TFS Financial CORP
Form 10-Q
February 07, 2014
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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 December 31, 2013
or
.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For transition period from to
Commission File Number 001-33390

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

United States of America (State or Other Jurisdiction of Incorporation or Organization)	52-2054948 (I.R.S. Employer Identification No.)
7007 Broadway Avenue Cleveland, Ohio	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 ý No ¨

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

Large accelerated filer	ý	Accelerated filer	¨

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

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

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

As of February 3, 2014 there were 307,148,024 shares of the Registrant's common stock, par value $0.01 per share, outstanding, of which 227,119,132 shares, or 73.9% of the Registrant's common stock, were held by Third Federal Savings and Loan Association of Cleveland, MHC, the Registrant's mutual holding company.

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GLOSSARY OF TERMS

TFS Financial Corporation provides the following list of acronyms as a tool for the reader. The acronyms identified below are used in Management's Discussion and Analysis of Financial Condition and Results of Operations, the Consolidated Financial Statements and in the Notes to Consolidated Financial Statements.

AOCI: Accumulated Other Comprehensive Income
ARM: Adjustable Rate Mortgage
ASC: Accounting Standards Codification
ASU: Accounting Standards Update
AVM: Automated Valuation Model
Association: Third Federal Savings and Loan Association of Cleveland
BAAS: OCC Bank Accounting Advisory Series
CDs: Certificates of Deposit
CFPB: Consumer Financial Protection Bureau
CLTV: Combined Loan-to-Value
Company: TFS Financial Corporation and its subsidiaries
DFA: Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
DIF: Depository Insurance Fund
EaR: Earnings at Risk
ESOP: Third Federal Employee (Associate) Stock Ownership Plan
EVE: Economic Value of Equity
FASB: Financial Accounting Standards Board
FDIC: Federal Deposit Insurance Corporation
FHFA: Federal Housing Finance Agency
FHLB: Federal Home Loan Bank
FNMA: Federal National Mortgage Association
FRB-Cleveland: Federal Reserve Bank of Cleveland
FRS: Board of Governors of the Federal Reserve System
GAAP: Generally Accepted Accounting Principles
GVA: General Valuation Allowances
HARP: Home Affordable Refinance Program
High LTV: High loan-to-value
HPI: Home Price Index
IRR: Interest Rate Risk
IRS: Internal Revenue Service
IVA: Individual Valuation Allowance
LIP: Loans-in-Process
MGIC: Mortgage Guaranty Insurance Corporation
MOU: Memorandum of Understanding
MVA: Market Valuation Allowances
NOW: Negotiable Order of Withdrawal
OCC: Office of the Comptroller of the Currency
OCI: Other Comprehensive Income
OTS: Office of Thrift Supervision
PMI: Private Mortgage Insurance
PMIC: Private Mortgage Insurance Co.
QTL: Qualified Thrift Lender
REMICs: Real Estate Mortgage Investment Conduits
REIT: Real Estate Investment Trust
SEC: United States Securities and Exchange Commission
SVA: Specific Valuation Allowances
TDR: Troubled Debt Restructuring
Third Federal Savings, MHC: Third Federal Savings and Loan Association of Cleveland, MHC

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

	December 31, 2013	September 30, 2013
ASSETS		
Cash and due from banks	$30,843	$34,694
Other interest-earning cash equivalents	286,067	251,302
Cash and cash equivalents	316,910	285,996
Investment securities:		
Available for sale (amortized cost $493,802 and $480,664, respectively)	487,519	477,376
Mortgage loans held for sale, at lower of cost or market ($3,369 measured at fair value, September 30, 2013)	1,497	4,179
Loans held for investment, net:		
Mortgage loans	10,250,656	10,185,674
Other loans	3,980	4,100
Deferred loan fees, net	(11,454)	(13,171)
Allowance for loan losses	(85,282)	(92,537)
Loans, net	10,157,900	10,084,066
Mortgage loan servicing assets, net	13,391	14,074
Federal Home Loan Bank stock, at cost	36,899	35,620
Real estate owned	21,853	22,666
Premises, equipment, and software, net	58,198	58,517
Accrued interest receivable	31,331	31,489
Bank owned life insurance contracts	185,326	183,724
Other assets	70,623	71,639
TOTAL ASSETS	$11,381,447	$11,269,346
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Deposits	$8,314,232	$8,464,499
Borrowed funds	986,022	745,117
Borrowers’ advances for insurance and taxes	68,882	71,388
Principal, interest, and related escrow owed on loans serviced	59,978	75,745
Accrued expenses and other liabilities	89,893	41,120
Total liabilities	9,519,007	9,397,869
Commitments and contingent liabilities		
Preferred stock, $0.01 par value, 100,000,000 shares authorized, none issued and outstanding	—	—
Common stock, $0.01 par value, 700,000,000 shares authorized; 332,318,750 shares issued; 307,128,353 and 309,230,591 outstanding at December 31, 2013 and September 30, 2013, respectively	3,323	3,323
Paid-in capital	1,697,701	1,696,370
Treasury stock, at cost; 25,190,397 and 23,088,159 shares at December 31, 2013 and September 30, 2013, respectively	(303,596)	(278,215)
Unallocated ESOP shares	(69,334)	(70,418)
Retained earnings—substantially restricted	544,849	529,021
Accumulated other comprehensive loss	(10,503)	(8,604)
Total shareholders’ equity	1,862,440	1,871,477

TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$11,381,447	$11,269,346

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 December 31,	
	2013	2012
INTEREST AND DIVIDEND INCOME:		
Loans, including fees	$90,401	$98,689
Investment securities available for sale	2,100	1,113
Other interest and dividend earning assets	518	586
Total interest and dividend income	93,019	100,388
INTEREST EXPENSE:		
Deposits	23,262	31,135
Borrowed funds	1,962	837
Total interest expense	25,224	31,972
NET INTEREST INCOME	67,795	68,416
PROVISION FOR LOAN LOSSES	6,000	18,000
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	61,795	50,416
NON-INTEREST INCOME:		
Fees and service charges, net of amortization	2,289	2,303
Net gain on the sale of loans	339	3,022
Increase in and death benefits from bank owned life insurance contracts	1,613	1,605
Other	837	1,317
Total non-interest income	5,078	8,247
NON-INTEREST EXPENSE:		
Salaries and employee benefits	22,082	20,603
Marketing services	3,253	3,125
Office property, equipment and software	4,989	5,021
Federal insurance premium and assessments	2,547	3,714
State franchise tax	1,687	1,663
Real estate owned expense, net	1,945	1,165
Other operating expenses	6,356	7,243
Total non-interest expense	42,859	42,534
INCOME BEFORE INCOME TAXES	24,014	16,129
INCOME TAX EXPENSE	7,990	4,976
NET INCOME	$16,024	$11,153
Earnings per share—basic and diluted	$0.05	$0.04
Weighted average shares outstanding		
Basic	300,634,212	301,576,327
Diluted	301,868,676	302,244,741

See accompanying notes to unaudited interim consolidated financial statements.

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

	For the Three Months Ended December 31,	
	2013	2012
Net income	$ 16,024	$ 11,153
Other comprehensive (loss) income, net of tax		
Change in net unrealized losses on securities available for sale	(1,947)	(710)
Change in pension obligation	48	90
Total other comprehensive loss	(1,899)	(620)
Total comprehensive income	$ 14,125	$ 10,533

See accompanying notes to unaudited interim consolidated financial statements.

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TFS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (unaudited)
Three Months Ended December 31, 2013 and 2012
(In thousands)

	Common stock	Paid-in capital	Treasury stock	Unallocated common stock held by ESOP	Retained earnings	Accumulated other comprehensive loss	Total shareholders' equity
Balance at September 30, 2012	$ 3,323	$ 1,691,884	$ (280,937)	$ (74,751)	$ 473,247	$ (5,916)	$ 1,806,850
Net income	—	—	—	—	11,153	—	11,153
Other comprehensive loss, net of tax	—	—	—	—	—	(620)	(620)
ESOP shares allocated or committed to be released	—	(137)	—	1,083	—	—	946
Compensation costs for stock-based plans	—	1,715	—	—	—	—	1,715
Treasury stock allocated to restricted stock plan	—	(222)	315	—	(93)	—	—
Balance at December 31, 2012	$ 3,323	$ 1,693,240	$ (280,622)	$ (73,668)	$ 484,307	$ (6,536)	$ 1,820,044
Balance at September 30, 2013	$ 3,323	$ 1,696,370	$ (278,215)	$ (70,418)	$ 529,021	$ (8,604)	$ 1,871,477
Net income	—	—	—	—	16,024	—	16,024
Other comprehensive loss, net of tax	—	—	—	—	—	(1,899)	(1,899)
ESOP shares allocated or committed to be released	—	212	—	1,084	—	—	1,296
Compensation costs for stock-based plans	—	1,797	—	—	—	—	1,797
Excess tax effect from stock-based compensation	—	49	—	—	—	—	49
Purchase of treasury stock (2,156,250 shares)			(26,058)				(26,058)
Treasury stock allocated to restricted stock plan	—	(727)	677	—	(196)	—	(246)
Balance at December 31, 2013	$ 3,323	$ 1,697,701	$ (303,596)	$ (69,334)	$ 544,849	$ (10,503)	$ 1,862,440

See accompanying notes to unaudited interim consolidated financial statements.

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

	For the Three Months Ended December 31,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$16,024	$11,153
Adjustments to reconcile net income to net cash provided by operating activities:		
ESOP and stock-based compensation expense	2,847	2,661
Excess tax effect related to stock-based compensation	49	—
Depreciation and amortization	3,129	6,221
Provision for loan losses	6,000	18,000
Net gain on the sale of loans	(339)	(3,022)
Other net losses (gains)	679	(415)
Principal repayments on and proceeds from sales of loans held for sale	10,022	22,197
Loans originated for sale	(7,143)	(15,757)
Increase in bank owned life insurance contracts	(1,619)	(1,613)
Net decrease in interest receivable and other assets	1,951	7,998
Net increase in accrued expenses and other liabilities	48,853	44,751
Other	139	33
Net cash provided by operating activities	80,592	92,207
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans originated	(535,266)	(511,600)
Principal repayments on loans	437,672	606,535
Proceeds from principal repayments and maturities of:		
Securities available for sale	30,015	57,918
Proceeds from sale of:		
Loans	11,079	61,231
Real estate owned	6,993	6,519
Purchases of:		
FHLB stock	(1,279)	—
Securities available for sale	(44,147)	(90,305)
Premises and equipment	(1,070)	(1,158)
Other	18	5
Net cash (used in) provided by investing activities	(95,985)	129,145
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net decrease in deposits	(150,267)	(176,924)
Net decrease in borrowers' advances for insurance and taxes	(2,506)	(442)
Net (decrease) increase in principal and interest owed on loans serviced	(15,767)	1,497
Net increase (decrease) in short term borrowed funds	124,225	(84,926)
Proceeds from long term borrowed funds	130,000	70,000
Repayment of long term borrowed funds	(13,320)	(5,265)
Purchase of treasury shares	(26,058)	—
Net cash provided by (used in) financing activities	46,307	(196,060)
NET INCREASE IN CASH AND CASH EQUIVALENTS	30,914	25,292
CASH AND CASH EQUIVALENTS—Beginning of period	285,996	308,262
CASH AND CASH EQUIVALENTS—End of period	$316,910	$333,554

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest on deposits	$23,470	$31,673
Cash paid for interest on borrowed funds	1,737	763
Cash paid for income taxes	508	6,600
SUPPLEMENTAL SCHEDULES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Transfer of loans to real estate owned	6,503	4,992
Transfer of loans from held for investment to held for sale	11,095	264,908

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, a federally chartered stock holding company, conducts its principal activities through its wholly owned subsidiaries. The principal line of business of the Company is retail consumer banking, including mortgage lending, deposit gathering, and, to a much lesser extent other financial services. On December 31, 2013, approximately 74% of the Company’s outstanding shares were owned by a federally chartered mutual holding company, Third Federal Savings and Loan Association of Cleveland, MHC. The thrift subsidiary of TFS Financial Corporation is Third Federal Savings and Loan Association of Cleveland.

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 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 the Company at December 31, 2013, 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 Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2013 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, 2014 or for any other period.

2. EARNINGS PER SHARE

Basic earnings per share is the amount of earnings available to each share of common stock outstanding during the reporting period. Diluted earnings per share is the amount of earnings available to each share of common stock outstanding during the reporting period adjusted to include the effect of potentially dilutive common shares. For purposes of computing earnings per share amounts, outstanding shares include shares held by the public, shares held by the ESOP that have been allocated to participants or committed to be released for allocation to participants, the 227,119,132 shares held by Third Federal Savings, MHC, and, for purposes of computing dilutive earnings per share, stock options and restricted stock units with a dilutive impact. At December 31, 2013 and 2012, respectively, the ESOP held 6,933,435 and 7,366,775 shares that were neither allocated to participants nor committed to be released to participants.

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

	For the Three Months Ended December 31,					
	2013			2012		
	Income	Shares	Per share amount	Income	Shares	Per share amount
	(Dollars in thousands, except per share data)					
Net income	$16,024			$11,153		
Less: income allocated to restricted stock units	77			58		
Basic earnings per share:						
Income available to common shareholders	$15,947	300,634,212	$0.05	$11,095	301,576,327	$0.04
Diluted earnings per share:						
Effect of dilutive potential common shares		1,234,464			668,414	
Income available to common shareholders	$15,947	301,868,676	$0.05	$11,095	302,244,741	$0.04

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

	For the Three Months Ended December 31,	
	2013	2012
Options to purchase shares	3,486,500	6,654,525
Restricted stock units	—	226,500

3. INVESTMENT SECURITIES

Investments available for sale are summarized as follows:

	December 31, 2013			
	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
U.S. government and agency obligations	$2,000	$33	$—	$2,033
Freddie Mac certificates	611	28	—	639
Ginnie Mae certificates	11,024	340	—	11,364
REMICs	464,061	1,432	(8,607)	456,886
FNMA certificates	11,293	767	(276)	11,784
Money market accounts	4,813	—	—	4,813
Total	$493,802	$2,600	$(8,883)	$487,519

	September 30, 2013			
	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
U.S. government and agency obligations	$2,000	$37	$—	$2,037
Freddie Mac certificates	894	56	—	950
Ginnie Mae certificates	11,919	423	—	12,342
REMICs	448,881	1,506	(5,810)	444,577
FNMA certificates	11,495	805	(305)	11,995

Money market accounts	5,475	—	—	5,475
Total	$480,664	$2,827	$(6,115)	$477,376

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Gross unrealized losses on securities and the estimated fair value of the related securities, aggregated by investment category and length of time the individual securities have been in a continuous loss position, at December 31, 2013 and September 30, 2013, were as follows:

	December 31, 2013					
	Less Than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Available for sale—						
REMICs	$257,074	$6,593	$68,459	$2,014	$325,533	$8,607
FNMA certificates	4,805	276	—	—	4,805	276
Total	$261,879	$6,869	$68,459	$2,014	$330,338	$8,883

	September 30, 2013					
	Less Than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Available for sale—						
REMICs	$237,774	$4,984	$45,768	$826	$283,542	$5,810
FNMA certificates	4,806	305	—	—	4,806	305
Total	$242,580	$5,289	$45,768	$826	$288,348	$6,115

The unrealized losses on investment securities were attributable to market rate increases. The contractual terms of U.S. government and agency obligations do not permit the issuer to settle the security at a price less than the par value of the investment. The contractual cash flows of mortgage-backed securities are guaranteed by FNMA, Freddie Mac and Ginnie Mae. REMICs are issued by or backed by securities issued by these governmental agencies. It is expected that the securities would not be settled at a price substantially less than the amortized cost of the investment. During the financial market upheaval of 2008, concern arose about the financial health of FNMA and Freddie Mac and, therefore, the viability of the payment guarantees issued by the agencies. This market was preserved when, in September 2008, the Federal Housing Finance Agency placed FNMA and Freddie Mac into conservatorship. Shortly after taking control, the U.S. Treasury Department established financing agreements to ensure FNMA and Freddie Mac meet their obligations to holders of mortgage-backed securities that they have issued or guaranteed.

Since the decline in value is attributable to changes in interest rates and not credit quality and because the Association has neither the intent to sell the securities nor is it more likely than not the Association will be required to sell the securities for the time periods necessary to recover the amortized cost, these investments are not considered other-than-temporarily impaired.

At December 31, 2013, the amortized cost and fair value of U.S. government and agency obligations available for sale due in more than one year but less than five years are $2,000 and $2,033, respectively as compared to $2,000 and $2,037 at September 30, 2013.

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4. LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans held for investment consist of the following:

	December 31, 2013	September 30, 2013
Real estate loans:		
Residential non-Home Today	$8,239,255	$8,118,511
Residential Home Today	171,410	178,353
Home equity loans and lines of credit	1,807,002	1,858,398
Construction	75,314	72,430
Real estate loans	10,292,981	10,227,692
Consumer and other loans	3,980	4,100
Less:		
Deferred loan fees—net	(11,454)	(13,171)
LIP	(42,325)	(42,018)
Allowance for loan losses	(85,282)	(92,537)
Loans held for investment, net	$10,157,900	$10,084,066

At December 31, 2013 and September 30, 2013, respectively, $1,497 and $4,179 of long-term loans were classified as mortgage loans held for sale.

A large concentration of the Company's lending is in Ohio and Florida. As of December 31, 2013 and September 30, 2013, the percentages of residential real estate loans held in Ohio were 73% and 74%, and the percentages held in Florida were 17% and 18%, respectively. As of both December 31, 2013 and September 30, 2013, home equity loans and lines of credit were concentrated in the states of Ohio (39%), Florida (29%) and California (12%), respectively. The economic conditions and market for real estate in those states, including to a greater extent Florida, have impacted the ability of borrowers in those areas to repay their loans.

Home Today is an affordable housing program targeted to benefit low- and moderate-income home buyers. Through this program the Association provided the majority of loans to borrowers who would not otherwise qualify for the Association's loan products, generally because of low credit scores. Although the credit profiles of borrowers in the Home Today program might be described as sub-prime, Home Today loans generally contain the same features as loans offered to our non-Home Today borrowers. Borrowers in the Home Today program must complete financial management education and counseling and must be referred to the Association by a sponsoring organization with which the Association has partnered as part of the program. Borrowers must also meet a minimum credit score threshold. Because the Association applied less stringent underwriting and credit standards to the majority of Home Today loans, loans originated under the program have greater credit risk than its traditional residential real estate mortgage loans. While effective March 27, 2009, the Home Today underwriting guidelines were changed to be substantially the same as the Association's traditional first mortgage product, the majority of loans in this program were originated prior to that date. As of December 31, 2013 and September 30, 2013, the principal balance of Home Today loans originated prior to March 27, 2009 was $168,025 and $174,974, respectively. The Association does not offer, and has not offered, loan products frequently considered to be designed to target sub-prime borrowers containing features such as higher fees or higher rates, negative amortization, a loan-to-value ratio greater than 100%, or pay option adjustable-rate mortgages.

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

	December 31, 2013	September 30, 2013
Real estate loans:		
Residential non-Home Today	$85,309	$91,048
Residential Home Today	33,062	34,813
Home equity loans and lines of credit	29,539	29,943
Construction	—	41
Total real estate loans	147,910	155,845
Consumer and other loans	—	—
Total non-accrual loans	$147,910	$155,845

Loans are placed in non-accrual status when they are contractually 90 days or more past due. Loans modified in troubled debt restructurings that were in non-accrual status prior to the restructurings remain in non-accrual status for a minimum of six months after restructuring. Additionally, home equity loans and lines of credit where the customer has a severely delinquent first mortgage and loans in Chapter 7 bankruptcy status where all borrowers have been discharged of their obligation are placed in non-accrual status. At December 31, 2013 and September 30, 2013, respectively, the recorded investment in non-accrual loans includes $55,955 and $54,311 in troubled debt restructurings which are current according to the terms of their agreement, of which $33,720 and $34,001 are performing loans in Chapter 7 bankruptcy status primarily where all borrowers have been discharged of their obligations. Additionally, at December 31, 2013 and September 30, 2013, the recorded investment in non-accrual status loans includes $3,783 and $5,277, respectively, of performing second lien loans subordinate to first mortgages delinquent greater than 90 days.

Interest on loans in accrual status, including certain loans individually reviewed for impairment, is recognized in interest income as it accrues, on a daily basis. Accrued interest on loans in non-accrual status is reversed by a charge to interest income and income is subsequently recognized only to the extent cash payments are received. Cash payments on loans in non-accrual status are applied to the oldest scheduled, unpaid payment first. Cash payments on loans with a partial charge-off are applied fully to principal, then to recovery of the charged off amount prior to interest income being recognized. A non-accrual loan is generally returned to accrual status when contractual payments are less than 90 days past due. However, a loan may remain in non-accrual status when collectability is uncertain, such as a troubled debt restructuring that has not met minimum payment requirements, a loan with a partial charge-off, an equity loan or line of credit with a delinquent first mortgage greater than 90 days, or a loan in Chapter 7 bankruptcy status where all borrowers have been discharged of their obligations. The number of days past due is determined by the number of scheduled payments that remain unpaid, assuming a period of 30 days between each scheduled payment.

An age analysis of the recorded investment in loan receivables that are past due at December 31, 2013 and September 30, 2013 is summarized in the following tables. When a loan is more than one month past due on its scheduled payments, the loan is considered 30 days or more past due. Balances are net of deferred fees and any applicable loans-in-process.

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total
December 31, 2013						
Real estate loans:						
Residential non-Home Today	$10,791	$7,894	$48,170	$66,855	$8,157,318	$8,224,173
Residential Home Today	9,679	5,447	17,479	32,605	136,160	168,765
Home equity loans and lines of credit	7,452	2,989	12,490	22,931	1,790,854	1,813,785

Construction	—	—	—	—	32,479	32,479
Total real estate loans	27,922	16,330	78,139	122,391	10,116,811	10,239,202
Consumer and other loans	—	—	—	—	3,980	3,980
Total	$27,922	$16,330	$78,139	$122,391	$10,120,791	$10,243,182

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	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total
September 30, 2013						
Real estate loans:						
Residential non-Home Today	$15,398	$4,874	$56,484	$76,756	$8,024,657	$8,101,413
Residential Home Today	8,597	5,989	18,341	32,927	142,666	175,593
Home equity loans and lines of credit	7,495	4,776	12,042	24,313	1,841,111	1,865,424
Construction	—	—	41	41	30,032	30,073
Total real estate loans	31,490	15,639	86,908	134,037	10,038,466	10,172,503
Consumer and other loans	—	—	—	—	4,100	4,100
Total	$31,490	$15,639	$86,908	$134,037	$10,042,566	$10,176,603

During the quarter ended December 31, 2013, $5,321 of residential loans were deemed uncollectible and fully charged-off as a result of implementing a new practice of charging off the remaining balance on loans that had remained delinquent and stalled in the foreclosure process for greater than 1,500 days. These loans previously were recorded at estimated net realizable value, with the potential for additional loss recognized within the allowance for loan losses. Any future foreclosure proceeds on these loans would result in recoveries of prior charge-offs. Activity in the allowance for loan losses is summarized as follows:

	For the Three Months Ended December 31, 2013				
	Beginning Balance	Provisions	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
Residential non-Home Today	$35,427	$5,081	$(7,476)	$430	$33,462
Residential Home Today	24,112	(807)	(2,933)	107	20,479
Home equity loans and lines of credit	32,818	1,757	(4,677)	1,329	31,227
Construction	180	(31)	(41)	6	114
Total real estate loans	92,537	6,000	(15,127)	1,872	85,282
Consumer and other loans	—	—	—	—	—
Total	$92,537	$6,000	$(15,127)	$1,872	$85,282

	For the Three Months Ended December 31, 2012				
	Beginning Balance	Provisions	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
Residential non-Home Today	$31,618	$5,777	$(4,635)	$331	$33,091
Residential Home Today	22,588	5,238	(3,534)	91	24,383
Home equity loans and lines of credit	45,508	7,259	(6,308)	787	47,246
Construction	750	(274)	(5)	10	481
Total real estate loans	100,464	18,000	(14,482)	1,219	105,201
Consumer and other loans	—	—	—	—	—
Total	$100,464	$18,000	$(14,482)	$1,219	$105,201

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The recorded investment in loan receivables at December 31, 2013 and September 30, 2013 is summarized in the following table. The table provides details of the recorded balances according to the method of evaluation used for determining the allowance for loan losses, distinguishing between determinations made by evaluating individual loans and determinations made by evaluating groups of loans not individually evaluated. Balances of recorded investments are net of deferred fees and any applicable loans-in-process.

	December 31, 2013			September 30, 2013		
	Individually	Collectively	Total	Individually	Collectively	Total
Real estate loans:						
Residential non-Home Today	$141,944	$8,082,229	$8,224,173	$149,102	$7,952,311	$8,101,413
Residential Home Today	75,117	93,648	168,765	79,065	96,528	175,593
Home equity loans and lines of credit	35,470	1,778,315	1,813,785	34,387	1,831,037	1,865,424
Construction	528	31,951	32,479	487	29,586	30,073
Total real estate loans	253,059	9,986,143	10,239,202	263,041	9,909,462	10,172,503
Consumer and other loans	—	3,980	3,980	—	4,100	4,100
Total	$253,059	$9,990,123	$10,243,182	$263,041	$9,913,562	$10,176,603

An analysis of the allowance for loan losses at December 31, 2013 and September 30, 2013 is summarized in the following table. The analysis provides details of the allowance for loan losses according to the method of evaluation, distinguishing between allowances for loan losses determined by evaluating individual loans and allowances for loan losses determined by evaluating groups of loans not individually evaluated.

	December 31, 2013			September 30, 2013		
	Individually	Collectively	Total	Individually	Collectively	Total
Real estate loans:						
Residential non-Home Today	$8,458	$25,004	$33,462	$7,138	$28,289	$35,427
Residential Home Today	6,285	14,194	20,479	7,677	16,435	24,112
Home equity loans and lines of credit	572	30,655	31,227	1,018	31,800	32,818
Construction	—	114	114	5	175	180
Total real estate loans	15,315	69,967	85,282	15,838	76,699	92,537
Consumer and other loans	—	—	—	—	—	—
Total	$15,315	$69,967	$85,282	$15,838	$76,699	$92,537

At December 31, 2013 and September 30, 2013, individually evaluated loans that required an allowance were comprised only of loans evaluated for impairment based on the present value of cash flows, such as performing troubled debt restructurings, and loans with a further deterioration in the fair value of collateral not yet identified as uncollectible. All other individually evaluated loans received a charge-off if applicable.

Because many variables are considered in determining the appropriate level of general valuation allowances, directional changes in individual considerations do not always align with the directional change in the balance of a particular component of the general valuation allowance. At December 31, 2013 and September 30, 2013, respectively, allowances on individually reviewed loans evaluated for impairment based on the present value of cash flows, such as performing troubled debt restructurings were $15,113 and $15,749; and allowances on loans with further deteriorations in the fair value of collateral not yet identified as uncollectible were $202 and $89.

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

As described earlier in this footnote, Home Today loans have greater credit risk than traditional residential real estate mortgage loans. At December 31, 2013 and September 30, 2013, respectively, approximately 49% and 50% of Home

Today loans include private mortgage insurance coverage. The majority of the coverage on these loans was provided by PMI

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Mortgage Insurance Co., which the Arizona Department of Insurance seized in 2011 and indicated that all claims payments would be reduced by 50%. In March 2013, PMIC notified the Association that all payments would be paid at 55% of the claim with the remainder deferred. Appropriate adjustments have been made to the Association’s affected valuation allowances and charge-offs, and estimated loss severity factors were adjusted accordingly for loans evaluated collectively. The amount of loans in our owned portfolio covered by mortgage insurance provided by PMIC as of December 31, 2013 and September 30, 2013, respectively, was $225,145 and $236,713 of which $204,365 and $214,920 was current. The amount of loans in our owned portfolio covered by mortgage insurance provided by Mortgage Guaranty Insurance Corporation as of December 31, 2013 and September 30, 2013, respectively, was $87,785 and $91,478 of which $86,533 and $90,099 was current. As of December 31, 2013, MGIC's long-term debt rating, as published by the major credit rating agencies, did not meet the requirements to qualify as "high credit quality"; however, MGIC continues to make claims payments in accordance with its contractual obligations and the Association has not increased its estimated loss severity factors related to MGIC's claim paying ability. No other loans were covered by mortgage insurers that were deferring claim payments or which were assessed as being non-investment grade.

Home equity lines of credit represent a significant portion of the residential real estate portfolio. The state of the economy and low housing prices continue to have an adverse impact on this portfolio since the home equity lines generally are in a second lien position. When the Association began to offer new home equity lines of credit again, the product was designed with prudent property and credit performance conditions to reduce future risk.

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

Consumer loans are comprised of loans secured by certificate of deposit accounts, which are fully recoverable in the event of non-payment.

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The recorded investment and the unpaid principal balance of impaired loans, including those reported as troubled debt restructurings, as of December 31, 2013 and September 30, 2013 are summarized as follows. Balances of recorded investments are net of deferred fees.

	December 31, 2013			September 30, 2013		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Residential non-Home Today	$80,381	$112,800	$—	$86,040	$114,799	$—
Residential Home Today	31,715	66,046	—	33,163	66,366	—
Home equity loans and lines of credit	28,579	61,843	—	27,494	58,267	—
Construction	528	547	—	422	544	—
Consumer and other loans	—	—	—	—	—	—
Total	$141,203	$241,236	$—	$147,119	$239,976	$—
With an allowance recorded:						
Residential non-Home Today	$61,563	$62,842	$8,458	$63,062	$64,468	$7,138
Residential Home Today	43,402	44,088	6,285	45,902	46,698	7,677
Home equity loans and lines of credit	6,891	6,935	572	6,893	6,996	1,018
Construction	—	—	—	65	65	5
Consumer and other loans	—	—	—	—	—	—
Total	$111,856	$113,865	$15,315	$115,922	$118,227	$15,838
Total impaired loans:						
Residential non-Home Today	$141,944	$175,642	$8,458	$149,102	$179,267	$7,138
Residential Home Today	75,117	110,134	6,285	79,065	113,064	7,677
Home equity loans and lines of credit	35,470	68,778	572	34,387	65,263	1,018
Construction	528	547	—	487	609	5
Consumer and other loans	—	—	—	—	—	—
Total	$253,059	$355,101	$15,315	$263,041	$358,203	$15,838

At December 31, 2013 and September 30, 2013, respectively, the recorded investment in impaired loans includes $194,958 and $201,692 of loans modified in troubled debt restructurings of which $27,871 and $30,550 were 90 days or more past due.

For all classes of loans, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal and interest according to the contractual terms of the loan agreement. Factors considered in determining that a loan is impaired may include the deteriorating financial condition of the borrower indicated by missed or delinquent payments, a pending legal action, such as bankruptcy or foreclosure, or the absence of adequate security for the loan.

Charge-offs on residential mortgage loans, home equity loans and lines of credit, and construction loans are recognized when triggering events, such as foreclosure actions, short sales, or deeds accepted in lieu of repayment, result in less than full repayment of the recorded investment in the loans.

Partial or full charge-offs are also recognized for the amount of impairment on loans considered collateral dependent that meet the conditions described below.

- For residential mortgage loans, payments are greater than 180 days delinquent;
- For home equity lines of credit, equity loans, and residential loans modified in a troubled debt restructuring, payments are greater than 90 days delinquent;
- For all classes of loans, a sheriff sale is scheduled within 60 days to sell the collateral securing the loan;

- For all classes of loans, all borrowers have been discharged of their obligation through a chapter 7 bankruptcy;
- For all classes of loans, a borrower obligated on a loan has filed bankruptcy and the loan is greater than 30 days delinquent;

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• For all classes of loans, it becomes evident that a loss is probable.

Collateral dependent residential mortgage loans and construction loans are charged off to the extent the recorded investment in a loan, net of anticipated mortgage insurance claims, exceeds the fair value less costs to dispose of the underlying property. Management can determine the loan is uncollectible for reasons such as foreclosures exceeding a reasonable time frame and recommend a full charge-off. Home equity loans or lines of credit are charged off to the extent the recorded investment in the loan plus the balance of any senior liens exceeds the fair value less costs to dispose of the underlying property or management determines the collateral is not sufficient to satisfy the loan. A loan in any portfolio that is identified as collateral dependent will continue to be reported as impaired until it is no longer considered collateral dependent, is less than 30 days past due and does not have a prior charge-off. A loan in any portfolio that has a partial charge-off consequent to impairment evaluation will continue to be individually evaluated for impairment until, at a minimum, the impairment has been recovered.

The following summarizes the effective dates of charge-off policies that changed or were first implemented during the current and previous four fiscal years and the portfolios to which those policies apply.

Effective Date	Policy	Residential Non-Home Today	Residential Home Today	Home Equity Lines of Credit	Home Equity Loans	Construction
9/30/2012	Pursuant to an OCC directive, a loan is considered collateral dependent and any collateral shortfall is charged off when all borrowers obligated on a loan are discharged through Chapter 7 bankruptcy	X	X	X	X	X
6/30/2012	Loans in any form of bankruptcy greater than 30 days past due are considered collateral dependent and any collateral shortfall is charged off	X	X	X	X	X
12/31/2011	Pursuant to an OCC directive, impairment on collateral dependent loans previously recognized as SVAs were charged off. Charge-offs are recorded to recognize confirmed collateral shortfalls on impaired loans. (1)	X	X	X	X	X
9/30/2010	Timing of impairment evaluation was accelerated to include equity loans greater than 90 days delinquent (2)				X	

(1) Prior to 12/31/2011, partial charge-offs were not used, but a SVA was established when the recorded investment in the loan exceeded the fair value of the collateral less costs to dispose. Individual loans were only charged off when a triggering event occurred, such as a foreclosure action was culminated, a short sale was approved, or a deed was accepted in lieu of repayment.

(2) Prior to 9/30/2010, impairment evaluations on equity loans were performed when the loan was greater than 180 days delinquent.

Loans modified in troubled debt restructurings that are not evaluated based on collateral are separately evaluated for impairment on a loan by loan basis at the time of restructuring and at each subsequent reporting date for as long as they are reported as troubled debt restructurings. The impairment evaluation is based on the present value of expected future cash flows discounted at the effective interest rate of the original loan. Expected future cash flows include a discount factor representing a potential for default. Valuation allowances are recorded for the excess of the recorded investments over the result of the cash flow analysis. Loans discharged in Chapter 7 bankruptcy are reported as troubled debt restructurings and also evaluated based on the present value of expected future cash flows unless evaluated based on collateral. We evaluate these loans using the expected future cash flows because we expect the borrower, not liquidation of the collateral, to be the source of repayment for the loan. 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 the restructuring agreement. No troubled debt restructurings were reclassified from impaired loans during

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the quarters ended December 31, 2013 or December 31, 2012.

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

	For the Three Months Ended December 31,			
	2013		2012	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Residential non-Home Today	$83,211	$ 281	$94,944	$ 399
Residential Home Today	32,439	87	36,456	68
Home equity loans and lines of credit	28,037	92	27,003	182
Construction	475	5	875	4
Consumer and other loans	—	—	—	—
Total	$144,162	$ 465	$159,278	$ 653
With an allowance recorded:				
Residential non-Home Today	$62,313	$ 743	$68,151	$ 842
Residential Home Today	44,652	553	57,037	642
Home equity loans and lines of credit	6,892	60	10,653	74
Construction	33	—	406	4
Consumer and other loans	—	—	—	—
Total	$113,890	$ 1,356	$136,247	$ 1,562
Total impaired loans:				
Residential non-Home Today	$145,524	$ 1,024	$163,095	$ 1,241
Residential Home Today	77,091	640	93,493	710
Home equity loans and lines of credit	34,929	152	37,656	256
Construction	508	5	1,281	8
Consumer and other loans	—	—	—	—
Total	$258,052	$ 1,821	$295,525	$ 2,215

The amounts of interest income on impaired loans recognized using a cash-basis method were $344 for the quarter ended December 31, 2013, and $599 for the quarter ended December 31, 2012.

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The recorded investment in troubled debt restructurings as of December 31, 2013 and September 30, 2013 is shown in the tables below.

December 31, 2013	Reduction in Interest Rates	Payment Extensions	Forbearance or Other Actions	Multiple Concessions	Multiple Modifications	Bankruptcy	Total
Residential non-Home Today	$ 17,424	$ 1,749	$ 11,796	$ 20,235	$ 20,632	$ 35,944	$ 107,780
Residential Home Today	14,042	128	8,246	17,944	21,132	5,238	66,730
Home equity loans and lines of credit	80	777	664	366	611	17,735	20,233
Construction	—	215	—	—	—	—	215
Total	$ 31,546	$ 2,869	$ 20,706	$ 38,545	$ 42,375	$ 58,917	$ 194,958

September 30, 2013	Reduction in Interest Rates	Payment Extensions	Forbearance or Other Actions	Multiple Concessions	Multiple Modifications	Bankruptcy	Total
Residential non-Home Today	$ 17,861	$ 1,670	$ 12,773	$ 21,227	$ 17,733	$ 39,530	$ 110,794
Residential Home Today	14,855	131	9,107	18,331	20,998	6,547	69,969
Home equity loans and lines of credit	82	596	675	225	561	18,512	20,651
Construction	—	278	—	—	—	—	278
Total	$ 32,798	$ 2,675	$ 22,555	$ 39,783	$ 39,292	$ 64,589	$ 201,692

For all loans modified during the quarters ended December 31, 2013 and December 31, 2012 (set forth in the table below), the pre-modification outstanding recorded investment was not materially different from the post-modification outstanding recorded investment.

The following tables set forth the recorded investment in troubled debt restructured loans modified during the periods presented, according to the types of concessions granted.

	For the Three Months Ended December 31, 2013						
	Reduction in Interest Rates	Payment Extensions	Forbearance or Other Actions	Multiple Concessions	Multiple Modifications	Bankruptcy	Total
Residential non-Home Today	$ 1,078	$ —	$ 225	$ 1,437	$ 1,066	$ 2,379	$ 6,185
Residential Home Today	90	—	—	227	1,024	219	1,560
Home equity loans and lines of credit	—	289	—	196	10	914	1,409
Total	$ 1,168	$ 289	$ 225	$ 1,860	$ 2,100	$ 3,512	$ 9,154

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

Troubled debt restructured loans may be modified more than once. Among other requirements, a re-modification may be available for a borrower upon the expiration of temporary modification terms if the borrower cannot return to regular loan payments. If the borrower is experiencing an income curtailment that temporarily has reduced his/her capacity to repay, such as loss of employment, reduction of hours, non-paid leave or short term disability, a temporary modification is considered. If the borrower lacks the capacity to repay the loan at the current terms due to a permanent condition, a permanent modification is

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considered. In evaluating the need for a re-modification, the borrower's ability to repay is generally assessed utilizing a debt to income and cash flow analysis. As the economy slowly improves, the need for re-modifications continues to linger. Loans discharged in Chapter 7 bankruptcy are classified as multiple modifications if the loan's original terms had also been modified by the Association.

The following tables provide information on troubled debt restructured loans modified within the previous 12 months that defaulted, or were at least 30 days past due on one scheduled payment, during the period presented.

	For the Three Months Ended December 31,			
	2013		2012	
Troubled Debt Restructurings That Subsequently Defaulted	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Dollars in thousands)		(Dollars in thousands)	
Residential non-Home Today	41	$4,262	72	$8,595
Residential Home Today	33	1,342	32	1,526
Home equity loans and lines of credit	32	1,210	35	1,739
Construction	—	—	2	98
Total	106	$6,814	141	$11,958

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

	Pass	Special Mention	Substandard	Loss	Total
December 31, 2013					
Real Estate Loans:					
Residential non-Home Today	$8,133,144	$—	$91,029	$—	$8,224,173
Residential Home Today	133,805	—	34,960	—	168,765
Home equity loans and lines of credit	1,772,369	7,533	33,883	—	1,813,785
Construction	31,951	—	528	—	32,479
Total	$10,071,269	$7,533	$160,400	$—	$10,239,202

	Pass	Special Mention	Substandard	Loss	Total
September 30, 2013					
Real Estate Loans:					
Residential non-Home Today	$8,004,890	$—	$96,523	$—	$8,101,413
Residential Home Today	139,481	—	36,112	—	175,593
Home equity loans and lines of credit	1,822,371	9,223	33,830	—	1,865,424
Construction	29,651	—	422	—	30,073
Total	$9,996,393	$9,223	$166,887	$—	$10,172,503

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

At December 31, 2013 and September 30, 2013, respectively, the recorded investment of impaired loans includes $107,277 and $113,520 of troubled debt restructurings that are individually evaluated for impairment, but have adequately performed under the terms of the restructuring and are classified as Pass loans. At December 31, 2013 and September 30, 2013, respectively, there were $14,648 and $17,396 of loans classified substandard and $7,503 and $9,193 of loans designated special

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mention that are not included in the recorded investment of impaired loans; rather, they are included in loans collectively evaluated for impairment.

Consumer loans are internally assigned a grade of nonperforming when they become 90 days or more past due. At December 31, 2013 and September 30, 2013, no consumer loans were graded as nonperforming.

5. DEPOSITS

Deposit account balances are summarized as follows:

	December 31, 2013	September 30, 2013
Negotiable order of withdrawal accounts	$1,045,107	$1,027,316
Savings accounts	1,817,289	1,808,953
Certificates of deposit	5,451,663	5,627,849
	8,314,059	8,464,118
Accrued interest	173	381
Total deposits	$8,314,232	$8,464,499

Brokered certificates of deposit, which are used as a cost effective funding alternative, totaled $55,000 and $13,000 at December 31, 2013 and September 30, 2013, respectively. The FDIC places restrictions on banks with regard to issuing brokered deposits based on the bank's capital classification. A well-capitalized institution may accept brokered deposits without FDIC restrictions. An adequately capitalized institution must obtain a waiver from the FDIC in order to accept brokered deposits, while an undercapitalized institution is prohibited by the FDIC from accepting brokered deposits.

6. OTHER COMPREHENSIVE INCOME (LOSS)

The change in accumulated other comprehensive loss by component is as follows:

	For the Three Months Ended December 31, 2013			For the Three Months Ended December 31, 2012		
	Unrealized losses on securities available for sale	Defined Benefit Plan	Total	Unrealized gains (losses) on securities available for sale	Defined Benefit Plan	Total
Balance at beginning of period	$(2,137)	$(6,467)	$(8,604)	$2,609	$(8,525)	$(5,916)
Other comprehensive loss before reclassifications, net of tax of $1,048 and $382	(1,947)	—	(1,947)	(710)	—	(710)
Amounts reclassified from accumulated other comprehensive (loss) income, net of tax of $26 and $49	—	48	48	—	90	90
Other comprehensive (loss) income	(1,947)	48	(1,899)	(710)	90	(620)
Balance at end of period	$(4,084)	$(6,419)	$(10,503)	$1,899	$(8,435)	$(6,536)

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The following table presents the reclassification adjustment out of accumulated other comprehensive loss included in net income and the corresponding line item on the consolidated statements of income for the periods indicated:

Details about Accumulated Other Comprehensive Income Components	Amounts Reclassified from Accumulated Other Comprehensive Income For the Three Months Ended December 31, 2013	2012	Line Item in the Statement of Income
Amortization of pension plan:			
Actuarial loss	$74	$139	(a)
Income tax benefit	(26)	(49)	Income tax expense
Net of income tax benefit	$48	$90	

(a) These items are included in the computation of net period pension cost. See Note 8. Defined Benefit Plan for additional disclosure.

7. INCOME TAXES

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and city jurisdictions. Federal income tax returns and the Association's Ohio Franchise Tax returns have been audited and settled for tax years through 2010 and 2011, respectively. With few exceptions, the Company is no longer subject to federal or state tax examinations for tax years prior to 2011.

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

8. DEFINED BENEFIT PLAN

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

The components, including an estimated settlement adjustment due to expected lump sum payments exceeding the sum of interest and service costs for the year, of net periodic income recognized in the statements of income are as follows:

	Three Months Ended December 31, 2013	2012
Interest cost	801	734
Expected return on plan assets	(1,055)	(1,029)
Amortization of net loss	74	139
Estimated net loss due to settlement	180	—
Net periodic income	$—	$(156)

There were no minimum employer contributions paid during the three months ended December 31, 2013. No minimum employer contributions are expected during the remainder of the fiscal year.

9. EQUITY INCENTIVE PLAN

In December 2013, 419,300 options to purchase our common stock and 98,900 restricted stock units were granted to certain directors, officers and employees of the Company. The awards were made pursuant to the shareholder-approved 2008 Equity Incentive Plan.

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During the three months ended December 31, 2013 and 2012, the Company recorded $1,797 and $1,715, respectively, of stock-based compensation expense, comprised of stock option expense of $771 and $847, respectively, and restricted stock units expense of $1,026 and $868, respectively.

At December 31, 2013, 6,927,700 shares were subject to options, with a weighted average exercise price of $11.14 per share and a weighted average grant date fair value of $2.95 per share. Expected future expense related to the 3,037,050 non-vested options outstanding as of December 31, 2013 is $4,957 over a weighted average of 1.7 years. At December 31, 2013, 1,139,238 restricted stock units, with a weighted average grant date fair value of $10.57 per unit, are unvested. Expected future compensation expense relating to the 1,475,297 restricted stock units outstanding as of December 31, 2013 is $5,816 over a weighted average period of 1.9 years. Each unit is equivalent to one share of common stock.

10. COMMITMENTS AND CONTINGENT LIABILITIES

In the normal course of business, the Company enters into commitments with off-balance sheet risk to meet the financing needs of its customers. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments to originate loans generally have fixed expiration dates of 60 to 360 days or other termination clauses and may require payment of a fee. Unfunded commitments related to home equity lines of credit generally expire 5 to 10 years following the date that the line of credit was established, subject to various conditions, which include compliance with payment obligations, adequacy of collateral securing the line and maintenance of a satisfactory credit profile by the borrower. Since some of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Off-balance sheet commitments to extend credit involve elements of credit risk and interest rate risk in excess of the amount recognized in the consolidated statements of condition. The Company's exposure to credit loss in the event of nonperformance by the other party to the commitment is represented by the contractual amount of the commitment. The

Company generally uses the same credit policies in making commitments as it does for on-balance-sheet instruments. Interest rate risk on commitments to extend credit results from the possibility that interest rates may have moved unfavorably from the position of the Company since the time the commitment was made.

At December 31, 2013, the Company had commitments to originate loans as follows:

Fixed-rate mortgage loans	$321,223
Adjustable-rate mortgage loans	207,992
Equity and bridge loans	10,231
Total	$539,446

At December 31, 2013, the Company had unfunded commitments outstanding as follows:

Home equity lines of credit (excluding commitments for suspended accounts)	$1,116,663
Construction loans	42,325
Private equity investments	12,941
Total	$1,171,929

At December 31, 2013, 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 $1,331,534.

The Company assumes a portion of the mortgage guaranty insurance on an excess of loss basis for the mortgage guaranty risks of certain mortgage loans in its own portfolio, including Home Today loans and loans in its servicing portfolio, through reinsurance contracts with two primary mortgage insurance companies. Under these contracts, the Company absorbs mortgage insurance losses in a range of 5% to 12% in excess of the initial 5% loss layer of a given pool of loans, in exchange for a portion of the pool's mortgage insurance premiums. The first 5% layer of loss must be exceeded before the Company assumes any liability. At December 31, 2013, the maximum losses remaining under the reinsurance contracts were limited to $6,820. The Company has paid $6,291 of losses under these reinsurance contracts and has provided a liability for the remaining estimated losses totaling $1,292 as of December 31, 2013. Management believes it has made adequate provision for estimated losses. Based upon notice from the Company's two primary mortgage insurance companies, no new contracts have been added to the Company’s risk exposure since December 31, 2008. The Company’s insurance partners have retained all new mortgage insurance premiums and all new risk after that date. Effective January 8, 2014, the Company entered into a Commutation and

Release Agreement with one of the mortgage insurance companies mentioned above that reduced the Company's maximum loss remaining under the contracts by $6,385 in exchange for a $1,000 payment.

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

	Three Months Ended December 31,	
	2013	2012
Balance, beginning of period	$2,158	$3,351
Incurred decrease	(113)	(251)
Paid claims	(753)	(479)
Balance, end of period	$1,292	$2,621

At December 31, 2013 and December 31, 2012, the Company had no commitments to securitize and sell mortgage loans.

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

11. FAIR VALUE

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

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

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

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

As permitted under the fair value guidance in U.S. GAAP, the Company elects to measure at fair value mortgage loans classified as held for sale that are subject to pending agency contracts to securitize and sell loans. This election is expected to reduce volatility in earnings related to market fluctuations between the contract trade and settlement dates. At December 31, 2013 and September 30, 2013, respectively, there were $0 and $3,369 of loans held for sale, with unpaid principal balances of $0 and $3,295, subject to pending agency contracts for which the fair value option was elected. Included in the net gain on the sale of loans is $(97) and $(210) for the three months ending December 31, 2013 and 2012, respectively, related to changes during the period in the fair value of loans held for sale subject to pending agency contracts.

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

Investment Securities Available for Sale—Investment securities available for sale are recorded at fair value on a recurring basis. At December 31, 2013 and September 30, 2013, respectively, this includes $482,706 and $471,901 of investments in U.S. government and agency obligations including U.S. Treasury notes and sequentially structured, highly liquid collateralized mortgage obligations issued by FNMA, Freddie Mac and Ginnie Mae and $4,813 and $5,475 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 collateralized mortgage obligations 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.

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Mortgage Loans Held for Sale – The fair value of mortgage loans held for sale is estimated using a market approach based on quoted secondary market pricing for loan portfolios with similar characteristics. Loans held for sale are carried at the lower of cost or fair value except, as described above, the Company elects the fair value measurement option for mortgage loans held for sale subject to pending agency contracts to securitize and sell loans. Loans held for sale are included in Level 2 of the hierarchy. At December 31, 2013 and September 30, 2013 there were $0 and $3,369, respectively, of loans held for sale measured at fair value and $1,497 and $810, respectively, of loans held for sale carried at cost.

Impaired Loans – Impaired loans represent certain loans held for investment that are subject to a fair value measurement under U.S. GAAP because they are individually evaluated for impairment and that impairment is measured using a fair value measurement, such as the observable market price of the loan or the fair value of the collateral less estimated costs to dispose. Impairment is measured using the market approach based on the fair value of the collateral less estimated costs to dispose for loans the Company considers to be collateral-dependent due to a delinquency status or other adverse condition severe enough to indicate that the borrower can no longer be relied upon as the continued source of repayment. These conditions are described more fully in Note 4, Loans and Allowance for Loan Losses. To calculate impairment of collateral-dependent loans, the fair market values of the collateral, estimated using exterior appraisals in the majority of instances, are reduced by calculated costs to dispose derived from historical experience and recent market conditions. Any indicated impairment is recognized by a charge to the allowance for loan losses. Subsequent increases in collateral values or principal pay downs on loans with recognized impairment could result in an impaired loan being carried below its fair value. 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. The recorded investment of 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. The range and weighted average impact of costs to dispose on fair values is determined at the time of impairment or when additional impairment is recognized and is included in quantitative information about significant unobservable inputs later in this note.

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 December 31, 2013 and September 30, 2013, respectively, this included $111,567 and $116,011 in recorded investment of troubled debt restructurings with related allowances for loss of $15,087 and $15,749.

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 the cost basis or fair value less estimated costs to dispose. Fair value is estimated under the market approach using independent third party appraisals. As these properties are actively marketed, estimated fair values may be adjusted by management to reflect current economic and market conditions. At December 31, 2013 and September 30, 2013, these adjustments were not significant to reported fair values. At December 31, 2013 and September 30, 2013, respectively, $20,025 and $19,644 of real estate owned is included in Level 3 of the hierarchy with assets measured at fair value on a non-recurring basis where the cost basis equals or exceeds the estimate of fair values less costs to dispose of these properties. Real estate owned, as reported in the Consolidated Statements of Condition, includes estimated costs to dispose of $1,947 and $1,986 related to properties measured at fair value and $3,775 and $5,008 of properties carried at their original or adjusted cost basis less than fair value at December 31, 2013 and September 30, 2013, respectively.

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

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Assets and liabilities carried at fair value on a recurring basis in the Consolidated Statements of Condition at December 31, 2013 and September 30, 2013 are summarized below. There were no liabilities carried at fair value on a recurring basis at December 31, 2013.

		Recurring Fair Value Measurements at Reporting Date Using		
	December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Investment securities available for sale:				
U.S. government and agency obligations	$2,033	$ —	$ 2,033	$ —
Freddie Mac certificates	639	—	639	—
Ginnie Mae certificates	11,364	—	11,364	—
REMICs	456,886	—	456,886	—
FNMA certificates	11,784	—	11,784	—
Money market accounts	4,813	4,813	—	—
Derivatives:				
Interest rate lock commitments	52	—	—	52
Total	$487,571	$ 4,813	$ 482,706	$ 52
Liabilities				
Derivatives:				
Forward commitments for the sale of mortgage loans	$—	$ —	$ —	$ —
Total	$—	$ —	$ —	$ —

		Recurring Fair Value Measurements at Reporting Date Using		
	September 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Investment securities available for sale:				
U.S. government and agency obligations	$2,037	$ —	$ 2,037	$ —
Freddie Mac certificates	950	—	950	—
Ginnie Mae certificates	12,342	—	12,342	—
REMICs	444,577	—	444,577	—
FNMA certificates	11,995	—	11,995	—
Money market accounts	5,475	5,475	—	—
Mortgage loans held for sale	3,369	—	3,369	—
Derivatives:				
Interest rate lock commitments	158	—	—	158
Total	$480,903	$ 5,475	$ 475,270	$ 158

Liabilities				
Derivatives:				
Forward commitments for the sale of mortgage loans	$6	$ —	$ 6	$ —
Total	$6	$ —	$ 6	$ —

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The table below presents a reconciliation of the beginning and ending balances and the location within the Consolidated Statements of Income where gains due to changes in fair value are recognized on interest rate lock commitments which are measured at fair value on a recurring basis using significant unobservable inputs (Level 3).

	Three Months Ended December 31,	
	2013	2012
Beginning balance	$ 158	$ 404
Loss during the period due to changes in fair value:		
Included in other non-interest income	(106)	(62)
Ending balance	$ 52	$ 342
Change in unrealized gains for the period included in earnings for assets held at end of the reporting date	$ 52	$ 342

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

		Nonrecurring Fair Value Measurements at Reporting Date Using		
	December 31, 2013	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
		(Level 1)	(Level 2)	(Level 3)
Impaired loans, net of allowance	$ 141,264	$ —	$ —	$ 141,264
Real estate owned[(1)]	20,025	—	—	20,025
Total	$ 161,289	$ —	$ —	$ 161,289

(1) Amounts represent fair value measurements of properties before deducting estimated costs to dispose.

		Nonrecurring Fair Value Measurements at Reporting Date Using		
	September 30, 2013	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
		(Level 1)	(Level 2)	(Level 3)
Impaired loans, net of allowance	$ 146,941	$ —	$ —	$ 146,941
Real estate owned[(1)]	19,644	—	—	19,644
Total	$ 166,585	$ —	$ —	$ 166,585

(1) Amounts represent fair value measurements of properties before deducting estimated costs to dispose.

The following provides quantitative information about significant unobservable inputs categorized within Level 3 of the Fair Value Hierarchy.

Fair Value 12/31/2013	Unobservable Input	Range	Weighted Average

		Valuation Technique(s)					
Impaired loans, net of allowance	$141,264	Market comparables of collateral discounted to estimated net proceeds	Discount appraised value to estimated net proceeds based on historical experience: • Residential Properties	0	-	24%	8.8%
Interest rate lock commitments	$52	Quoted Secondary Market pricing	Closure rate	0	-	100%	58.3%

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	Fair Value 9/30/2013	Valuation Technique(s)	Unobservable Input	Range	Weighted Average
Impaired loans, net of allowance	$146,941	Market comparables of collateral discounted to estimated net proceeds	Discount appraised value to estimated net proceeds based on historical experience: • Residential Properties	0 - 24%	9.3%
Interest rate lock commitments	$158	Quoted Secondary Market pricing	Closure rate	0 - 100%	53.2%

The following tables present the estimated fair value of the Company's financial instruments. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

	December 31, 2013				
	Carrying	Estimated Fair Value			
	Amount	Total	Level 1	Level 2	Level 3
Assets:					
Cash and due from banks	$30,843	$30,843	$30,843	$—	$—
Other interest earning cash equivalents	286,067	286,067	286,067	—	—
Investment securities:					
Available for sale	487,519	487,519	4,813	482,706	—
Mortgage loans held for sale	1,497	1,526	—	1,526	
Loans, net:					
Mortgage loans held for investment	10,153,920	10,333,921	—	—	10,333,921
Other loans	3,980	4,184	—	—	4,184
Federal Home Loan Bank stock	36,899	36,899	N/A	—	—
Private equity investments	516	516	—	—	516
Accrued interest receivable	31,331	31,331	—	31,331	—
Derivatives	52	52	—	—	52
Liabilities:					
NOW and passbook accounts	$2,862,396	$2,862,396	$—	$2,862,396	$—
Certificates of deposit	5,451,836	5,299,173	—	5,299,173	—
Borrowed funds	986,022	985,167	—	985,167	—
Borrowers' advances for taxes and insurance	68,882	68,882	—	68,882	—
Principal, interest and escrow owed on loans serviced	59,978	59,978	—	59,978	—

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	September 30, 2013				
	Carrying	Estimated Fair Value			
	Amount	Total	Level 1	Level 2	Level 3
Assets:					
Cash and due from banks	$34,694	$34,694	$34,694	$—	$—
Other interest earning cash equivalents	251,302	251,302	251,302	—	—
Investment securities:					
Available for sale	477,376	477,376	5,475	471,901	—
Mortgage loans held for sale	4,179	4,222	—	4,222	
Loans, net:					
Mortgage loans held for investment	10,079,966	10,344,246	—	—	10,344,246
Other loans	4,100	4,353	—	—	4,353
Federal Home Loan Bank stock	35,620	35,620	N/A	—	—
Private equity investments	654	654	—	—	654
Accrued interest receivable	31,489	31,489	—	31,489	—
Derivatives	158	158	—	—	158
Liabilities:					
NOW and passbook accounts	$2,836,269	$2,836,269	$—	$2,836,269	$—
Certificates of deposit	5,628,230	5,510,241	—	5,510,241	—
Borrowed funds	745,117	745,294	—	745,294	—
Borrowers’ advances for taxes and insurance	71,388	71,388	—	71,388	—
Principal, interest and escrow owed on loans serviced	75,745	75,745	—	75,745	—
Derivatives	6	6	—	6	—

Presented below is a discussion of the valuation techniques and inputs used by the Company to estimate fair value.

Cash and Due from Banks, Interest Earning Cash Equivalents— The carrying amount is a reasonable estimate of fair value.

Investment and Mortgage-Backed Securities— Estimated fair value for investment and mortgage-backed securities is based on quoted market prices, when available. If quoted prices are not available, management will use as part of their estimation process fair values that are obtained from third party independent nationally recognized pricing services using pricing models, quoted prices of securities with similar characteristics or discounted cash flows.

Mortgage Loans Held for Sale— Fair value of mortgage loans held for sale is based on quoted secondary market pricing for loan portfolios with similar characteristics.

Loans— For mortgage loans held for investment and other loans, fair value is estimated by discounting contractual cash flows adjusted for prepayment estimates using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining term. The use of current rates to discount cash flows reflects current market expectations with respect to credit exposure. Impaired loans are measured at the lower of cost or fair value as described earlier in this footnote.

Federal Home Loan Bank Stock— It is not practical to estimate the fair value of FHLB stock due to restrictions on its transferability. The fair value is estimated at the carrying value, which is par. All transactions in capital stock of the FHLB of Cincinnati are executed at par.

Private Equity Investments— Private equity investments are initially valued based upon transaction price. The carrying value is subsequently adjusted when it is considered necessary based on current performance and market conditions. The carrying values are adjusted to reflect expected exit values. These investments are included in Other Assets in the accompanying Consolidated Statements of Condition at fair value.

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Deposits— The fair value of demand deposit accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using discounted cash flows and rates currently offered for deposits of similar remaining maturities.

Borrowed Funds— Estimated fair value for borrowed funds is estimated using discounted cash flows and rates currently charged for borrowings of similar remaining maturities.

Accrued Interest Receivable, Borrowers' Advances for Insurance and Taxes, and Principal, Interest and Escrow Owed on Loans Serviced— The carrying amount is a reasonable estimate of fair value.

Derivatives— Fair value is estimated based on the valuation techniques and inputs described earlier in this footnote.

12. DERIVATIVE INSTRUMENTS

The Company enters into forward commitments for the sale of mortgage loans principally to protect against the risk of adverse interest rate movements on net income. The Company recognizes the fair value of such contracts when the characteristics of those contracts meet the definition of a derivative. These derivatives are not designated in a hedging relationship; therefore, gains and losses are recognized immediately in the statement of income. In addition, the Company enters into commitments to originate a portion of its loans, which when funded, are classified as held for sale. Such commitments meet the definition of a derivative and are not designated in a hedging relationship; therefore, gains and losses are recognized immediately in the statement of income. The Company had no derivatives designated as hedging instruments under FASB ASC 815, "Derivatives and Hedging," at December 31, 2013 or September 30, 2013.

The following table provides the locations within the Consolidated Statements of Condition and the fair values for derivatives not designated as hedging instruments.

	Asset Derivatives			
	December 31, 2013		September 30, 2013	
	Location	Fair Value	Location	Fair Value
Interest rate lock commitments	Other Assets	$52	Other Assets	$158

	Liability Derivatives			
	December 31, 2013		September 30, 2013	
	Location	Fair Value	Location	Fair Value
Forward commitments for the sale of mortgage loans	Other Liabilities	$—	Other Liabilities	$6

The following table summarizes the locations and amounts of gain or (loss) recognized within the Consolidated Statements of Income on derivative instruments not designated as hedging instruments.

	Location of Gain or (Loss) Recognized in Income	Amount of Gain or (Loss) Recognized in Income on Derivatives Three Months Ended December 31, 2013	2012
Interest rate lock commitments	Other non-interest income	$(106)	$(62)
Forward commitments for the sale of mortgage loans	Net gain on the sale of loans	6	243
Total		$(100)	$181

13. RECENT ACCOUNTING PRONOUNCEMENTS

Pending as of December 31, 2013

In January 2014, the FASB issued Accounting Standards Update 2014-04, Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40), Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon

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Foreclosure to reduce diversity by clarifying when an in-substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The only impact of these amendments on the Company's consolidated financial statements will be additional disclosures. The Company's timing for derecognition of the receivable and the recognition of the real estate property clarified in these amendments will not change as a result of this amendment.

Adopted in quarter ended December 31, 2013
FASB ASU 2013-02, "Comprehensive Income (Topic 220), Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income" supersedes ASU 2011-12, “Comprehensive Income (Topic 220), Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05” and the presentation requirements for reclassifications out of accumulated other comprehensive income in ASU 2011-05. ASU 2013-02 requires entities to present separately significant amounts reclassified out of each component of OCI, either on the face of the statement where net income is presented or in the notes, if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other significant amounts, entities shall provide cross-references to the notes where additional details about the effect of the reclassifications are disclosed. The disclosures required by this amendment are included in Note 6. Other Comprehensive Income (Loss).
The Company has determined that all other recently issued accounting pronouncements will not have a material impact on the Company’s consolidated financial statements or do not apply to its operations.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements

This report contains forward-looking statements, which can be identified by the use of such words as estimate, project, believe, intend, anticipate, plan, seek, expect and similar expressions. These forward-looking statements include, among other things:

- statements of our goals, intentions and expectations;
- statements regarding our business plans and prospects and growth and operating strategies;
- statements concerning trends in our provision for loan losses and charge-offs;
- statements regarding the trends in factors affecting our financial condition and results of operations, including asset quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, the following important factors that could affect the actual outcome of future events:

- significantly increased competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our interest margins or reduce the fair value of financial instruments;
- general economic conditions, either nationally or in our market areas, including employment prospects, real estate values and conditions that are worse than expected;
- decreased demand for our products and services and lower revenue and earnings because of a recession or other events;
- adverse changes and volatility in the securities markets;
- adverse changes and volatility in credit markets;
- legislative or regulatory changes that adversely affect our business, including changes in regulatory costs and capital requirements and changes related to our ability to pay dividends and the ability of Third Federal Savings, MHC to waive dividends;
- our ability to enter new markets successfully and take advantage of growth opportunities, and the possible short-term dilutive effect of potential acquisitions or de novo branches, if any;
- changes in consumer spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board and the Public Company Accounting Oversight Board;
- future adverse developments concerning FNMA or Freddie Mac;
- changes in monetary and fiscal policy of the U.S. Government, including policies of the U.S. Treasury and the FRS and changes in the level of government support of housing finance;
- changes in policy and/or assessment rates of taxing authorities that adversely affect us;
- changes in expense trends (including, but not limited to trends affecting non-performing assets, charge-offs and provisions for loan losses);
- the impact of the governmental effort to restructure the U.S. financial and regulatory system;
- the inability of third-party providers to perform their obligations to us;
- adverse changes and volatility in real estate markets;
- a slowing or failure of the moderate economic recovery;
- the extensive reforms enacted in the DFA, which will continue to impact us;
- the adoption of implementing regulations by a number of different regulatory bodies under the DFA, and uncertainty in the exact nature, extent and timing of such regulations and the impact they will have on us;
- the continuing impact of our coming under the jurisdiction of new federal regulators;
- changes in our organization, or compensation and benefit plans;
- the strength or weakness of the real estate markets and of the consumer and commercial credit sectors and its impact on the credit quality of our loans and other assets;

- the ability of the U.S. Government to manage federal debt limits; and
- the uncertainty regarding the timing and probability of the termination of the current restrictions imposed pursuant to a February 7, 2011 MOU, now administered by the FRS, with respect to our ability to repurchase stock and pay dividends.

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Because of these and other uncertainties, our actual future results may be materially different from the results indicated by any forward-looking statements. Any forward-looking statement made by us in this report speaks only as of the date on which it is made. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future developments or otherwise, except as may be required by law. Please see Item 1A. Risk Factors for a discussion of certain risks related to our business.

Overview

Our business strategy is to operate as a well-capitalized and profitable financial institution dedicated to providing exceptional personal service to our customers.

Since being organized in 1938, we grew to become, at the time of our initial public offering of stock in April 2007, the nation's largest mutually-owned savings and loan association based on total assets. We credit our success to our continued emphasis on our primary values: "Love, Trust, Respect, and a Commitment to Excellence, along with Having Fun." Our values are reflected in the design and pricing of our loan and deposit products, and historically, in our Home Today program, as described below. Our values are further reflected in the Broadway Redevelopment Initiative (a long-term revitalization program encompassing the three-mile corridor of the Broadway-Slavic Village neighborhood in Cleveland, Ohio where our main office was established and continues to be located) and the educational programs we have established and/or supported. We intend to continue to adhere to our primary values and to support our customers and the communities in which we operate.

During the last several years, regionally high unemployment, weak residential real estate values, less than robust capital and credit markets, and a general lack of confidence in the financial services sector of the economy presented significant challenges for us. More recently, improving regional employment levels, recovering residential real estate values, recovering capital and credit markets and greater confidence in the financial services sector have resulted in better credit metrics and improved operating results for us.

Management believes that the following matters are those most critical to our success: (1) controlling our interest rate risk exposure; (2) monitoring and limiting our credit risk; (3) maintaining access to adequate liquidity and alternative funding sources; and (4) monitoring and controlling operating expenses.

Controlling Our Interest Rate Risk Exposure. Although housing and credit quality issues have had and, to a lesser extent, continue to have a negative effect on our operating results and, as described below, are certainly a matter of significant concern for us, historically our greatest risk has been our exposure to interest rate risk. When we hold long-term, fixed-rate assets, funded by liabilities with shorter re-pricing characteristics, we are exposed to potentially adverse impacts from rising interest rates. Generally, and particularly over extended periods of time that encompass full economic cycles, interest rates associated with longer-term assets, like fixed-rate mortgages, have been higher than interest rates associated with shorter-term funding sources, like deposits. This difference has been an important component of our net interest income and is fundamental to our operations. We manage the risk of holding long-term, fixed-rate mortgage assets primarily by maintaining high levels of tangible capital and by promoting adjustable-rate loans and shorter-term, fixed-rate loans. Additionally, in years prior to fiscal 2010, we also managed this risk by actively selling long-term, fixed-rate mortgage loans in the secondary market, a strategy pursuant to which we were able to modulate the amount of long-term, fixed-rate loans held in our portfolio. As described in greater detail below, during fiscal 2013 we adopted the necessary procedural changes that, subsequent thereto, we believe result in certain of our long-term, fixed-rate loan originations being eligible for delivery and sale to FNMA, and will prospectively provide us with additional options in managing our interest rate risk profile. The total balance of loans sold subsequent to June 30, 2010 has not been significant when measured in relation to the total balance of our owned fixed-rate portfolio. During the fiscal year ended September 30, 2013, we sold $221.1 million of long-term, fixed-rate first mortgage loans compared to $11.4 million and $33.6 million during the fiscal years ended September 30, 2012 and 2011, respectively, and as further compared to sales of $1.03 billion during the fiscal year ended September 30, 2010. Also, during fiscal 2013 we sold $128.1 million of long-term, adjustable-rate first mortgage loans to a private investor. The adjustable-rate transaction demonstrated our ability to further manage interest rate risk and liquidity by selling Smart Rate loans in the secondary market. No long-term, adjustable-rate first mortgage loans were sold during any of the fiscal years ended September 30, 2012, 2011 or 2010. During the three months ended December 31, 2013 and

2012, we sold $20.9 million and $77.2 million, respectively of fixed-rate, first mortgage loans. As described in the following paragraphs, the relatively low volume of long-term, fixed-rate first mortgage loan sales since June 30, 2010 reflects the impact of changes by FNMA related to requirements for loans that it accepts and our reduced level of longer-term, fixed-rate loan originations.

FNMA, historically the Association’s primary loan investor, implemented, effective July 1, 2010, certain loan origination requirement changes affecting loan eligibility that we chose not to adopt until May 2013. Subsequent to the May 2013 implementation date of our revised loan origination procedures, and upon review and validation by FNMA which was received on November 15, 2013, we expect that those fixed-rate, first mortgage loans that are originated under the revised procedures,

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will thereafter be eligible for sale to FNMA in either whole loan or mortgage-backed security form. During the three months ended December 31, 2013, we delivered and sold to FNMA $11.1 million of fixed-rate, first mortgage loans that had been originated under the revised procedures. Previously, our decision not to implement the changes necessary to comply with FNMA’s revised requirements, was based on our consideration that between 1991 and 2010, the Association, employing only non-commissioned loan originators and utilizing a centralized underwriting process, had sold loans to FNMA under a series of proprietary variances, or contractual waivers, that were negotiated between us and FNMA throughout the term of that relationship. Those proprietary concessions related to certain loan file documentation and quality control procedures the lack of which, in our opinion, did not diminish in any way the excellent credit quality of the loans that we delivered to FNMA, but facilitated the efficiency and effectiveness of our operations and the quality and value of the loan products that we were able to offer to our borrowers. The high credit quality of the loans that we delivered to FNMA was consistently evidenced by the superior delinquency profile of our portfolio in peer performance comparisons prepared by FNMA. In response to the housing crisis that commenced in 2008, and with the objective of improving the credit profile of its overall loan portfolio, FNMA enacted many credit tightening measures, culminating in the effective elimination of proprietary variances and waivers, accompanied by the imposition of additional file documentation requirements and expanded quality control procedures. In addition to substantively changing FNMA’s operating procedures, effects of the housing crisis spread throughout the secondary residential mortgage market and resulted in a significantly altered operating framework for all secondary market participants. We believed that this dramatically altered operating framework offered opportunities for business process innovators to create new secondary market solutions especially as such opportunities would be expected to target high credit quality residential loans similar to those that we have traditionally originated. During the fiscal year ended September 30, 2011, $20.3 million of non-agency eligible, fixed-rate mortgage loans were sold (on a servicing retained basis) to a private investor. No loan sales to private investors were completed during the fiscal year ended September 30, 2012, while during the fiscal year ended September 30, 2013, $276.9 million of non-agency eligible, whole loan sales, all on a servicing retained basis, were completed. During the three months ended December 31, 2013, there were no non-agency eligible, whole loan sales, nor were any non-agency eligible, whole loans classified as mortgage loans held for sale at December 31, 2013. Additionally, there were no loan sale commitments outstanding with respect to such loans at December 31, 2013. While we were successful in completing several non-agency backed whole loan sales during the fiscal year ended September 30, 2013, in our opinion, the breadth of, and the transaction pricing in, the non-agency market did not develop in the manner, or with the speed that we believe justified the continuing delay in our adoption of FNMA's loan origination requirements. Accordingly, while we continue to evaluate available opportunities in the secondary market, we have developed a parallel operation, approved by FNMA on November 15, 2013, that fully complies with current FNMA loan eligibility standards. Previously, during the quarter ended June 30, 2012, the Association implemented procedures necessary for participation in FNMA's HARP II initiative. The balances of mortgage loans held for sale at December 31, 2013 and September 30, 2013, were $1.5 million and $4.2 million, respectively, and were comprised entirely of agency-compliant HARP II loans. HARP II loan sales during the three months ended December 31, 2013 and the fiscal year ended September 30, 2013, totaled $9.8 million and $72.3 million, respectively. HARP II loan sales during the three months ended December 31, 2012 totaled $18.9 million. At September 30, 2013, outstanding loan sales commitments, all of which were agency-compliant HARP II loans, totaled $3.3 million. At December 31, 2013, there were no outstanding loan sales commitments.

In response to the changes made in FNMA's loan eligibility requirements, in July 2010 we began marketing an adjustable-rate mortgage loan product that provides us with improved interest rate risk characteristics when compared to a long-term, fixed-rate mortgage loan. Since its introduction, the “Smart Rate” adjustable rate mortgage has offered borrowers an interest rate lower than that of a long-term fixed-rate loan. The rate is locked for three or five years then resets annually after that. It contains a feature to re-lock the rate an unlimited number of times at our then, current rate and fee schedule, for another three or five years (dependent on the original reset period) without having to complete a full refinance transaction. Re-lock eligibility is subject to a satisfactory payment performance history by the borrower (never 60 days late, no 30-day delinquencies during the last twelve months, current at the time of re-lock, and no foreclosures or bankruptcies since the Smart Rate application was taken). In addition to a satisfactory payment history, re-lock eligibility requires that the property continues to be the borrower’s primary residence. The loan term cannot be extended in connection with a re-lock nor can new funds be advanced. All interest rate caps and floors remain as originated. During the three month periods ended December 31, 2013 and 2012, adjustable-rate mortgage loan originations totaled $192.0 million and $236.8 million, respectively, while during the same time periods, fixed-rate mortgage loan originations totaled $279.1 million and $210.7 million, respectively. By comparison, during the nine months ended June 30, 2010, the last nine months of operations prior to the introduction of our Smart Rate product, adjustable-rate mortgage loan originations totaled $28.7 million while fixed-rate originations totaled $1.15 billion. The amount of origination volumes, including refinances by our existing customers, along with the portion of that activity that pertains to loans that we previously sold (but for which we retained the right to provide mortgage servicing so as to maintain our relationship with our customer) when coupled with the level of loan sales, if any, determines the balance of loans held on our balance sheet. The amount of adjustable-rate loan activity described above resulted in $3.23 billion of long-term adjustable-rate loans in our residential mortgage loans held for investment portfolio at December 31, 2013, as compared to $3.19 billion at September 30, 2013. At December 31, 2013, the amount of adjustable-rate residential mortgage loans represented 38% of the total residential

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mortgage loans held for investment portfolio. Primarily as a result of changes in the balance of 10-year fixed-rate loans as described in the next paragraph, the fixed-rate mortgage loan activity described above resulted in $5.18 billion of long-term fixed rate loans in our residential mortgage loans held for investment portfolio, as compared to $5.11 billion at September 30, 2013, and $4.98 billion at December 31, 2012. The December 31, 2013, September 30, 2013 and December 31, 2012 measurements excluded $1.5 million, $4.2 million and $155.3 million, respectively, of long-term, fixed-rate loans reported as mortgage loans held for sale. The December 31, 2012 measurement also excluded $169.1 million of adjustable-rate loans that were designated as mortgage loans held for sale. No adjustable-rate loans were designated as mortgage loans held for sale at either December 31, 2013 or September 30, 2013.

In addition to actively marketing our Smart Rate product, beginning in the latter portion of fiscal 2012, we also began to feature our ten-year, fully amortizing fixed-rate first mortgage loan in our product promotions. The ten-year, fixed-rate loan has a less severe interest rate risk profile when compared to loans with fixed-rate terms of 15 to 30 years and helps us to more effectively manage our interest rate risk exposure, yet provides our borrowers with the certainty of a fixed interest rate throughout the life of the obligation. While the total balance of fixed-rate mortgage loans increased between December 31, 2012 and December 31, 2013, as described in the preceding paragraph, changes in the composition of the fixed-rate portion of the portfolio followed divergent paths. Between December 31, 2012 and December 31, 2013 the total fixed-rate portion of our first mortgage loan portfolio increased $195.8 million and was comprised of an increase of $547.7 million in the balance of fixed-rate loans with original terms of 10 years or less, and a decrease of $351.9 million in the balance of fixed-rate loans with original terms greater than 10 years. Also, between September 30, 2013 and December 31, 2013 the total fixed-rate portion of our first mortgage loan portfolio increased $66.4 million and was comprised of an increase of $124.9 million in the balance of fixed-rate loans with original terms of 10 years or less, and a decrease of $58.6 million in the balance of fixed-rate loans with original terms greater than 10 years. During the three months ended December 31, 2013, ten-year fixed-rate first mortgage loan originations totaled $157.7 million, or 57% of our fixed-rate originations and 33% of our total originations.

In the past, we have also managed interest rate risk by promoting home equity lines of credit, which have a variable interest rate. As described below, this product carries an incremental credit risk component and has been adversely impacted by the housing market downturn. Between June 28, 2010 and March 20, 2012, due to the deterioration in overall housing conditions including concerns for loans and credit lines in a second lien position, home equity lines of credit and home equity loans were not offered by the Association. Beginning in March 2012, the Association offered redesigned home equity lines of credit to qualifying existing home equity customers, subject to certain property and credit performance conditions. In February 2013 the Association further modified the product design and the terms included monthly principal and interest payments throughout the entire term. In April 2013 we extended the offer to both existing home equity customers and new consumers in Ohio, Florida and selected counties in Kentucky. These offers were, and are, subject to certain property and credit performance conditions which include:

- lower CLTV maximum ratios (80% in Ohio/Kentucky and 70% in Florida; for programs in place prior to 2012 the CLTV extended to as high as 89.99%);
- limited geographic offering (only Ohio, Kentucky and Florida; programs in place prior to 2012 were offered nationwide);
- borrower income is fully verified (in prior programs income was not always fully verified);
- beginning in February 2013, borrowers are qualified using a principal and interest payment based on the interest rate offered to the borrower, plus 2.00%, amortized over 30 years; for applications taken between March 2012 and February 2013, borrowers were qualified using a principal and interest payment based on the interest rate offered to the borrower plus 2.00%, amortized over 20 years (for programs in place prior to 2012, borrowers were qualified using only the interest rate offered to the borrower);
- the minimum credit score to qualify for the re-introduced home equity line of credit is 700 in Ohio and Kentucky and 720 in Florida (our prior home equity line of credit offering in 2010 required a minimum credit score of 680 in all markets); and
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beginning in February 2013, the term for new home equity line of credit applications is a five year draw period, during which monthly principal and interest payments are made based on the portion of the original term of 30 years that remains, followed by a 25-year repayment only period, during which payments will be comprised of both principal and interest; for applications taken between March 2012 and February 2013, the term for new home equity line of credit applications was a five year draw period during which interest only payments are made, followed by a 20-year repayment period, during which payments are comprised of both principal and interest (for programs in place prior to 2012, terms generally offered a 10-year draw period, with interest only payments, followed by a 10-year repayment period, with payments of principal and interest).

The existing home equity lines of credit portfolio, with a principal balance of $1.64 billion at December 31, 2013, favorably impacts our interest rate risk profile. The efforts described above are intended to prudently stem the portfolio attrition/reduction that has been experienced during the last three years and to ultimately re-establish home equity line of credit lending as a meaningful strategy used to manage our interest rate risk profile.

Should a rapid and substantial increase occur in general market interest rates, it is probable that, prospectively and particularly over a multi-year time horizon, the level of our net interest income would be adversely impacted.

Monitoring and Limiting Our Credit Risk. While, historically, we had been successful in limiting our credit risk exposure by generally imposing high credit standards with respect to lending, the confluence of unfavorable regional and macro-economic events since 2008, coupled with our pre-2010 expanded participation in the second lien mortgage lending markets, has significantly refocused our attention with respect to credit risk. In response to the evolving economic landscape, we have continuously revised and updated our quarterly analysis and evaluation procedures, as needed, for each category of our lending with the objective of identifying and recognizing all appropriate credit impairments. At December 31, 2013, 89% of our assets consisted of residential real estate loans (both “held for sale” and “held for investment”) and home equity loans and lines of credit, the overwhelming majority of which were originated to borrowers in the states of Ohio and Florida. Our analytic procedures and evaluations include specific reviews of all home equity loans and lines of credit that become 90 or more days past due, as well as specific reviews of all first mortgage loans that become 180 or more days past due. We also expanded our analysis of current performing home equity lines of credit to better mitigate future risk of loss. In accordance with regulatory guidance issued in January 2012, performing home equity lines of credit subordinate to first mortgages delinquent greater than 90 days are transferred to non-accrual status. At December 31, 2013, the recorded investment of such performing home equity lines of credit, not otherwise classified as non-accrual, was $3.8 million. Also, the OCC issued guidance in July 2012 that requires loans, where at least one borrower has been discharged of their obligation in Chapter 7 bankruptcy, to be classified as troubled debt restructurings. Also required pursuant to this guidance is the charge-off of performing loans to collateral value and non-accrual classification when all borrowers have had their obligations discharged in Chapter 7 bankruptcy, regardless of how long the loans have been performing. At December 31, 2013, $58.9 million of loans in Chapter 7 bankruptcy status were included in total troubled debt restructurings. At December 31, 2013, the recorded investment in non-accrual status loans included $33.7 million of performing loans in Chapter 7 bankruptcy status where at least one borrower had been discharged of their obligation.

In response to the unfavorable regional and macro-economic environment that arose beginning in 2008, and in an effort to limit our credit risk exposure and improve the credit performance of new customers, we have tightened our credit criteria in evaluating a borrower’s ability to successfully fulfill his or her repayment obligation and we have revised the design of many of our loan products to require higher borrower down-payments, limited the products available for condominiums, and eliminated certain product features (such as interest-only adjustable-rate loans, loans above certain loan-to-value ratios, and prior to March 2012, home equity lending products with the exception of bridge loans).

One aspect of our credit risk concern relates to the high percentage of our loans that are secured by residential real estate in the states of Ohio and Florida, particularly in light of the difficulties that have arisen with respect to the real estate markets in those states. At December 31, 2013, approximately 72.6% and 17.8% of the combined total of our residential, non-Home Today and construction loans held for investment were secured by properties in Ohio and Florida, respectively. Our 30 or more days delinquency ratios on those loans in Ohio and Florida at December 31, 2013 were 0.7% and 1.6%, respectively. Our 30 or more days delinquency ratio for the non-Home Today portfolio as a whole was 0.8% at December 31, 2013. Also, at December 31, 2013, approximately 38.9% and 29.0% of our home equity loans and lines of credit were secured by properties in Ohio and Florida, respectively. Our 30 days or more delinquency ratios on those loans in Ohio and Florida at December 31, 2013 were each 1.3%. Our 30 or more days delinquency ratio for the home equity loans and lines of credit portfolio as a whole at December 31, 2013 was 1.3%. While we focus our attention on, and are concerned with respect to the resolution of, all loan delinquencies, our highest concern is centered on loans that are secured by properties in Florida. The “Allowance for Loan Losses” portion of the Critical Accounting Policies section provides extensive details regarding our loan portfolio composition, delinquency statistics, our methodology in evaluating our loan loss provisions and the adequacy of our allowance for loan losses. In spite of recent improving credit metrics, as long as unemployment levels remain high, particularly in Ohio and Florida, and Florida housing values remain depressed, due to prior overbuilding and speculation which has resulted in considerable inventory on the market, we expect that we will continue to experience elevated levels of delinquencies and risk of loss.

Our residential Home Today loans are another area of credit risk concern. Although the recorded investment in these loans totaled $168.8 million at December 31, 2013, and constituted only 1.7% of our total “held for investment” loan portfolio balance, these loans comprised 22.4% and 26.6% of our 90 days or greater delinquencies and our total delinquencies, respectively. At December 31, 2013, approximately 95.4% and 4.4% of our residential, Home Today loans were secured by properties in Ohio and Florida, respectively. At December 31, 2013, the percentages of those loans delinquent 30 days or more in Ohio and Florida were 19.5% and 15.4%, respectively. The disparity between the portfolio composition ratio and delinquency composition ratio reflects the nature of the Home Today loans. We do not offer, and have 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, or low initial payment features with adjustable interest rates. Our Home Today loans, the majority of which were entered into with borrowers that had credit profiles that would not have otherwise qualified for our loan products due to deficient credit scores, generally contained the same features as loans offered to our non-Home Today borrowers. The overriding objective of our Home Today lending, just as it is with our non-Home Today lending, was to create successful homeowners. We have attempted to manage our Home Today credit risk by requiring that borrowers attend pre- and post-borrowing financial management education and counseling and that the borrowers be referred to us by a sponsoring organization with which we have partnered. Further, to manage the credit aspect of these loans, inasmuch as the majority of these buyers do not have sufficient funds for required down payments, many loans include private mortgage insurance. At December 31, 2013, 48.7% of Home Today loans included private mortgage insurance coverage. From a peak recorded investment of $306.6 million at December 31, 2007, the total recorded investment of the Home Today portfolio has declined to $168.8 million at December 31, 2013. This trend generally reflects the evolving conditions in the mortgage real estate market and the tightening of standards imposed by issuers of private mortgage insurance. As part of our effort to manage credit risk, effective March 27, 2009, the Home Today underwriting guidelines were revised to be substantially the same as our traditional mortgage product. At December 31, 2013, the recorded investment in Home Today loans originated subsequent to March 27, 2009 was $2.3 million. Unless and until lending standards and private mortgage insurance requirements loosen, we expect the Home Today portfolio to continue to decline in balance due to contractual amortization.

Maintaining Access to Adequate Liquidity and Alternative Funding Sources. For most insured depositories, customer and community confidence are critical to their ability to maintain access to adequate liquidity and to conduct business in an orderly fashion. The Company believes that maintaining high levels of capital is one of the most important factors in nurturing customer and community confidence. Accordingly, we have managed the pace of our growth in a manner that reflects our emphasis on high capital levels. At December 31, 2013, the Association’s ratio of core capital to adjusted tangible assets (a basic industry measure that deems 5.00% or above to represent a “well capitalized” status) was 13.45%. The Association's current core capital ratio is lower than its ratios at September 30, 2013 (14.18%) and December 31, 2012 (13.59%), due to an $85 million cash dividend payment that the Association made to the Company, its sole shareholder. The amount of the dividend was determined using regulatory guidelines that allow dividends in an amount that does not exceed the Association's current calendar year to date net income, plus the preceding two year's retained net income. Because of its intercompany nature, this dividend payment did not impact the Company's consolidated capital ratios. We expect to continue to remain a well capitalized institution.

In managing its level of liquidity, the Company monitors available funding sources, which include attracting new deposits (including brokered CDs), borrowings from others, the conversion of assets to cash and the generation of funds through profitable operations. The Company has traditionally relied on retail deposits as its primary means in meeting its funding needs. At December 31, 2013, deposits totaled $8.31 billion (including $55.0 million of brokered CDs), while borrowings totaled $986.0 million and borrowers’ advances and servicing escrows totaled $128.9 million, combined. In evaluating funding sources, we consider many factors, including cost, duration, current availability, expected sustainability, impact on operations and capital levels.

To attract retail deposits, we offer our customers reasonable rates of return on our deposit products. Our deposit products typically offer rates that are highly competitive with the rates on similar products offered by other financial institutions. We intend to continue this practice.

We preserve the availability of alternative funding sources through various mechanisms. First, by maintaining high capital levels, we retain the flexibility to increase our balance sheet size without jeopardizing our capital adequacy. Effectively, this permits us to increase the rates that we offer on our deposit products thereby attracting more potential customers. Second, we pledge available real estate mortgage loans and investment securities with the FHLB of Cincinnati and the FRB-Cleveland. At December 31, 2013, these collateral pledge support arrangements provide the ability to immediately borrow an additional $9.0 million from the FHLB of Cincinnati and $168.9 million from the FRB-Cleveland Discount Window. From the perspective of collateral value securing FHLB of Cincinnati advances, our capacity limit for additional borrowings beyond the immediately available limits at December 31, 2013 was $4.01 billion, subject to satisfaction of the FHLB of Cincinnati common stock ownership requirement. To satisfy the common stock ownership requirement we would need to increase our ownership of FHLB of Cincinnati common stock by an additional $80.2 million. Third, we invest in high quality marketable securities that exhibit limited market price variability, and to the extent that they are not needed as collateral for borrowings, can be sold in the institutional market and converted to cash. At December 31, 2013, our investment securities portfolio totaled $487.5 million. Finally, cash flows from operating activities have been a regular source of funds. During the three months ended December 31, 2013 and 2012, cash flows from operations totaled $80.6 million and $92.2 million, respectively.

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Historically, a portion of the residential first mortgage loans that we originated were considered to be highly liquid as they were eligible for delivery/sale to FNMA. However, due to delivery requirement changes imposed by FNMA, effective July 1, 2010, this was not a viable channel of available liquidity prior to our recent implementation of certain loan origination changes required by FNMA which resulted in our November 15, 2013 reinstatement as an approved seller to FNMA. Refer to the earlier section, Controlling Our Interest Rate Risk Exposure, for additional details. At December 31, 2013, $1.5 million of agency eligible, long-term, fixed-rate HARP II first mortgage loans were classified as “held for sale”. During the quarter ended December 31, 2013, $9.8 million of agency-compliant HARP II loans were sold and $11.1 million of long-term, fixed-rate, agency-compliant, non-HARP II first mortgage loans were sold to FNMA. As described earlier, we have implemented the loan origination changes which will allow a portion of our future first mortgage loan originations to be eligible for sale to FNMA in either whole loan or mortgage backed security form.

Overall, while customer and community confidence can never be assured, the Company believes that our liquidity is adequate and that we have adequate access to alternative funding sources.

Monitoring and Controlling Operating Expenses. We continue to focus on managing operating expenses. Our ratio of non-interest expense to average assets was 1.52% for the quarter ended ended December 31, 2013 and 1.50% for the quarter ended ended December 31, 2012. As of December 31, 2013, our average assets per full-time employee and our average deposits per full-time employee were $11.3 million and $8.3 million, respectively. We believe that each of these measures compares favorably with the averages for our peer group. Our average deposits held at our branch offices ($218.8 million per branch office as of December 31, 2013) contribute to our expense management efforts by limiting the overhead costs of serving our deposit customers. We will continue our efforts to control operating expenses as we grow our business.

Critical Accounting Policies

Critical accounting policies are defined as those that involve significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We believe that the most critical accounting policies upon which our financial condition and results of operations depend, and which involve the most complex subjective decisions or assessments, are our policies with respect to our allowance for loan losses, mortgage servicing rights, income taxes, pension benefits, and stock-based compensation.

Allowance for Loan Losses. We provide for loan losses based on the allowance method. Accordingly, all loan losses are charged to the related allowance and all recoveries are credited to it. Additions to the allowance for loan losses are provided by charges to income based on various factors which, in our judgment, deserve current recognition in estimating probable losses. We regularly review the loan portfolio and make provisions for loan losses in order to maintain the allowance for loan losses in accordance with accounting principles generally accepted in the United States of America. Our allowance for loan losses consists of two components:

(1) individual valuation allowances established for any impaired loans dependent on cash flows, such as performing troubled debt restructurings, and IVAs related to a portion of the allowance on loans individually reviewed that represents further deterioration in the fair value of the collateral not yet identified as uncollectible; and

(2) general valuation allowances, which are comprised of quantitative GVAs, which are general allowances for loan losses for each loan type based on historical loan loss experience and qualitative GVAs, previously described as MVAs, which are adjustments to the quantitative GVAs, maintained to cover uncertainties that affect our estimate of incurred probable losses for each loan type.

The qualitative GVAs expand our ability to identify and estimate probable losses and are based on our evaluation of the following factors, some of which are consistent with factors that impact the determination of quantitative GVAs. For example, delinquency statistics (both current and historical) are used in developing the quantitative GVAs while the trending of the delinquency statistics is considered and evaluated in the determination of the qualitative GVAs. Factors impacting the determination of qualitative GVAs include:

- changes in lending policies and procedures including underwriting standards, collection, charge-off or recovery practices;
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changes in national, regional, and local economic and business conditions and trends including national, regional and local housing market factors and trends, such as the status of loans in foreclosure, real estate in judgment and real estate owned, and unemployment statistics and trends;

- changes in the nature and volume of the portfolios including equity lines of credit nearing the end of the draw period;
- changes in the experience, ability or depth of lending management;

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- changes in the volume or severity of past due loans, volume of nonaccrual loans, or the volume and severity of adversely classified loans including the trending of delinquency statistics (both current and historical), historical loan loss experience and trends, the frequency and magnitude of re-modifications of loans previously the subject of troubled debt restructurings, and uncertainty surrounding borrowers' ability to recover from temporary hardships for which short-term loan modifications are granted;
- changes in the quality of the loan review system;
- changes in the value of the underlying collateral including asset disposition loss statistics (both current and historical) and the trending of those statistics, and additional charge-offs on individually reviewed loans;
- existence of any concentrations of credit;
- effect of other external factors such as competition, or legal and regulatory requirements including market conditions and regulatory directives that impact the entire financial services industry.

When loan modifications qualify as troubled debt restructurings and the loans are performing according to the terms of the restructuring, we record an IVA based on the present value of expected future cash flows, which includes a factor for subsequent potential defaults, discounted at the effective interest rate of the original loan contract. Potential defaults are distinguished from re-modifications as borrowers who default are generally not eligible for re-modification. At December 31, 2013, the balance of such individual valuation allowances was $15.1 million. In instances when loans require re-modification, additional valuation allowances may be required. The new valuation allowance on a re-modified loan is calculated based on the present value of the expected cash flows, discounted at the effective interest rate of the original loan contract, considering the new terms of the modification agreement. Due to the immaterial amount of this exposure to date, we continue to capture this exposure as a component of our qualitative GVA evaluation. The significance of this exposure will be monitored and if warranted, we will enhance our loan loss methodology to include a new default factor (developed to reflect the estimated impact to the balance of the allowance for loan losses that will occur as a result of future re-modifications) that will be assessed against all loans reviewed collectively. If new default factors are implemented, the qualitative GVA methodology will be adjusted to preclude duplicative loss consideration.

We evaluate the allowance for loan losses based upon the combined total of the quantitative and qualitative GVAs. Generally, when the loan portfolio increases, absent other factors, the allowance for loan loss methodology results in a higher dollar amount of estimated probable losses than would be the case without the increase. Generally, when the loan portfolio decreases, absent other factors, the allowance for loan loss methodology results in a lower dollar amount of estimated probable losses than would be the case without the decrease.

Home equity loans and equity lines of credit generally have higher credit risk than traditional residential mortgage loans. These loans and credit lines are usually in a second lien position and when combined with the first mortgage, result in generally higher overall loan-to-value ratios. In a stressed housing market with high delinquencies and eroded housing prices, as arose beginning in 2008, these higher loan-to-value ratios represent a greater risk of loss to the Company. A borrower with more equity in the property has more of a vested interest in keeping the loan current compared to a borrower with little or no equity in the property. In light of the past weakness in the housing market, the current level of delinquencies and the current uncertainty with respect to future employment levels and economic prospects, we currently conduct an expanded loan level evaluation of our home equity loans and lines of credit, including bridge loans, which are delinquent 90 days or more. This expanded evaluation is in addition to our traditional evaluation procedures. Our home equity loans and lines of credit portfolio continues to comprise a significant portion of our net charge-offs, although the level of home equity loans and lines of credit charge-offs has receded over the last year from levels previously experienced. At December 31, 2013, we had a recorded investment of $1.81 billion in home equity loans and equity lines of credit outstanding, 0.7% of which were 90 days or more past due.

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.

We periodically evaluate the carrying value of loans and the allowance is adjusted accordingly. While we use the best information available to make evaluations, future additions to the allowance may be necessary based on unforeseen changes in loan quality and economic conditions.

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The following table sets forth the composition of the portfolio of loans held for investment, by type of loan segregated by geographic location for the periods indicated, excluding loans held for sale. The majority of our small construction portfolio are loans on properties located in Ohio and the balances of consumer loans are immaterial. Therefore, neither was segregated by geographic location.

	December 31, 2013		September 30, 2013		December 31, 2012	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
Real estate loans:						
Residential non-Home Today						
Ohio	$5,957,490		$5,947,791		$5,873,206	
Florida	1,475,469		1,465,907		1,349,511	
Other	806,296		704,813		426,791	
Total Residential non-Home Today	8,239,255	80.1 %	8,118,511	79.4 %	7,649,508	76.6 %
Residential Home Today						
Ohio	163,464		170,206		192,828	
Florida	7,627		7,826		8,459	
Other	319		321		328	
Total Residential Home Today	171,410	1.7	178,353	1.7	201,615	2.0
Home equity loans and lines of credit						
Ohio	702,229		721,890		804,381	
Florida	524,195		539,152		607,545	
California	222,146		227,841		250,349	
Other	358,432		369,515		416,131	
Total Home equity loans and lines of credit	1,807,002	17.5	1,858,398	18.2	2,078,406	20.8
Total Construction	75,314	0.7	72,430	0.7	61,670	0.6
Consumer and other loans	3,980	—	4,100	—	4,173	—
Total loans receivable	10,296,961	100.0 %	10,231,792	100.0 %	9,995,372	100.0 %
Deferred loan fees, net	(11,454)		(13,171)		(18,128)	
Loans in process	(42,325)		(42,018)		(30,829)	
Allowance for loan losses	(85,282)		(92,537)		(105,201)	
Total loans receivable, net	$10,157,900		$10,084,066		$9,841,214	

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The following table sets forth the allowance for loan losses allocated by loan category, the percent of allowance in each category to the total allowance, and the percent of loans in each category to total loans at the dates indicated. The allowance for loan losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

	December 31, 2013		
	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans
	(Dollars in thousands)		
Real estate loans:			
Residential non-Home Today			