ 54,910 | $ 98,395 | $ 153,305 | $ 46,039 | $ 87,201 | $ 133,240 |

The allowance for loan losses is assessed on a quarterly basis and provisions for loan losses are made in order to maintain the allowance at a level sufficient to absorb credit losses in the portfolio. Mortgage loan portfolios are evaluated as homogeneous pools based on similarities in credit profile, product and property types. Through the evaluation, general allowances for loan losses are assessed based on historical loan loss experience for each homogeneous pool. General allowances are adjusted to address other factors that affect estimated probable losses, including current delinquency statistics; the status of loans in foreclosure, real estate in judgment and real estate owned; national, regional and local economic factors and trends; and asset disposition loss statistics (both current and historical). Specific allowances are assessed on impaired loans as described later in this footnote.

Residential non-Home Today mortgage loans represent the largest piece of our residential real estate portfolio. We believe overall credit risk is low based on nature, composition, collateral, products, lien position and performance of the portfolio. The portfolio does not include loan types or structures that have recently experienced severe performance problems at other financial institutions (sub-prime, no documentation, pay option adjustable rate mortgages).

As described earlier in this footnote, Home Today loans, particularly those originated prior to March 27, 2009, have greater credit risk than traditional residential real estate mortgage loans. At June 30, 2011, more than 54% of Home Today loans include private mortgage insurance coverage.

Equity lines of credit represent a significant portion of our residential real estate portfolio. The state of the economy and low housing prices continue to have an adverse impact on this portfolio since the equity lines generally are in a second lien position. Effective June 28, 2010, due to the perceived deterioration in the overall housing conditions including concerns for loans and lines in a second lien position, equity lines of credit and home equity loans are no longer offered.

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Construction loans generally have greater credit risk than traditional residential real estate mortgage loans. The repayment of these loans depends upon the sale of the property to third parties or the availability of permanent financing upon completion of all improvements. In the event we make a loan on property that is not yet approved for the planned development, there is the risk that approvals will not be granted or will be delayed. These events may adversely affect the borrower and the collateral value of the property. Construction loans also expose us to the risk that improvements will not be completed on time in accordance with specifications and projected costs. In addition, the ultimate sale or rental of the property may not occur as anticipated.

Consumer loans include $1 of auto loans at June 30, 2011 and September 30, 2010. The remaining balance is comprised of loans secured by certificate of deposit accounts, which are fully recoverable in the event of non-payment.

Loans are charged off when less than the full payment is accepted as satisfaction for a loan; a foreclosure action is completed and the fair value of the collateral received is insufficient to satisfy the loan; management concludes the costs of foreclosure exceed the potential recovery; or, in the case of equity loans and lines of credit, management determines the collateral is not sufficient to satisfy the loan.

The recorded investment and the unpaid principal balance of impaired loans, including those whose terms have been modified in troubled debt restructurings, as of June 30, 2011 and September 30, 2010 are summarized as follows. Balances of recorded investments are net of deferred fees.

| | June 30, 2011 | | | September 30, 2010 | | |
|---|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| With no related allowance recorded: | | | | | | |
| Residential non-Home Today | $ 44,608 | $ 44,803 | $ 0 | $ 39,430 | $ 39,624 | $ 0 |
| Residential Home Today | 18,438 | 18,519 | 0 | 37,458 | 37,643 | 0 |
| Home equity loans and lines of credit | 14,451 | 14,376 | 0 | 20,377 | 20,255 | 0 |
| Construction | 241 | 243 | 0 | 192 | 194 | 0 |
| Consumer and other loans | 0 | 0 | 0 | 0 | 0 | 0 |
| Total | $ 77,738 | $ 77,941 | $ 0 | $ 97,457 | $ 97,716 | $ 0 |
| With an allowance recorded: | | | | | | |
| Residential non-Home Today | $ 114,252 | $ 114,752 | $ 21,871 | $ 107,572 | $ 108,104 | $ 15,790 |
| Residential Home Today | 116,642 | 117,153 | 17,685 | 92,263 | 92,719 | 9,752 |
| Home equity loans and lines of credit | 27,215 | 27,073 | 13,738 | 35,731 | 35,517 | 18,508 |
| Construction | 6,361 | 6,415 | 1,615 | 7,689 | 7,762 | 1,988 |
| Consumer and other loans | 1 | 1 | 1 | 1 | 1 | 1 |
| Total | $ 264,471 | $ 265,394 | $ 54,910 | $ 243,256 | $ 244,103 | $ 46,039 |
| Total impaired loans: | | | | | | |
| Residential non-Home Today | $ 158,860 | $ 159,555 | $ 21,871 | $ 147,002 | $ 147,728 | $ 15,790 |
| Residential Home Today | 135,080 | 135,672 | 17,685 | 129,721 | 130,362 | 9,752 |
| Home equity loans and lines of credit | 41,666 | 41,449 | 13,738 | 56,108 | 55,772 | 18,508 |
| Construction | 6,602 | 6,658 | 1,615 | 7,881 | 7,956 | 1,988 |
| Consumer and other loans | 1 | 1 | 1 | 1 | 1 | 1 |
| Total | $ 342,209 | $ 343,335 | $ 54,910 | $ 340,713 | $ 341,819 | $ 46,039 |

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At June 30, 2011 and September 30, 2010, respectively, the recorded investment in impaired loans includes $160,843 and $134,696 of loans modified in troubled debt restructurings of which $23,093 and $12,292 are 90 days or more past due.

The average recorded investment in impaired loans and the amount of interest income recognized during the time within the period that the loans were impaired are summarized below. Beginning the three months ended June 30, 2011, the reported amount of interest income recognized includes interest income on all impaired loans. Prior to that period, the reported amount included interest income from only impaired loans with an allowance, resulting in a reported amount that was less than, but not materially different from, the actual amount of interest income recognized. Balances of average recorded investments are net of deferred fees.

| | Three Months Ended June 30, | | | |
|---|---|---|---|---|
| | 2011 | | 2010 | |
| | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| With no related allowance recorded: | | | | |
| Residential non-Home Today | $ 42,508 | $ 194 | $ 49,298 | $ 0 |
| Residential Home Today | 22,697 | 97 | 45,783 | 0 |
| Home equity loans and lines of credit | 14,892 | 60 | 24,744 | 0 |
| Construction | 218 | 1 | 0 | 0 |
| Consumer and other loans | 0 | 0 | 0 | 0 |
| Total | $ 80,315 | $ 352 | $ 119,825 | $ 0 |
| With an allowance recorded: | | | | |
| Residential non-Home Today | 115,134 | $ 703 | $ 78,795 | $ 343 |
| Residential Home Today | 111,846 | 796 | 69,130 | 315 |
| Home equity loans and lines of credit | 29,526 | 75 | 34,582 | 40 |
| Construction | 6,835 | 29 | 1,370 | 0 |
| Consumer and other loans | 1 | 0 | 0 | 0 |
| Total | $ 263,342 | $ 1,603 | $ 183,877 | $ 698 |
| Total impaired loans: | | | | |
| Residential non-Home Today | $ 157,642 | $ 897 | $ 128,093 | $ 343 |
| Residential Home Today | 134,543 | 893 | 114,913 | 315 |
| Home equity loans and lines of credit | 44,418 | 135 | 59,326 | 40 |
| Construction | 7,053 | 30 | 1,370 | 0 |
| Consumer and other loans | 1 | 0 | 0 | 0 |
| Total | $ 343,657 | $ 1,955 | $ 303,702 | $ 698 |

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| | Nine Months Ended June 30, 2011 Average Recorded Investment | 2011 Interest Income Recognized | 2010 Average Recorded Investment | 2010 Interest Income Recognized |
|---|---|---|---|---|
| With no related allowance recorded: | | | | |
| Residential non-Home Today | $ 42,018 | $ 194 | $ 41,055 | $ 0 |
| Residential Home Today | 27,948 | 97 | 40,901 | 0 |
| Home equity loans and lines of credit | 17,415 | 60 | 24,549 | 0 |
| Construction | 216 | 1 | 0 | 0 |
| Consumer and other loans | 0 | 0 | 0 | 0 |
| Total | $ 87,597 | $ 352 | $ 106,505 | $ 0 |
| With an allowance recorded: | | | | |
| Residential non-Home Today | $ 110,912 | $ 1,810 | $ 67,422 | $ 776 |
| Residential Home Today | 104,453 | 1,855 | 59,108 | 812 |
| Home equity loans and lines of credit | 31,474 | 176 | 33,661 | 146 |
| Construction | 7,025 | 47 | 1,253 | 0 |
| Consumer and other loans | 1 | 0 | 0 | 0 |
| Total | $ 253,865 | $ 3,888 | $ 161,444 | $ 1,734 |
| Total impaired loans: | | | | |
| Residential non-Home Today | $ 152,930 | $ 2,004 | $ 108,477 | $ 776 |
| Residential Home Today | 132,401 | 1,952 | 100,009 | 812 |
| Home equity loans and lines of credit | 48,889 | 236 | 58,210 | 146 |
| Construction | 7,241 | 48 | 1,253 | 0 |
| Consumer and other loans | 1 | 0 | 0 | 0 |
| Total | $ 341,462 | $ 4,240 | $ 267,949 | $ 1,734 |

The amount of interest income on impaired loans recognized using a cash-basis method is $542 for the three months ended June 30, 2011, not materially different for the nine months ended June 30, 2011 and not material for the three and nine months ended June 30, 2010.

Loans identified by management as having significant weaknesses, such that a loss is probable, are separately evaluated for impairment. Specific allowances are established for any impaired individually-evaluated loan for which the recorded investment in the loan exceeds the measured value of the collateral or, alternatively, the present value of expected future cash flows for the loan. The valuation is based on the fair value of the collateral when it is probable that repayment will not come from the borrower but from liquidation of the collateral, including but not limited to foreclosure and repossession. In light of housing market deterioration, the unfavorable delinquency statistics and the current instability in employment and economic prospects, we conducted an expanded loan level evaluation of equity lines of credit which are delinquent 90 days or more and residential real estate loans and equity loans which are delinquent 180 days or more. This expanded loan level evaluation supplements, and is in addition to, traditional evaluation procedures. Previously, these loans were part of large groups of homogenous loans which were collectively evaluated by portfolio for impairment in accordance with U.S. GAAP. Beginning September 30, 2010, equity loans, bridge loans, and loans modified in troubled debt restructurings were included in loans individually evaluated based on the fair value of the collateral at 90 or more days past due. Prior to September 30, 2010, the collateral-based evaluation was performed on these loans at 180 or more days past due.

Loans modified in troubled debt restructurings are separately evaluated for impairment at the time of restructuring and at each subsequent reporting date for as long as they are reported as troubled debt restructurings. The impairment evaluation is based on the present value of expected future cash flows discounted at the effective interest rates of the original loans when the loan is less than 90 days past due. The result of the cash flow analysis is further discounted by a factor representing a potential for default. Valuation allowances are recorded for the excess of the recorded investments over the result of the cash flow analyses. Troubled debt restructurings that are 90 days or more past due are evaluated for impairment based on the fair value of the collateral. The fair value less estimated cost to dispose of the underlying property is compared to the combined basis in the loan to estimate a loss recorded as a specific valuation allowance in the allowance for credit losses. This applies to all mortgage loans and lines of credit. Consumer loans are not considered for restructuring. A loan modified in a troubled debt restructuring is classified as an impaired loan for a minimum of one year. After one year, a loan is no longer included in the

balance of impaired loans if the loan was modified to yield a market rate for loans of similar credit risk at the time of restructuring and the loan is not impaired based on the terms of restructuring agreement.

The following table represents the recorded investment prior to modification and immediately after modification for all loans modified during the period. This table does not reflect the end of period recorded investment. The pre-modification outstanding recorded investment may be higher than the post-modification outstanding recorded investment due to borrower funds applied during modification. In contrast, the pre-modification outstanding recorded investment may be lower than the post-modification outstanding recorded investment when past due escrows are added to the unpaid principal balance.

| | For the Three Months Ended June 30, 2011 | | | For the Nine Months Ended June 30, 2011 | | |
|---|---|---|---|---|---|---|
| | 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 |
| | | (Dollars in thousands) | | | (Dollars in thousands) | |
| Residential non-Home Today | 30 | $ 5,524 | $ 5,536 | 113 | $ 19,878 | $ 19,911 |
| Residential Home Today | 106 | 9,951 | 10,116 | 235 | 21,634 | 21,962 |
| Home equity loans and lines of credit | 6 | 327 | 318 | 10 | 560 | 551 |
| Total | 142 | $ 15,802 | $ 15,970 | 358 | $ 42,072 | $ 42,424 |

The following tables set forth the recorded investment in troubled debt restructured loans modified during the period, by the types of concessions granted.

| | For the Three Months Ended June 30, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Reduction in Interest Rates | Payment Extensions | Forbearance or Other Actions | Multiple Concessions | Multiple Modifications | Total |
| Residential non-Home Today | $ 1,745 | $ 597 | $ 615 | $ 1,467 | $ 1,099 | $ 5,523 |
| Residential Home Today | 2,932 | 93 | 1,424 | 1,731 | 3,934 | 10,114 |
| Home equity loans and lines of credit | 84 | 0 | 0 | 167 | 63 | 314 |
| Total | $ 4,761 | $ 690 | $ 2,039 | $ 3,365 | $ 5,096 | $ 15,951 |

| | For the Nine Months Ended June 30, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Reduction in Interest Rates | Payment Extensions | Forbearance or Other Actions | Multiple Concessions | Multiple Modifications | Total |
| Residential non-Home Today | $ 6,918 | $ 872 | $ 5,158 | $ 2,277 | $ 4,093 | $ 19,318 |
| Residential Home Today | 7,603 | 408 | 5,240 | 3,323 | 5,278 | 21,852 |
| Home equity loans and lines of credit | 84 | 0 | 127 | 167 | 166 | 544 |
| Total | $ 14,605 | $ 1,280 | $ 10,525 | $ 5,767 | $ 9,537 | $ 41,714 |

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The following table provides information on troubled debt restructured loans modified within the last 12 months that defaulted during the period presented.

| Troubled Debt Restructurings That Subsequently Defaulted | For the Three Months Ended June 30, 2011 Number of Contracts | Recorded Investment | For the Nine Months Ended June 30, 2011 Number of Contracts | Recorded Investment |
|---|---|---|---|---|
| | (Dollars in thousands) | | (Dollars in thousands) | |
| Residential non-Home Today | 18 | $ 2,800 | 23 | $ 3,548 |
| Residential Home Today | 52 | 5,681 | 65 | 7,020 |
| Home equity loans and lines of credit | 3 | 365 | 4 | 409 |
| Construction | 0 | 0 | 0 | 0 |
| Total | 73 | $ 8,846 | 92 | $ 10,977 |

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

| | Pass | Special Mention | Substandard | Loss | Total |
|---|---|---|---|---|---|
| **June 30, 2011** | | | | | |
| Real Estate Loans: | | | | | |
| Residential non-Home Today | $ 6,829,907 | $ 0 | $ 107,526 | $ 20,178 | $ 6,957,611 |
| Residential Home Today | 193,121 | 0 | 58,805 | 14,534 | 266,460 |
| Home equity loans and lines of credit | 2,517,901 | 13,143 | 28,953 | 13,656 | 2,573,653 |
| Construction | 41,217 | 0 | 4,207 | 1,469 | 46,893 |
| Total | $ 9,582,146 | $ 13,143 | $ 199,491 | $ 49,837 | $ 9,844,617 |

| | Pass | Special Mention | Substandard | Loss | Total |
|---|---|---|---|---|---|
| **September 30, 2010** | | | | | |
| Real Estate Loans: | | | | | |
| Residential non-Home Today | $ 5,968,435 | $ 0 | $ 125,105 | $ 14,707 | $ 6,108,247 |
| Residential Home Today | 189,426 | 0 | 83,044 | 6,682 | 279,152 |
| Home equity loans and lines of credit | 2,789,966 | 18,224 | 39,906 | 17,840 | 2,865,936 |
| Construction | 46,521 | 0 | 6,217 | 1,717 | 54,455 |
| Total | $ 8,994,348 | $ 18,224 | $ 254,272 | $ 40,946 | $ 9,307,790 |

Residential loans are internally assigned a grade using the standard grades and classifications outlined in the Office of Thrift Supervision Examination Handbook for Asset Quality. Pass loans are assets well protected by the current paying capacity of the borrower and the value of the underlying collateral. Special Mention loans have a potential weakness that we feel deserves management s attention and may result in further deterioration in their repayment prospects and/or the Association s credit position. Substandard loans are inadequately protected by the current payment capacity of the borrower or the collateral pledged with a defined weakness that jeopardizes the liquidation of the debt. Loss loans are considered uncollectible and continuing to carry the asset without a specific valuation allowance or charge-off is not warranted.

At June 30, 2011 and September 30, 2010, respectively, the recorded investment of impaired loans includes $118,951 and $90,167 of troubled debt restructurings that are individually evaluated for impairment, but have adequately performed under the terms of the restructuring and are classified as pass loans. At June 30, 2011 and September 30, 2010, respectively, there are $26,071 and $44,689 of loans classified substandard and $13,142 and $18,206 of loans classified special mention that are not included in the recorded investment of impaired loans; rather, they are included in loans collectively evaluated for impairment.

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

| | June 30, 2011 | September 30, 2010 |
|---|---|---|
| Performing | $ 6,915 | $ 7,198 |
| Nonperforming | 1 | 1 |
| Total | $ 6,916 | $ 7,199 |

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

**5. DEPOSITS**

Deposit account balances are summarized as follows:

| | June 30, 2011 | September 30, 2010 |
|---|---|---|
| Negotiable order of withdrawal accounts | $ 983,958 | $ 967,645 |
| Savings accounts | 1,664,812 | 1,579,065 |
| Certificates of deposit | 6,052,184 | 6,303,585 |
| | 8,700,954 | 8,850,295 |
| Accrued interest | 942 | 1,646 |
| Total deposits | $ 8,701,896 | $ 8,851,941 |

**6. INCOME TAXES**

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and city jurisdictions. With a few immaterial exceptions, we are no longer subject to federal and state income tax examinations for tax years prior to 2007. The Internal Revenue Service is currently conducting an audit of the Company s 2008 federal tax return. The State of Ohio has examined the Association through 2006 with no adjustment.

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

**7. DEFINED BENEFIT PLAN**

The Third Federal Savings Retirement Plan ( the Plan ) is a defined benefit pension plan. Effective December 31, 2002, the Plan was amended to limit participation to employees who met the Plan s eligibility requirements on that date. After December 31, 2002, employees not participating in the Plan, upon meeting the applicable eligibility requirements, participate in a separate tier of the Company s defined contribution 401(k) Savings Plan. Benefits under the Plan are based on years of service and the employee s average annual compensation (as defined in the Plan). The funding policy of the Plan is consistent with the funding requirements of U.S. federal and other governmental laws and regulations.

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

| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Service cost | $ 1,085 | $ 995 | $ 3,253 | $ 2,985 |
| Interest cost | 838 | 894 | 2,806 | 2,682 |
| Expected return on plan assets | (841) | (725) | (2,524) | (2,176) |
| Amortization of net loss | 205 | 538 | 1,081 | 1,612 |
| Amortization of prior service cost | (16) | (16) | (46) | (46) |
| Net periodic benefit cost | $ 1,271 | $ 1,686 | $ 4,570 | $ 5,057 |

Minimum employer contributions paid during the nine months ended June 30, 2011 were $4,586. Minimum employer contributions expected during the remainder of the fiscal year are $1,175.

**8. EQUITY INCENTIVE PLAN**

During the nine months ended June 30, 2011 and 2010, the Company recorded $5,397 and $4,984, respectively, of stock-based compensation expense, comprised of stock option expense of $2,144 and $1,898, respectively, and restricted stock units expense of $3,253 and $3,086, respectively.

At June 30, 2011, 5,005,925 shares were subject to options, with a weighted average exercise price of $11.96 per share and a weighted average grant date fair value of $3.04 per share. Expected future expense related to the 4,515,276 non-vested options outstanding as of June 30, 2011 is $7,609 over a weighted average of 3.4 years. At June 30, 2011, 1,665,400 restricted stock units, with a weighted average grant date fair value of $11.78 per unit are unvested. Expected future compensation expense relating to the 1,711,950 restricted stock units outstanding as of June 30, 2011 is $9,053 over a weighted average period of 4.1 years. Each unit is equivalent to one share of common stock.

**9. COMMITMENTS AND CONTINGENCIES**

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

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

At June 30, 2011, the Company had commitments to originate loans as follows:

| | |
|---|---|
| Fixed-rate mortgage loans | $ 76,063 |
| Adjustable-rate mortgage loans | 156,774 |
| Bridge loans | 1,462 |

| | |
|---|---|
| Total | $ 234,299 |

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At June 30, 2011, the Company had unfunded commitments outstanding as follows:

| | |
|---|---|
| Equity lines of credit | $ 1,506,043 |
| Construction loans | 43,106 |
| Private equity investments | 13,813 |
| Total | $ 1,562,962 |

At June 30, 2011, the unfunded commitment on home equity lines of credit, including commitments for accounts suspended as a result of material default or a decline in equity is $1,766,538.

The Company assumes mortgage guaranty insurance on an excess of loss basis for the mortgage guaranty risks of certain mortgage loans in its own portfolio, including Home Today loans and loans in its servicing portfolio, through reinsurance contracts with two primary mortgage insurance companies. Under these contracts, the Company absorbs mortgage insurance losses in a range of five to seven percentage points in excess of the initial five percentage point loss layer of a given pool of loans, in exchange for a portion of the pool s mortgage insurance premiums. The first five percent layer of loss must be exceeded before the Company assumes any liability. At June 30, 2011, the maximum losses under the reinsurance contracts were limited to $15,088. The Company has paid $2,202 of losses under these reinsurance contracts and has provided a liability for the remaining estimated losses totaling $4,282 as of June 30, 2011. When evaluating whether or not the reserves provide a reasonable provision for unpaid loss and loss adjustment expenses, it is necessary to project future loss and loss adjustment expense emergence and payments for loan delinquencies occurring through the balance sheet date. The actual future loss and loss adjustment expense may not develop as actuarially projected. They may in fact vary considerably from the projections as mortgage insurance results are influenced by factors such as unemployment, housing market conditions, loan repayment rates, etc. Management believes it has made adequate provision for estimated losses. Based upon notice from our two primary mortgage insurance companies, no new contracts are being added to the Company s risk exposure. Our insurance partners will retain all new mortgage insurance premiums and all new risk.

In management s opinion, the above commitments will be funded through normal operations.

**10. FAIR VALUE**

Under U.S. GAAP, fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date and a fair value framework is established whereby assets and liabilities measured at fair value are grouped into three levels of a fair value hierarchy, based on the transparency of inputs and the reliability of assumptions used to estimate fair value. The Company s policy is to recognize transfers between levels of the hierarchy as of the end of the quarter in which the transfer occurs. The three levels of inputs are defined as follows:

*Level 1* quoted prices (unadjusted) for identical assets or liabilities in active markets.

*Level 2* quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets with few transactions, or model-based valuation techniques using assumptions that are observable in the market.

*Level 3* a company s own assumptions about how market participants would price an asset or liability.

As permitted under the fair value guidance in U.S. GAAP, the Company elects to measure at fair value mortgage loans classified as held for sale that are subject to pending loan securitization contracts. This election is expected to reduce volatility in earnings related to timing issues on loan securitization contracts.

At June 30, 2011 and September 30, 2010, there were no loans held for sale subject to pending securitization contracts. For the three months ended June 30, 2011 and 2010, net gain(loss) on the sale of loans included ($5) and $909, respectively, and for the nine months ended June 30, 2011 and 2010, net gain on the sale of loans included $0 and $517, respectively, related to changes during the period in the fair value of loans held for sale subject to pending securitization contracts that are fully offset by an equal amount of gains and losses on the derivative securitization contracts. Interest income on mortgage loans held for sale is recorded in interest income on loans. Mortgage loans held for sale not included in securitization contracts are recorded at the lower of cost or fair value. At June 30, 2011 there were no loans held for sale and at September 30, 2010, loans held for sale were reported at cost, $25,027.

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

***Investment Securities Available for Sale-*** Investment securities available for sale are recorded at fair value on a recurring basis. At June 30, 2011 and September 30, 2010, respectively, this includes $7,921 and $15,857 of investments in U.S. government agencies including U.S. Treasury notes and sequentially structured, highly liquid collateralized mortgage obligations ( CMOs ) issued by Fannie Mae, Freddie Mac, and Ginnie Mae and $8,743 and $8,762 of secured institutional money market deposits insured by the FDIC up to the current coverage limits, with any excess collateralized by the holding institution. Both are measured using the market approach. The fair values of treasury notes and CMOs represent unadjusted price estimates obtained from third party independent nationally recognized pricing services using pricing models or quoted prices of securities with similar characteristics and are included in Level 2 of the hierarchy. At the time of initial measurement and, subsequently, when changes in methodologies occur, management obtains and reviews documentation of pricing methodologies used by third party pricing services to verify that prices are determined in accordance with fair value guidance in U.S. GAAP and to ensure that assets are properly classified in the fair value hierarchy. Additionally, third party pricing is reviewed on a monthly basis for reasonableness based on the market knowledge and experience of company personnel that interact daily with the markets for these types of securities. The carrying amount of the money market deposit accounts is considered a reasonable estimate of their fair value because they are cash deposits in interest bearing accounts valued at par. These accounts are included in Level 1 of the hierarchy.

***Mortgage Loans Held for Sale included in Pending Securitization Contracts -*** The fair value of mortgage loans held for sale is estimated using a market approach based on quoted secondary market pricing for loan portfolios with similar characteristics, including that portion which is included in pending securitization contracts. As described above, the Company elects the fair value measurement option for mortgage loans held for sale subject to pending securitization contracts. These loans are included in Level 2 of the hierarchy.

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

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

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

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

Loans held for investment that have been restructured in troubled debt restructurings and are performing according to the modified terms of the loan agreement are individually evaluated for impairment using the present value of future cash flows based on the loan s effective interest rate, which is not a fair value measurement. At June 30, 2011 and September 30, 2010, respectively, this included $138,332 and $122,971 in unpaid principal balances of loans with related allowances for loss of $6,238 and $5,086.

***Real Estate Owned*** Real estate owned includes real estate acquired as a result of foreclosure or by deed in lieu of foreclosure and is carried at the lower of acquisition cost or fair value less estimated costs to sell. Fair value is estimated under the market approach using independent third party appraisals. As these properties are actively marketed, estimated fair values may be adjusted by management to reflect current economic and market conditions. At June 30, 2011 and September 30, 2010, respectively, there was $10,227 and $9,421 of real estate owned included in Level 3 of the hierarchy with assets measured at fair value on a non-recurring basis where the acquisition costs exceeded the fair values less estimated costs to sell of these properties. Real estate owned, as reported in the consolidated statements of condition, includes estimated costs to sell of $743 and $514 related to these properties at June 30, 2011 and September 30, 2010, respectively.

***Mortgage Loan Servicing Assets -*** Mortgage loan servicing assets are initially recorded at fair value and subsequently amortized over the estimated period of servicing income. The servicing assets are assessed for impairment, based on fair value, on a quarterly basis using a discounted cash flow model incorporating assumptions market participants would use including estimated prepayment speeds, discount factors, and estimated costs to service. For measurement purposes, servicing assets are separated into stratum segregated primarily by the predominant risk characteristics of the loans serviced, such as type, fixed and adjustable rates, original terms, and interest rates. When the carrying value of the servicing asset for an individual stratum exceeds the fair value, the stratum is considered impaired. The amount of impairment is recognized through a valuation allowance recorded in current earnings and the stratum is included in Level 3 of the hierarchy with assets measured at fair value on a non-recurring basis.

***Land held for development*** Land held for development includes real estate surrounding the Company s main office in Cleveland, Ohio, acquired to preserve and redevelop the community. It is carried at the lower of acquisition cost or fair value less estimated costs to sell or develop and is included in other assets on the Consolidated Statement of Condition. Fair value is estimated under the market approach using values for comparable projects, adjusted by management to reflect current economic and market conditions. At June 30, 2011 and September 30, 2010, respectively, there was $2,544 and $2,467 of land held for development included in Level 3 of the hierarchy with assets measured at fair value on a non-recurring basis. The acquisition costs of these properties exceeded their fair values less estimated cost to sell or develop by $1,500 at June 30, 2011 and September 30, 2010.

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

Assets carried at fair value on a recurring basis on the Consolidated Statement of Condition at June 30, 2011 and September 30, 2010 are summarized below. There were no liabilities carried at fair value on a recurring basis on the Consolidated Statement of Condition at June 30, 2011 and September 30, 2010.

| | | Recurring Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| | **June 30, 2011** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Assets | | | | |
| Investment securities available for sale: | | | | |
| U.S. government and agency obligations | $ 1,983 | $ 0 | $ 1,983 | $ 0 |
| REMIC s | 5,938 | 0 | 5,938 | 0 |
| Money market accounts | 8,743 | 8,743 | 0 | 0 |
| Total | $ 16,664 | $ 8,743 | $ 7,921 | $ 0 |

| | **September 30, 2010** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
|---|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| Assets | | | | |
| Investment securities available for sale: | | | | |
| U.S. government and agency obligations | $ 7,063 | $ 0 | $ 7,063 | $ 0 |
| REMIC s | 8,794 | 0 | 8,794 | 0 |
| Money market accounts | 8,762 | 8,762 | 0 | 0 |
| Total | $ 24,619 | $ 8,762 | $ 15,857 | $ 0 |

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Summarized in the table below are those assets measured at fair value on a nonrecurring basis. This includes loans held for investment that are individually evaluated for impairment, certain strata of mortgage loan servicing assets identified as having a fair value below amortized cost, and properties included in real estate owned that are carried at fair value less estimated costs to sell at the reporting date.

| | | Nonrecurring Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| | June 30, 2011 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Impaired loans, net of allowance | $ 156,331 | $ 0 | $ 0 | $ 156,331 |
| Real estate owned[1] | 10,227 | 0 | 0 | 10,227 |
| Land held for development | 2,544 | 0 | 0 | 2,544 |
| Total | $ 169,102 | $ 0 | $ 0 | $ 169,102 |

| | September 30, 2010 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Impaired loans, net of allowance | $ 177,895 | $ 0 | $ 0 | $ 177,895 |
| Real estate owned[1] | 9,421 | 0 | 0 | 9,421 |
| Land held for development | 2,467 | 0 | 0 | 2,467 |
| Mortgage loan servicing assets | 237 | 0 | 0 | 237 |
| Total | $ 190,020 | $ 0 | $ 0 | $ 190,020 |

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