TFS Financial CORP
Form 10-K
November 26, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended September 30, 2008

or

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

For transition period from to

Commission File Number 001-33390

TFS FINANCIAL CORPORATION

(Exact Name of Registrant as Specified in its Charter)

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

(216) 441-6000

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value $0.01 per share

(Title of class)

The NASDAQ Stock Market, LLC

(Name of exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

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

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

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

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

At November 18, 2008 there were 312,042,600 shares of the Registrant s common stock, par value $0.01 per share, outstanding, of which 227,119,132 shares, or 72.78% of the Registrant s common stock, were held by Third Federal Savings & Loan Association of Cleveland, MHC, the Registrant s mutual holding company.

DOCUMENTS INCORPORATED BY REFERENCE (to the Extent Indicated Herein)

Portions of the registrant s Proxy Statement for the 2009 Annual Meeting of Shareholders are incorporated by reference in Part III hereof.

Table of Contents

TFS Financial Corporation

INDEX

Part I		
Item 1.	Business	3
Item 1A.	Risk Factors	37
Item 1B.	Unresolved Staff Comments	41
Item 2.	Properties	41
Item 3.	Legal Proceedings	41
Item 4.	Submission of Matters to a Vote of Security Holders	42
Part II		
Item 5.	Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	43
Item 6.	Selected Financial Data	46
Item 7.	Management s Discussion and Analysis of Financial Condition and Results of Operation	48
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk.	67
Item 8.	Financial Statements and Supplementary Data	69
Item 9.	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	69
Item 9A.	Controls and Procedures	70
Item 9B.	Other Information	72
Part III		
Item 10.	Directors, Executive Officers and Corporate Governance	72
Item 11.	Executive Compensation	72
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	72
Item 13.	Certain Relationships and Related Transactions, and Director Independence	72
Item 14.	Principal Accounting Fees and Services	73
Part IV		
Item 15.	Exhibits and Financial Statement Schedules	73

Table of Contents

PART I

Item 1. Business

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:

- statements of our goals, intentions and expectations;
- statements regarding our business plans and prospects and growth and operating strategies;
- statements regarding the 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, that are worse than expected;
- decreased demand for our products and services and lower revenue and earnings because of a recession;
- adverse changes and volatility in the securities markets;
- adverse changes and volatility in credit markets;
- legislative or regulatory changes that adversely affect our business;
- 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 Fannie Mae or Freddie Mac;
- changes in monetary and fiscal policy of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board;
- changes in policy and/or assessment rates of taxing authorities that adversely affect us;
- inability of third-party providers to perform their obligations to us;
- changes in our organization, compensation and benefit plans; and
- 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.

Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. Please see **Item 1A. Risk Factors**, for a discussion of certain risks related to our business.

Table of Contents

TFS FINANCIAL CORPORATION

TFS Financial Corporation (we us our or the Company) was organized in 1997 as the mid-tier stock holding company for Third Federal Saving and Loan Association of Cleveland (Third Federal Savings and Loan or the Association). We completed our initial public stock offering on April 20, 2007 and issued 100,199,618 shares of common stock, or 30.16% of our post-offering outstanding common stock, to subscribers in the offering. Additionally, at the time of the public offering, 5,000,000 shares of our common stock, or 1.50% of our outstanding shares, were issued to our newly formed charitable foundation, Third Federal Foundation (the Foundation). Third Federal Savings and Loan Association of Cleveland, MHC (Third Federal Savings, MHC), our mutual holding company parent, holds the remainder of our outstanding common stock (227,119,132 shares). Net proceeds from our initial public stock offering were approximately $886 million and reflected the costs we incurred in completing the offering as well as a $106.5 million loan to the Third Federal Employee Stock Ownership Plan related to its acquisition of shares in the initial public stock offering. In February 2008, the Company s board of directors authorized a stock repurchase program totaling 15.8 million shares. A second repurchase program was authorized in September 2008 for 5.0 million shares, commencing immediately following completion of the first repurchase program. Through September 30, 2008, approximately 16.1 million shares had been repurchased at a total cost of $192.7 million.

Our ownership of the Association remains our primary business activity.

We also operate Third Capital, Inc. as a wholly-owned subsidiary.

As the holding company of Third Federal Savings and Loan, we are authorized to pursue other business activities permitted by applicable laws and regulations for savings and loan holding companies, which include making equity investments and the acquisition of banking and financial services companies. We have no plans for any mergers or acquisitions at the present time.

Our cash flow depends primarily on earnings from the investment of the portion of the net offering proceeds we retained, and any dividends we receive from Third Federal Savings and Loan and Third Capital, Inc. The majority of our officers are also officers of the Association. In addition, we use the services of the support staff of the Association from time to time. We may hire additional employees, as needed, to the extent we expand our business in the future.

THIRD CAPITAL, INC.

Third Capital, Inc. is a Delaware corporation that was organized in 1998 as our wholly-owned subsidiary. At September 30, 2008, Third Capital, Inc. had consolidated assets of $78.4 million, and for the fiscal year ended September 30, 2008, Third Capital, Inc. had consolidated net income of $2.1 million. Third Capital, Inc. has no separate operations other than as the holding company for its operating subsidiaries, and as a minority investor or partner in other entities including minority investments in private equity funds. The following is a description of the entities, other than the private equity funds, in which Third Capital, Inc. is the owner, an investor or a partner.

Hazelmere Investment Group I, Ltd. and Hazelmere of California Limited Partnership. These entities engage in net lease transactions of commercial buildings in targeted United States markets. Third Capital, Inc. is a partner of each of these entities, receives a preferred return on amounts contributed to acquire investment properties and has a 70% ownership interest in remaining earnings. James Gascoigne, a director of the Company, indirectly owns or controls the majority of the remaining 30% ownership interest of these entities. Overall, the Hazelmere entities had pre-tax income of $1.5 million during fiscal 2008.

Third Cap Associates, Inc. This corporation also maintains minority investments in private equity funds, and owns between 49% and 60% of two title agencies that provide escrow and settlement services in the State of Ohio, primarily to customers of Third Federal Savings and Loan. For the fiscal year ended September 30, 2008, Third Cap Associates, Inc. recorded net income of $2.5 million.

Third Capital Mortgage Insurance Company. This Vermont corporation reinsures private mortgage insurance on residential mortgage loans originated by Third Federal Savings and Loan. For the fiscal year ended September 30, 2008, Third Capital Mortgage Insurance Company incurred a net loss of $2.2 million.

THIRD FEDERAL SAVINGS AND LOAN ASSOCIATION OF CLEVELAND

General

Third Federal Savings and Loan is a federally chartered savings and loan association headquartered in Cleveland, Ohio that was organized in 1938. In May 1997, the Association reorganized into its current two-tier mutual holding company structure. The Association s principal business consists of originating residential real estate mortgage loans and equity loans and lines of credit and attracting retail savings deposits.

The Association s business strategy is to originate mortgage loans with interest rates that are competitive with those of similar products offered by other financial institutions in its markets. Similarly, the Association offers high-yield checking accounts and high-yield savings accounts and certificate of deposit accounts, each bearing interest rates that are competitive with similar products offered by other financial institutions in its markets. The Association expects to continue to pursue this business philosophy. While this strategy does not enable it to earn the highest rates of interest on loans it offers or pay the lowest rates on its deposit accounts, the Association believes that this strategy is the primary reason for its successful growth in the past.

The Association attracts retail deposits from the general public in the areas surrounding its main office and its branch offices. It also utilizes its internet website and its telephone call center to generate loan applications and attract retail deposits. In addition to residential real estate mortgage loans and equity loans and lines of credit, the Association originates residential construction loans. The Association retains in its portfolio the majority of the loans that it originates. Loans that the Association sells consist primarily of long-term, fixed-rate residential real estate mortgage loans. The Association retains the servicing rights on all loans that it sells. The Association s revenues are derived primarily from interest on loans and, to a lesser extent, interest on interest-bearing deposits in other financial institutions, federal funds sold, and investment securities including mortgage-backed securities. The Association also generates revenues from fees and service charges. The Association s primary sources of funds are deposits, borrowings, principal and interest payments on loans and securities and proceeds from loan sales.

The Association s website address is *www.thirdfederal.com*. Filings of the Company made with the Securities and Exchange Commission are available for free on the Association s website. Information on that website is not and should not be considered a part of this document.

Market Area

Third Federal Savings and Loan conducts its operations from its main office in Cleveland, Ohio, and from 37 additional, full-service branches and eight loan production offices located throughout the states of Ohio and Florida. In Ohio, the Association s 23 full-service offices are located in the northeast Ohio counties of Cuyahoga, Lake, Lorain, Medina and Summit, four loan production offices are located in the central Ohio county of Franklin (Columbus, Ohio) and four loan production offices are located in the southern Ohio county of Hamilton (Cincinnati, Ohio). In Florida, 15 full-service branches are located in the counties of Pasco, Pinellas, Hillsboro, Sarasota, Lee, Collier, Miami-Dade, Palm Beach and Broward. The economies and housing markets in Ohio and Florida have been seriously impacted by the current economic downturn. Both states have experienced dramatic increases in foreclosures and reductions in employment rates and housing values. The depressed housing market and employment uncertainties have created an aura of pessimism and apprehension, and are manifested in suppressed consumer housing demand. Additionally, a number of troubled financial institutions, both national and regional, that compete in our markets have targeted retail deposit gathering as an alternative funding source as the wholesale funding markets that they previously utilized have either ceased to function or have imposed

punitive pricing parameters. Faced with the alternative of high wholesale funding costs, these institutions have pursued retail deposit gathering and significantly increased their interest rates paid to depositors. The combination of reduced demand by borrowers and higher rates paid to depositors has created an increasingly competitive marketplace that could adversely affect future operating results.

The Association also provides savings products in all 50 states and offers secured lines of credit in 20 states through its internet site.

Competition

The Association faces intense competition in its market areas both in making loans and attracting deposits. Its market areas have a high concentration of financial institutions, including large money center and regional banks, community banks and credit unions and it faces additional competition for deposits from money market funds, brokerage firms, mutual funds and insurance companies. Some of its competitors offer products and services that the Association currently does not offer, such as commercial business loans, trust services and private banking.

The majority of the Association s deposits are held in its offices located in Cuyahoga County, Ohio. As of June 30, 2008 (the latest date for which information is publicly available), the Association had $4.67 billion of deposits in Cuyahoga County, and ranked third among all financial institutions with offices in the county in terms of deposits, with a market share of 8.92%. As of that date, the Association had $5.71 billion of deposits in the State of Ohio, and ranked 9th among all financial institutions in the state in terms of deposits, with a market share of 2.51%. As of June 30, 2008, the Association had $2.56 billion of deposits in the State of Florida, and ranked 22nd among all financial institutions in terms of deposits, with a market share of 0.67%.

From January 2008 through September 2008, the Association had the largest market share of conventional purchase mortgage loans originated in Cuyahoga County, Ohio. For the same period, it also had the largest market share of conventional purchase mortgage loans originated in four of the largest northeast Ohio counties. In addition, based on the same statistic, the Association has consistently been one of the six largest lenders in Franklin County (Columbus, Ohio) and Hamilton County (Cincinnati, Ohio) since it entered those markets in 1999.

The Association s primary strategy for increasing and retaining its customer base is to offer competitive deposit and loan rates and other product features, delivered with exceptional customer service, in each of the markets it serves.

We rely on our 70 year history of serving our customers and the communities in which we operate, our high capital levels, and liquidity alternatives to maintain and nurture customer and marketplace confidence. Our high capital ratio continues to reflect the beneficial impact of our April 2007 initial public offering, which raised net proceeds of $886 million. At September 30, 2008, our ratio of shareholders equity to total assets was 17.1%. Our liquidity alternatives include management and monitoring of the level of liquid assets held in our portfolio as well as the maintenance of alternative wholesale funding sources. At September 30, 2008, our liquidity ratio was 8.93% and we had the ability to immediately borrow an additional $499.8 million from the Federal Home Loan Bank of Cincinnati (FHLB of Cincinnati) under existing credit arrangements. See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation Liquidity and Capital Resources.

In many respects, nurturing customer and marketplace confidence is as much an art as it is a science. To address this, we continue to utilize a multifaceted approach that supports our efforts in several different ways. First, we provide thorough and timely information to all of our associates so as to prepare them for their day-to-day interactions with customers and other individuals who are not part of the Company. We believe that it is important that our customers and others sense the comfort level and confidence of our associates throughout their dealings. Second, we encourage our management team to maintain a presence and to be available in our

branches and other areas of customer contact, so as to provide more opportunities for informal contact and interaction with our customers and community members. Third, our CEO remains accessible to both local and national media, as a spokesman for our institution as well as an observer and interpreter of financial marketplace situations and events. Fourth, we periodically include advertisements in local newspapers that display our strong capital levels and history of service. We also continue to emphasis our traditional tagline STRONG * STABLE * SAFE in our advertisements and branch displays. Finally, for customers who adhere to the old adage of trust but verify, we refer them to the safety/security rankings of two nationally recognized, independent rating organizations that specialize in the evaluation of financial institutions (each of which have awarded Third Federal Savings with its highest rating).

Lending Activities

The Association s principal lending activity is the origination of first mortgage loans to purchase or refinance residential real estate. Its current policies generally provide that it will maintain between 40% and 70% of its assets in fixed-rate, residential real estate, first mortgage loans and up to 20% of its assets in adjustable-rate, residential real estate, first mortgage loans, subject to its liquidity levels and the credit demand of its customers. The Association also originates a significant amount of equity loans and equity lines of credit, and, to a lesser extent, residential construction loans. At September 30, 2008, residential real estate mortgage loans totaled $6.70 billion, or 72.0% of our loan portfolio, equity loans and lines of credit totaled $2.49 billion, or 26.7% of our loan portfolio, and residential construction loans totaled $115.3 million, or 1.2% of our loan portfolio.

Loan Portfolio Composition. The following table sets forth the composition of the Association s loan portfolio, by type of loan at the dates indicated, excluding loans held for sale.

	At September 30,									
	2008		2007		2006		2005		2004	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Real estate loans:										
Residential non-Home Today	$ 6,399,492	68.7%	$ 5,842,827	71.5%	$ 5,278,290	69.4%	$ 5,257,601	67.5%	$ 4,572,814	61.9%
Residential Home Today	303,153	3.3	304,046	3.7	285,492	3.8	250,068	3.2	194,715	2.6
Equity loans and lines of credit(1)	2,488,054	26.7	1,867,899	22.8	1,803,900	23.7	1,965,604	25.2	2,301,777	31.1
Construction	115,323	1.2	150,695	1.8	207,634	2.7	270,136	3.5	236,681	3.2
Commercial					2,335	0.0	2,383	0.0	3,354	0.0
Consumer loans:										
Automobile	1,044	0.0	5,627	0.1	15,676	0.2	33,410	0.4	70,647	1.0
Other	6,555	0.1	9,065	0.1	12,793	0.2	10,847	0.2	11,243	0.2
Total loans receivable	$ 9,313,621	100.0%	$ 8,180,159	100.0%	$ 7,606,120	100.0%	$ 7,790,049	100.0%	$ 7,391,231	100.0%
Deferred loan costs (fees)	(14,596)		(19,174)		(18,698)		(22,783)		(16,602)	
Loans in process	(46,493)		(62,167)		(89,676)		(127,944)		(114,413)	
Allowance for loan losses	(43,796)		(25,111)		(20,705)		(18,601)		(15,080)	
Total loans receivable, net	$ 9,208,736		$ 8,073,707		$ 7,477,041		$ 7,620,721		$ 7,245,136	

(1) Includes bridge loans.

Table of Contents

Loan Portfolio Maturities. The following table summarizes the scheduled repayments of the Association s loan portfolio at September 30, 2008. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in the fiscal year ending September 30, 2009. Maturities are based on the final contractual payment date and do not reflect the impact of prepayments and scheduled principal amortization.

Due During the Years Ending September 30,	Residential Real Estate Non-Home Today	Residential Real Estate Home Today	Equity Loans and Lines of Credit(1)	Construction Loans	Automobile Loans	Other Consumer Loans	Total
				(In thousands)			
2009	$ 9,584	$ 1	$ 39,892	$ 37,073	$ 891	$ 6,072	$ 93,513
2010	4,205		5,334	15,827	153		25,519
2011	9,712		8,531				18,243
2012 to 2013	56,424		31,642				88,066
2014 to 2018	502,981	1,719	89,257			483	594,440
2019 to 2023	715,843	5,470	295,625	8,208			1,025,146
2024 and beyond	5,100,743	295,963	2,017,773	54,215			7,468,694
Total	$ 6,399,492	$ 303,153	$ 2,488,054	$ 115,323	$ 1,044	$ 6,555	$ 9,313,621

(1) Includes bridge loans.

The following table sets forth the scheduled repayments of fixed- and adjustable-rate loans at September 30, 2008 that are contractually due after September 30, 2009.

	Due After September 30, 2009 Fixed	Adjustable	Total
		(In thousands)	
Real estate loans:			
Residential non-Home Today	$ 5,630,197	$ 759,711	$ 6,389,908
Residential Home Today	302,915	237	303,152
Equity Loans and Lines of Credit(1)	203,896	2,244,266	2,448,162
Construction	67,081	11,169	78,250
Consumer Loans:			
Automobile	153		153
Other	483		483
Total	$ 6,204,725	$ 3,015,383	$ 9,220,108

(1) Includes bridge loans.

Residential Real Estate Mortgage Loans. The Association s primary lending activity is the origination of residential real estate mortgage loans. At September 30, 2008, $6.70 billion, or 72.0% of its total loan portfolio, consisted of residential real estate mortgage loans. The Association offers conforming and non-conforming, fixed-rate and adjustable-rate residential real estate mortgage loans with maturities of up to 30 years and maximum loan amounts generally of up to $2.0 million, although a substantial portion of real estate mortgage loans are in amounts of $650,000 or less.

The Association currently offers fixed-rate conventional mortgage loans with terms of up to 30 years that are fully amortizing with monthly loan payments, and adjustable-rate mortgage loans that amortize over a period of up to 30 years, provide an initial fixed interest rate for one, three, or five years and then adjust annually. The Association originates fixed-rate mortgage loans with terms of less than 15 years, but at rates applicable

to our

15-year loans. It also offers interest only loans, where the borrower pays interest for an initial period (one, three or five years), after which the loan converts to a fully amortizing loan. The Association s Lowest Rate Guarantee program provides that, subject to the terms and conditions of the guarantee program, if a loan applicant finds a lower fixed interest rate on a residential real estate mortgage loan than the rate the Association offers, the Association will offer a lower rate or, after the applicant closes a loan with another lender at the lower interest rate, pay the loan applicant $1,000.

Residential real estate mortgage loans are generally underwritten according to Fannie Mae guidelines, and the Association refers to loans that conform to such guidelines as conforming loans. The Association generally originates both fixed- and adjustable-rate mortgage loans in amounts up to the maximum conforming loan limits as established by the Office of Federal Housing Enterprise Oversight, which is currently $417,000 for single-family homes in most of our lending markets. The Association also originates loans above the lending limit for conforming loans, which the Association refers to as jumbo loans. The Association generally underwrites jumbo loans in a manner similar to conforming loans. These jumbo loans are generally eligible for sale to various firms that specialize in purchasing non-conforming loans although activity in the market for jumbo loans has decreased dramatically during 2008. Jumbo loans are not uncommon in the Association s market areas.

The Association has always considered the promotion of home ownership a primary goal. In that regard, it offers affordable housing programs in all of its market areas. These programs are targeted toward low- and moderate-income home buyers. The Association s primary program is called Home Today and is described in detail below. Recently, attention has focused on sub-prime lending and its negative effect on borrowers and financial markets alike. Borrowers in the Home Today program are not charged higher fees or interest rates than non-Home Today borrowers. These loans are not interest only or negative amortizing and contain no low initial payment features or adjustable interest rates, features often associated with sub-prime lending. While the credit risk profiles of the Association s Home Today borrowers are generally higher risk than the credit risk profiles of its non-Home Today borrowers, the Association attempts to mitigate that higher risk through the use of private mortgage insurance and continued pre- and post-purchase counseling. The Association s philosophy has been to provide borrowers the opportunity for home ownership within their financial means. While the Home Today Program does have a higher risk characteristic, the Association does not classify it as a sub-prime lending program based on the exclusion provided to community development loans in the Office of Thrift Supervision s *Expanded Guidance for Sub-prime Lending*.

Through the Association s Home Today program, the Association originates loans with its standard terms to borrowers who might not otherwise qualify for such loans. To qualify for the Association s Home Today program, a borrower 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 meet a minimum credit score threshold. The Association will originate loans with a loan-to-value ratio of up to 95% through its Home Today program, provided that any loan originated through this program with a loan-to-value ratio in excess of 80% must meet the underwriting criteria mandated by its private mortgage insurance carrier. Because the Association applies less stringent underwriting and credit standards to these loans, loans originated under the Home Today program have greater credit risk than traditional residential real estate mortgage loans. Effective October 2007, the private mortgage insurance carrier that provides coverage for the Home Today loans with loan-to-value ratios in excess of 80% has imposed more restrictive lending requirements that have already decreased the volume of Home Today lending, which we expect will continue through 2009. As of September 30, 2008, the Association had $303.2 million of loans outstanding that were originated through its Home Today program. See Non-performing and Problem Assets Delinquent Loans for a discussion of the asset quality of this portion of the Association s loan portfolio.

The Association also originates loans under its High LTV program. These loans have loan-to-value ratios of 90% or greater, and may be as high as 95%. To qualify for this program, the loan applicant must satisfy more stringent underwriting criteria (credit score, income qualification, and other criteria). Borrowers do not obtain private mortgage insurance with respect to these loans. High LTV loans are originated with higher interest rates

than the Association s other residential real estate loans. The higher credit quality of this portion of the Association s portfolio offsets the risk of not requiring private mortgage insurance. While these loans are not initially covered by private mortgage insurance, the Association has negotiated with a private mortgage insurance carrier a contract under which, at the Association s option, a pre-determined dollar amount of qualifying loans may be grouped and submitted to the carrier for pooled private mortgage insurance coverage. As of September 30, 2008, the Association had $392.5 million of loans outstanding that were originated through its High LTV program, $340.9 million of which the Association has insured through a mortgage insurance carrier.

For loans with loan-to-value ratios in excess of 80% but lower than 90%, the Association requires either private mortgage insurance or a higher interest rate. For loans with loan-to-value ratios of 90% that are not its High LTV loans, the Association requires private mortgage insurance.

The Association actively monitors its interest rate risk position to determine the desirable level of investment in fixed-rate mortgages. Depending on market interest rates and its capital and liquidity positions, the Association may retain all of its newly originated longer-term fixed-rate residential mortgage loans, the Association may sell all or a portion of such loans in the secondary mortgage market to governmental entities such as Fannie Mae or other purchasers, or the Association may securitize such loans by selling the loans in exchange for mortgage-backed securities. These securities can be sold more readily to meet its liquidity or interest rate risk management needs, and have a lower risk-weight than the underlying loans, which reduces the Association s regulatory capital requirements. Almost all of the loans that the Association securitizes are fixed-rate mortgage loans.

During the financial market upheaval of 2008, concern arose about the financial health of Fannie Mae and Freddie Mac, the value of their guarantees and therefore the continued existence of the secondary market for mortgage loans upon which the Association relies for liquidity and interest rate risk management. This market was preserved when, in September 2008, the Federal Housing Finance Agency placed Fannie Mae and Freddie Mac into conservatorship. Shortly after taking control, the U.S. Treasury Department established financing agreements to ensure Fannie Mae and Freddie Mac meet their obligations to holders of mortgage-backed securities that they have issued or guaranteed.

During periods of low market interest rates, the Association may sell a substantial portion of its newly originated fixed-rate residential real estate mortgage loans. The Association currently retains the servicing rights on all loans sold in order to generate fee income and reinforce its commitment to customer service. For the fiscal year ended September 30, 2008, the Association received servicing fees related to these servicing rights of $21.5 million. As of September 30, 2008, the principal balance of loans serviced for others totaled $6.93 billion.

The Association currently offers several adjustable-rate mortgage loan products secured by residential properties with interest rates that are fixed for an initial period ranging from one year to five years. The Association also offers adjustable-rate mortgage loans that are fully-amortizing and that provide for the repayment of interest, and not principal (interest only loans), during an initial period. After the initial fixed period, the interest rate on adjustable-rate mortgage loans is generally reset every year based upon a contractual spread or margin above the average yield on U.S. Treasury securities, adjusted to a constant maturity of one year, as published weekly by the Federal Reserve Board, subject to periodic and lifetime limitations on interest rate changes. All of its interest only loans and its traditional adjustable-rate mortgage loans with initial fixed-rate periods of one, three or five years have initial and periodic caps of two percentage points on interest rate changes, with a cap of six percentage points for the life of the loan. Interest only loans are not available for initial fixed periods of more than five years. Previously, the Association offered adjustable-rate mortgage loans with an initial fixed-rate period of seven years. Loans originated under that program have an initial cap of five percentage points on the changes in interest rate, with a two percentage point cap on subsequent changes and a cap of five percentage points for the life of the loan. Many of the borrowers who select adjustable-rate mortgage loans have shorter-term credit needs than those who select long-term, fixed-rate mortgage loans. The Association will permit borrowers to convert adjustable-rate mortgage loans into fixed-rate mortgage loans at no cost to the borrower.

The Association does not offer Option ARM loans, where borrowers can pay less than the interest owed on their loan, resulting in an increased principal balance during the life of the loan.

Adjustable-rate mortgage loans generally present different credit risks than fixed-rate mortgage loans primarily because the underlying debt service payments of the borrowers increase as interest rates increase, thereby increasing the potential for default. Interest-only loans present different credit risks than fully amortizing loans, as the principal balance of the loan does not decrease during the interest-only period. As a result, the Association s exposure to loss of principal in the event of default does not decrease during this period. These adjustable rate, interest only, loans comprise less than 3% of our residential loans and have historically not been popular with consumers during periods of volatile interest rates, such as we expect in the next twelve months.

The Association requires title insurance on all of its residential real estate mortgage loans, and the Association also requires that borrowers maintain fire and extended coverage casualty insurance (and, if appropriate, flood insurance) in an amount at least equal to the lesser of the loan balance or the replacement cost of the improvements. A majority of its residential real estate mortgage loans have a mortgage escrow account from which disbursements are made for real estate taxes and flood insurance. The Association does not conduct environmental testing on residential real estate mortgage loans unless specific concerns for hazards are identified by the appraiser used in connection with the origination of the loan.

Equity Loans and Equity Lines of Credit. The Association offers equity loans and equity lines of credit, which are primarily secured by a second mortgage on residences. The Association also offers an equity lending product that is secured by a third mortgage; although the Association only originates this loan to borrowers where the Association also holds the second mortgage. At September 30, 2008, equity loans totaled $243.8 million, or 2.6%, of total loans receivable, and equity lines of credit totaled $2.24 billion, or 24.1%, of total loans receivable. Additionally, at September 30, 2008, the unadvanced amounts of equity lines of credit totaled $2.41 billion. The Association s equity lending products include bridge loans, where a borrower can utilize the existing equity in their current home to fund the purchase of a new home before the current home is sold. As of September 30, 2008, bridge loans totaled $42.0 million, or 0.5% of total loans receivable, which is included in the total for equity loans, above.

The underwriting standards for equity loans and equity lines of credit include an evaluation of the applicant s credit history, an assessment of the applicant s ability to meet existing obligations and payments on the proposed loan and the value of the collateral securing the loan. In the fall of 2007, the combined loan-to-value ratio (first and second mortgage liens) for equity loans and equity lines of credit was reestablished at a limit of 85%, (from a limit of 89.99% that was generally in effect from the spring of 2006 through the fall of 2007). The Association originates its equity loans and equity lines of credit without application fees (except for bridge loans) or borrower-paid closing costs. Equity loans are offered with fixed interest rates, are fully amortizing and have terms of up to 15 years. The Association s equity lines of credit are offered with adjustable rates of interest indexed to the prime rate, as reported in *The Wall Street Journal*. The Association s Lowest Rate Guarantee program provides that, subject to the terms and conditions of the guarantee program, if a loan applicant or current equity line of credit borrower finds and qualifies for a better interest rate on a similar product with another lender, the Association will offer a lower rate or, if they close under the rate and terms presented with respect to the other lender, the Association will pay the loan applicant or borrower $1,000.

Bridge loans are originated for a one-year term, with no prepayment penalties. These loans have fixed interest rates, and are limited to a combined 85% loan-to-value ratio (first and second mortgage liens). The Association charges a closing fee with respect to bridge loans.

Construction Loans. The Association originates construction loans for the purchase of developed lots and for the construction of single-family residences. Construction loans are offered to individuals for the construction of their personal residences by a qualified builder (construction/permanent loans), and to qualified builders (builder loans). At September 30, 2008, construction loans totaled $115.3 million, or 1.2% of total loans receivable. At September 30, 2008, the unadvanced portion of these construction loans totaled $46.5 million.

The Association s construction/permanent loans generally provide for disbursements to the builder or sub-contractors during the construction phase as work progresses. During the construction phase, the borrower only pays interest on the drawn balance. Upon completion of construction, the loan converts to a permanent amortizing loan without the expense of a second closing. The Association offers construction/permanent loans with fixed or adjustable rates, and a maximum loan-to-completed-appraised value ratio of 95%. At September 30, 2008, the Association s construction/permanent loans totaled $62.4 million, or 0.7% of total loans receivable.

The Association s builder loans consist of loans for homes that have been pre-sold as well as loans to developers that build homes before a buyer has been identified. The Association does not make land loans to developers for the acquisition and development of raw land. Construction loans to developers are limited to an 85% loan-to-completed-appraised value ratio for homes that are under contract for purchase and a 75% loan-to-completed-appraised value ratio for loans where no buyer has been identified. The interest rates are based on and adjust with the prime rate of interest, and are for terms of up to two years. As of September 30, 2008, the Association s builder loans totaled $52.9 million, or 0.6% of total loans receivable.

Before making a commitment to fund a construction loan, the Association requires an appraisal of the property by an independent licensed appraiser. The Association generally also reviews and inspects each property before disbursement of funds during the term of the construction loan.

Construction financing generally involves greater credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost (including interest) of construction and other assumptions. If the estimate of construction cost proves to be inaccurate, the Association may be required to advance additional funds beyond the amount originally committed in order to protect the value of the property. Moreover, if the estimated value of the completed project proves to be inaccurate, the borrower may hold a property with a value that is insufficient to assure full repayment of the construction loan upon the sale of the property. This is more likely to occur in a recession where home prices are falling, like our current economic environment.

Loan Originations, Purchases, Sales, Participations and Servicing. Lending activities are conducted primarily by the Association s loan personnel (all of whom are salaried employees) operating at our main and branch office locations and at our loan production offices. All loans that the Association originates are underwritten pursuant to its policies and procedures, which incorporate Fannie Mae underwriting guidelines to the extent applicable. The Association originates both adjustable-rate and fixed-rate loans. Its ability to originate fixed- or adjustable-rate loans is dependent upon the relative customer demand for such loans, which is affected by current market interest rates as well as anticipated future market interest rates. The Association s loan origination and sales activity may be adversely affected by a rising interest rate environment or economic recession, which typically results in decreased loan demand. Most of the Association s residential real estate mortgage loan originations are generated by its in-house loan representatives, by referrals from existing or past customers, by referrals from local builders and real estate brokers, from calls to its telephone call center and from the internet. The Association has a relationship with only one mortgage broker, which is affiliated with a national builder. During the fiscal year ended September 30, 2008, the Association originated $53.1 million of loans through this relationship. All such loans are underwritten to conform to the Association s loan underwriting policies and procedures. The Association also advertises extensively throughout its market area.

The Association decides whether to retain the loans that it originates, sell loans in the secondary market or securitize loans after evaluating current and projected market interest rates, its interest rate risk objectives, its liquidity needs and other factors. The Association securitized and sold $744.7 million of residential real estate mortgage loans (all fixed-rate loans, and primarily with 30-year terms) during the fiscal year ended September 30, 2008, and it held $200.7 million of loans for sale in the secondary market at September 30, 2008. The fixed-rate mortgage loans that the Association originated and retained during the fiscal year ended September 30, 2008 consisted primarily of loans with 30-year terms. As discussed earlier, the recent government

support of Fannie Mae and Freddie Mac has addressed concerns about guarantees and the Association expects to continue to be able to securitize and sell loans.

The Association primarily sells its loans without recourse. Historically, the Association has retained the servicing rights on all residential real estate mortgage loans that it has sold, and intends to continue this practice in the future. At September 30, 2008, the Association serviced loans owned by others with a principal balance of $6.93 billion. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent borrowers, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans. The Association retains a portion of the interest paid by the borrower on the loans it services as consideration for its servicing activities. The Association did not enter into any loan participations during the fiscal year ended September 30, 2008 and is not expected to do so in the near future.

Loan Approval Procedures and Authority. The Association s lending activities follow written, non-discriminatory underwriting standards and loan origination procedures established by its board of directors. The loan approval process is intended to assess the borrower s ability to repay the loan and the value of the property that will secure the loan. To assess the borrower s ability to repay, the Association reviews the borrower s employment and credit history and information on the historical and projected income and expenses of the borrower.

The Association s policies and loan approval limits are established by its board of directors. The Association s board of directors has delegated authority to its Executive Committee (consisting of the Association s Chief Executive Officer and two directors) to review and assign lending authorities to certain individuals of the Association to consider and approve loans within their designated authority. Residential real estate mortgage loans and construction loans in amounts above $650,000 require the approval of two individuals with designated underwriting authority. Loans in amounts below $650,000, including equity loans and equity lines of credit (which the Association caps at $200,000) require the approval of one individual with designated underwriting authority. All loans that are approved by designated individuals are reviewed and ratified by the Executive Committee on a weekly basis.

The Association also maintains automated underwriting systems for point-of-sale approvals of residential real estate mortgage loans, equity loans and equity lines of credit. Applications for loans in amounts no greater than the conforming loan limit that meet certain credit and income criteria may receive a full approval with respect to the amount of credit available and the subject property. If the property securing the loan cannot be valued using an automated valuation model, the borrower may receive a credit approval only. Applications for loan amounts in excess of the conforming loan limit may only receive a credit approval, subject to an appraisal of the subject property.

The Association generally requires independent third-party appraisals of real property securing loan amounts in excess of $250,000, although the Association may rely on alternative property valuation methods for loans up to the conforming loan limit. The Association obtains valuations or appraisals for all loans even if an appraisal is not required. The Association uses an automated valuation model to value most loans of $250,000 or less. Appraisals are performed by independent licensed appraisers. All appraisers are reviewed and approved by the Association s board of directors annually.

Non-performing and Problem Assets. Within 15 days of a borrower s delinquency, the Association attempts personal, direct contact with the borrower to determine the reason for the delinquency, to ensure that the borrower correctly understands the terms of the loan and to emphasize the importance of making payments on or before the due date. If necessary, subsequent late charges and delinquent notices are issued and the borrower s account will be monitored on a regular basis thereafter. The Association also mails system-generated reminder notices on a monthly basis. When a loan is more than 30 days past due, the Association attempts to contact the borrower and develop a plan of repayment. By the 90th day of delinquency, the Association may recommend foreclosure. By this date, if a repayment agreement has not been established, or if an agreement is established but

Table of Contents

is subsequently broken, the borrower s credit file is reviewed and, if considered necessary, information is updated or confirmed and the property securing the loan is re-evaluated. A summary report of all loans 30 days or more past due is provided to the Association s board of directors.

Loans are automatically placed on non-accrual status when payment of principal or interest is more than 90 days delinquent. Loans are also placed on non-accrual status if collection of principal or interest in full is in doubt or if the loan has been restructured. When loans are placed on a non-accrual status, unpaid accrued interest is fully reversed, and further income is recognized only to the extent received. The loan may be returned to accrual status if unpaid principal and interest are repaid so that the loan is less than 90 days delinquent.

Non-Performing Assets. The table below sets forth the amounts and categories of our non-performing assets at the dates indicated.

	At September 30,				
	2008	2007	2006	2005	2004
	(Dollars in thousands)				
Non-accrual loans:					
Real estate loans:					
Residential non-Home Today	$ 43,935	$ 21,746	$ 22,420	$ 21,527	$ 20,542
Residential Home Today	63,679	55,653	40,153	25,724	9,335
Equity loans and lines of credit(1)	54,430	31,467	15,867	13,220	7,725
Construction	10,842	4,659	1,266	630	679
Commercial					13
Consumer loans:					
Automobile			3	33	23
Other				5	16
Total non-performing loans	172,886	113,525	79,709	61,139	38,333
Real estate owned	14,108	9,903	6,895	6,308	1,480
Other non-performing assets					
Total non-performing assets	$ 186,994	$ 123,428	$ 86,604	$ 67,447	$ 39,813
Troubled debt restructurings:					
Real estate loans:					
Residential non-Home Today	$ 643	$	$	$ 157	$ 69
Residential Home Today	226				
Equity loans and lines of credit(1)					
Construction					
Commercial					
Consumer loans:					
Automobile					
Other					
Total	$ 869	$	$	$ 157	$ 69
Ratios:					
Total non-performing loans to total loans	1.86%	1.39%	1.05%	0.78%	0.52%
Total non-performing loans to total assets	1.60%	1.10%	0.93%	0.69%	0.45%
Total non-performing assets to total assets	1.73%	1.20%	1.01%	0.76%	0.47%

(1) Includes bridge loans.

For the year ended September 30, 2008, gross interest income that would have been recorded had the non-accruing loans been current in accordance with their original terms was $2.8 million. Interest income recognized on such loans for the year ended September 30, 2008 was not material. See Delinquent Loans.

14

Table of Contents

Delinquent Loans. The following table sets forth loan delinquencies by type and by amount at the dates indicated.

	Loans Delinquent For					
	30-89 Days		90 Days and Over		Total	
	Number(1)	Amount	Number(1)	Amount	Number(1)	Amount
			(Dollars in thousands)			
At September 30, 2008						
Real estate loans:						
Residential non-Home Today	287	$ 31,385	422	$ 43,935	709	$ 75,320
Residential Home Today	330	30,018	688	63,679	1,018	93,697
Equity loans and lines of credit(2)	546	26,704	796	54,430	1,342	81,134
Construction	4	758	57	10,842	61	11,600
Commercial						
Consumer loans:						
Automobile	4	3			4	3
Other						
Total	1,171	$ 88,868	1,963	$ 172,886	3,134	$ 261,754
At September 30, 2007						
Real estate loans:						
Residential non-Home Today	278	$ 23,276	244	$ 21,746	522	$ 45,022
Residential Home Today	292	26,775	600	55,653	892	82,428
Equity loans and lines of credit(2)	536	24,795	500	31,467	1,036	56,262
Construction	5	595	30	4,659	35	5,254
Commercial						
Consumer loans:						
Automobile	20	95			20	95
Other						
Total	1,131	$ 75,536	1,374	$ 113,525	2,505	$ 189,061
At September 30, 2006						
Real estate loans:						
Residential non-Home Today	235	$ 18,337	280	$ 22,420	515	$ 40,757
Residential Home Today	309	29,107	431	40,153	740	69,260
Equity loans and lines of credit(2)	500	23,447	290	15,867	790	39,314
Construction	5	595	12	1,266	17	1,861
Commercial						
Consumer loans:						
Automobile	53	365	1	3	54	368
Other						
Total	1,102	$ 71,851	1,014	$ 79,709	2,116	$ 151,560
At September 30, 2005						
Real estate loans:						
Residential non-Home Today	250	$ 19,099	295	$ 21,527	545	$ 40,626
Residential Home Today	296	27,275	280	25,274	576	52,549
Equity loans and lines of credit(2)	432	17,819	264	13,220	696	31,039
Construction			6	630	6	630
Commercial						
Consumer loans:						
Automobile	55	554	8	33	63	587
Other			1	5	1	5
Total	1,033	$ 64,747	854	$ 61,139	1,887	$ 125,885
At September 30, 2004						

Real estate loans:						
Residential non-Home Today	167	$ 11,234	277	$ 20,542	444	$ 31,776
Residential Home Today	169	15,209	101	9,335	270	24,544
Equity loans and lines of credit(2)	305	11,419	142	7,725	447	19,144
Construction	7	1,061	6	679	13	1,740
Commercial	1	7	3	13	4	20
Consumer loans:						
Automobile	112	1,135	2	23	114	1,158
Other	14	73	8	16	22	89
Total	775	$ 40,138	539	$ 38,333	1,314	$ 78,471

(1) Number of delinquent loans at September 30, 2004 does not reflect information with respect to Ohio Central Savings, a subsidiary sold in March 2005; as such information is not available. Amount of delinquent loans includes information with respect to Ohio Central Savings.

(2) Includes bridge loans.

Table of Contents

Our equity loans and lines of credit portfolio consist of $201.8 million in equity loans, $42.0 million in bridge loans and $2.24 billion in equity lines of credit. The following table sets forth committed and drawn amounts, percent delinquent 90 days or more and the mean combined loan-to-value (CLTV) percent at the time of origination of our equity line of credit portfolio by geographical distribution as of September 30, 2008:

State	Committed Amount	Drawn Amount	Percent Delinquent 90 days or more	Mean CLTV Percent at Origination
	(Dollars in thousands)			
Ohio	$ 2,149,095	$ 904,322	1.59%	67%
Florida	1,331,460	706,173	3.08%	64%
California	588,038	282,925	0.69%	68%
Other(1)	663,238	350,868	2.60%	72%
Total	$ 4,731,831	$ 2,244,288	2.10%	67%

(1) No individual state has a committed or drawn balance greater than 3% of the total.

The following table represents committed and drawn amounts, percent delinquent 90 days or more and the mean CLTV percent at the time of origination of our equity line of credit portfolio by the year originated as of September 30, 2008:

Year Originated	Committed Amount	Drawn Amount	Percent Delinquent 90 days or more	Mean CLTV Percent at Origination
	(Dollars in thousands)			
2000 and prior	$ 599,196	$ 246,545	2.55%	65%
2001	223,587	112,919	4.31%	70%
2002	344,863	150,689	2.91%	66%
2003	591,748	267,417	2.36%	71%
2004	327,827	143,866	3.04%	69%
2005	231,078	108,626	5.12%	69%
2006	527,563	270,962	4.13%	68%
2007	763,515	414,131	1.01%	69%
2008	1,122,454	529,133	0.00%	61%
Total	$ 4,731,831	$ 2,244,288	2.10%	67%

In the early months of the calendar year 2008, we noted unfavorable trends in our primary lending markets, including but not limited to instability in employment and economic prospects, record residential foreclosure rates, further unfavorable trending of our equity line of credit delinquency level, and a steepening decline in residential housing values, linked, we believe, to the wholesale dumping of foreclosed housing stock by national mortgage lenders attempting to raise cash and maintain liquidity. In light of these events, beginning as of June 30, 2008 and prospectively, we have conducted an expanded loan level evaluation of our equity lines of credit which are delinquent 90 days or more. As a result of this evaluation process, we increased our allowance for loan losses related to equity lines of credit by $15.0 million during the fiscal year ended September 30, 2008. We expect that, as these delinquencies of 90 days or more are resolved, and contingent upon future delinquency trends, we may realize an increase in net charge-offs related to equity lines of credit that will be applied against the allowance and could result in a net reduction in the balance of the allowance for loan losses.

Loans originated under the Home Today program, where the Association provides loans with its standard terms to borrowers who might not otherwise qualify for such loans, have greater credit risk than traditional residential real estate mortgage loans. At September 30, 2008, we had $303.2 million of loans that were

originated under the Home Today program, 30.9% of which were delinquent 30 days or more in repayments, compared to 1.2% for the portfolio of non-Home Today loans as of that date. At September 30, 2008, $63.7 million of loans originated under the Home Today program were non-accruing loans, representing 36.8% of total non-accruing loans as of that date.

Real Estate Owned. Real estate acquired as a result of foreclosure or by deed in lieu of foreclosure is classified as real estate owned until sold. When property is acquired it is recorded at the lower of cost or estimated fair market value at the date of foreclosure, establishing a new cost basis. Estimated fair value generally represents the sale price a buyer would be willing to pay on the basis of current market conditions, including normal terms from other financial institutions, less the estimated costs to sell the property. Holding costs and declines in estimated fair market value result in charges to expense after acquisition. At September 30, 2008, we had $14.1 million in real estate owned. For additional discussion see Management s Discussion and Analysis of Financial Condition and Results of Operation.

Classification of Assets. Our policies, consistent with regulatory guidelines, provide for the classification of loans and other assets that are considered to be of lesser quality as substandard, doubtful, or loss assets. An asset is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those assets characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Assets (or portions of assets) classified as loss are those considered uncollectible and of such little value that their continuance as assets is not warranted. Assets that do not expose us to risk sufficient to warrant classification in one of the aforementioned categories, but which possess potential weaknesses that deserve our close attention, are required to be designated as special mention.

When we classify assets as either substandard or doubtful, we allocate a portion of the related general loss allowances to such assets as we deem prudent. The allowance for loan losses is the amount estimated by management as necessary to absorb credit losses incurred in the loan portfolio that are both probable and reasonably estimable at the balance sheet date. When we classify a problem asset as loss, we provide a specific reserve for that portion of the asset that is uncollectible. Our determination as to the classification of our assets and the amount of our loss allowances are subject to review by our principal federal regulator, the Office of Thrift Supervision, which can require that we establish additional loss allowances. We regularly review our asset portfolio to determine whether any assets require classification in accordance with applicable regulations. On the basis of our review of our assets at September 30, 2008, classified assets consisted of substandard assets of $160.8 million, doubtful assets of $7.5 million and loss assets of $22.8 million. As of September 30, 2008, we did not have any individual assets classified as substandard with balances exceeding $1 million. The classified assets total includes $172.9 million of nonperforming loans, $14.1 million of real estate owned, and $4.1 million of performing loans displaying a weakness sufficient to warrant an adverse classification. As of September 30, 2008, we had $26.0 million of assets designated as special mention.

Impaired 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. During the year ended September 30, 2008 in response to rapidly declining home values, the Company changed the population of loans that it individually evaluates for impairment to include real estate secured loans 180 days or more past due, except equity lines of credit which it evaluates at 90 or more days past due. Large groups of smaller balance homogeneous loans are combined and collectively evaluated by portfolio for impairment. For a collateral dependent loan, impairment is measured based on the fair value of the collateral. For a loan whose terms are modified in a troubled debt restructuring, the Company measures impairment based on the present value of expected future cash flows discounted at the loan s effective interest rate, where the loan s effective interest rate is based on the contractual rate of the original loan, not the terms of the restructuring. When the recorded investment of an impaired loan exceeds the fair value of the

collateral (or the present value of its expected future cash flows), a valuation allowance is established for the excess. For additional information regarding impaired loans, see footnote 5 in Item 15 (a)(1) Financial Statements.

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. The allowance for loan losses consists of three components:

(1) specific allowances established for any impaired loans for which the recorded investment in the loan exceeds the measured value of the collateral or, alternatively, the present value of expected future cash flows for the loan;

(2) general allowances for loan losses for each loan type based on historical loan loss experience; and

(3) adjustments to historical loss experience (general allowances), maintained to cover uncertainties that affect our estimate of probable losses for each loan type.

The adjustments to historical loss experience are based on our evaluation of several factors, including:

- delinquency statistics (both current and historical) and the factors behind delinquency trends;
- the status of loans in foreclosure, real estate in judgment and real estate owned;
- the composition of the loan portfolio;
- national, regional and local economic factors;
- asset disposition loss statistics (both current and historical); and
- the current status of all assets classified during the immediately preceding meeting of the Asset Classification Committee.

We evaluate the allowance for loan losses based upon the combined total of the specific, historical loss and general components. 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.

As described in Non-performing and Problem Assets Delinquent Loans, loans originated under the Home Today program have greater credit risk than traditional residential real estate mortgage loans. At September 30, 2008, we had $303.2 million of loans that were originated under our Home Today program, 30.9% of which were delinquent 30 days or more in repayments, compared to 1.2% for our portfolio of non-Home Today loans as of that date.

Construction loans generally have greater credit risk than traditional residential real estate mortgage loans. The repayment of these loans depends upon the sale of the property to third parties or the availability of permanent financing upon completion of all improvements. In the event we make a loan on property that is not yet approved for the planned development, there is the risk that approvals will not be granted or will

be delayed. These events may adversely affect the borrower and the collateral value of the property. Construction loans also expose us to the risk that improvements will not be completed on time in accordance with specifications and projected costs. In addition, the ultimate sale or rental of the property may not occur as anticipated.

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 adjustments to the allowance may be necessary if

Table of Contents

conditions differ substantially from the information used in making the evaluations. In addition, as an integral part of its examination process, the Office of Thrift Supervision periodically reviews the allowance for loan losses. The Office of Thrift Supervision may require us to recognize additions to the allowance based on its analysis of information available to it at the time of its examination. For more on loan losses, see Management s Discussion and Analysis of Financial Condition and Results of Operation.

The following table sets forth activity in our allowance for loan losses for the fiscal years indicated.

	At or For the Years Ended September 30,				
	2008	**2007**	**2006**	**2005**	**2004**
	(Dollars in thousands)				
Allowance balance (beginning of year)	$ 25,111	$ 20,705	$ 18,601	$ 15,080	$ 11,932
Charge-offs:					
Real estate loans:					
Residential non-Home Today	4,999	1,248	487	468	307
Residential Home Today	4,283	1,118	1,434	11	
Equity loans and lines of credit(1)	6,187	2,839	2,631	1,750	1,875
Construction	598				
Commercial		517			
Consumer loans:					
Automobile	8	9	51		16
Other		7		59	63
Total charge-offs	16,075	5,738	4,603	2,288	2,261
Recoveries:					
Real estate loans:					
Residential non-Home Today	128	271	89		
Residential Home Today	117	251	49		
Equity loans and lines of credit(1)	8	22	519		175
Construction					
Commercial					
Consumer loans:					
Automobile					3
Other	7			2	18
Total recoveries	260	544	657	2	196
Net charge-offs	(15,815)	(5,194)	(3,946)	(2,286)	(2,065)
Reduction due to sale of subsidiary					