Capitol Federal Financial Inc
Form 10-Q
August 04, 2011

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

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2011

or

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

Commission file number: 001-34814

Capitol Federal Financial, Inc.
(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)

27-2631712 (I.R.S. Employer Identification No.)

700 Kansas Avenue, Topeka, Kansas (Address of principal executive offices)

66603 (Zip Code)

Registrant's telephone number, including area code:
(785) 235-1341

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 requirements for the past 90 days. Yes þ 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes þ 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 definition of "accelerated filer, large accelerated filer, and smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

As of July 29, 2011, there were 167,498,133 shares of Capitol Federal Financial, Inc. Common Stock outstanding.

PART I -- FINANCIAL INFORMATION

Item 1. Financial Statements

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS (Unaudited)

(Dollars in thousands)

	June 30, 2011	September 30, 2010
ASSETS:		
Cash and cash equivalents (includes interest-earning deposits of $143,446 and $50,771)	$161,872	$65,217
Securities:		
Available-for-sale ("AFS") at estimated fair value (amortized cost of $1,225,848 and $1,009,142)	1,269,987	1,060,366
Held-to-maturity ("HTM") at amortized cost (estimated fair value of $2,739,016 and $1,913,454)	2,693,719	1,880,154
Loans receivable, net (of allowance for credit losses ("ACL") of $14,856 and $14,892)	5,162,846	5,168,202
Bank-owned life insurance ("BOLI")	56,059	54,710
Capital stock of Federal Home Loan Bank ("FHLB"), at cost	125,797	120,866
Accrued interest receivable	31,351	30,220
Premises and equipment, net	46,890	41,260
Real estate owned ("REO"), net	10,064	9,920
Income taxes receivable, net	--	716
Other assets	43,872	55,499
TOTAL ASSETS	$9,602,457	$8,487,130
LIABILITIES:		
Deposits	$4,558,574	$4,386,310
Advances from FHLB, net	2,453,642	2,348,371
Other borrowings	565,000	668,609
Advance payments by borrowers for taxes and insurance	31,019	55,036
Income taxes payable	9,579	--
Deferred income tax liabilities, net	19,986	33,244
Accounts payable and accrued expenses	30,646	33,610
Total liabilities	7,668,446	7,525,180
STOCKHOLDERS' EQUITY:		
Preferred stock ($0.01 par value) 100,000,000 shares authorized; none issued	--	--
Common stock ($0.01 par value) 1,400,000,000 shares authorized, 167,498,133		
shares issued; 167,498,133 and 73,992,678 shares outstanding		
as of June 30, 2011 and September 30, 2010, respectively	1,675	915
Additional paid-in capital	1,391,860	457,795
Unearned compensation, Employee Stock Ownership Plan ("ESOP")	(51,290)	(6,050)
Unearned compensation, Recognition and Retention Plan ("RRP")	(155)	(255)
Retained earnings	564,467	801,044
Accumulated other comprehensive income ("AOCI"), net of tax	27,454	31,862
Less shares held in treasury (0 and 17,519,609 shares as of June 30, 2011		

and September 30, 2010, respectively, at cost)	--	(323,361)
Total stockholders' equity	1,934,011	961,950
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$9,602,457	$8,487,130

See accompanying notes to consolidated financial statements.

<Index>

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(Dollars in thousands, except share and per share data)

	For the Three Months Ended June 30,		For the Nine Months Ended June 30,	
	2011	2010	2011	2010
INTEREST AND DIVIDEND INCOME:				
Loans receivable	$62,393	$68,990	$189,890	$213,831
Mortgage-backed securities ("MBS")	19,619	16,864	52,379	56,245
Investment securities	5,103	4,565	14,621	10,850
Capital stock of FHLB	925	1,005	2,710	2,991
Cash and cash equivalents	43	61	671	162
Total interest and dividend income	88,083	91,485	260,271	284,079
INTEREST EXPENSE:				
FHLB advances	22,539	24,417	67,638	73,535
Deposits	15,516	19,149	48,966	61,030
Other borrowings	5,720	7,032	18,798	21,090
Total interest expense	43,775	50,598	135,402	155,655
NET INTEREST INCOME	44,308	40,887	124,869	128,424
PROVISION FOR CREDIT LOSSES	1,240	1,816	2,410	8,131
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	43,068	39,071	122,459	120,293
OTHER INCOME:				
Retail fees and charges	3,961	4,681	11,465	13,617
Insurance commissions	548	573	2,254	1,908
Loan fees	589	670	1,865	1,925
Income from BOLI	512	351	1,348	842
Gain on securities, net	--	--	--	6,454
Other income, net	490	1,479	1,629	2,675
Total other income	6,100	7,754	18,561	27,421
OTHER EXPENSES:				
Salaries and employee benefits	12,046	10,858	33,104	32,197
Communications, information technology, and occupancy	4,168	3,703	12,021	11,499
Federal insurance premium	1,158	1,835	4,144	5,494
Deposit and loan transaction costs	1,033	1,238	3,659	3,934
Regulatory and outside services	1,243	927	3,571	3,369
Advertising and promotional	1,110	1,295	2,634	4,276
Contribution to Capitol Federal Foundation (“Foundation”)	--	--	40,000	--

Other expenses, net	2,344	768	10,162	5,704
Total other expenses	23,102	20,624	109,295	66,473
INCOME BEFORE INCOME TAX EXPENSE	26,066	26,201	31,725	81,241
INCOME TAX EXPENSE	8,807	9,443	10,088	28,848
NET INCOME	$17,259	$16,758	$21,637	$52,393

(Continued)

	For the Three Months Ended June 30,		For the Nine Months Ended June 30,	
	2011	2010	2011	2010
Basic earnings per common share	$0.10	$0.10	$0.13	$0.32
Diluted earnings per common share	$0.10	$0.10	$0.13	$0.32
Dividends declared per public share	$0.08	$0.50	$1.55	$1.79
Basic weighted average common shares	161,641,630	165,869,158	162,908,873	165,819,456
Diluted weighted average common shares	161,647,914	165,922,703	162,916,379	165,869,015

(Concluded)

See accompanying notes to consolidated financial statements.

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(Unaudited)
(Dollars in thousands)

	Common Stock	Additional Paid-In Capital	Unearned Compensation- ESOP	Unearned Compensation- RRP	Retained Earnings	AOCI (Loss)	Treasury Stock	Total Stockholders' Equity
Balance at October 1, 2010	$ 915	$ 457,795	$ (6,050)	$ (255)	$ 801,044	$ 31,862	$ (323,361)	$ 961,950
Comprehensive income:								
Net income					21,637			21,637
Other comprehensive (loss) income:								
Changes in unrealized gain/losses on securities AFS, net of deferred income taxes of $2,677						(4,408)		(4,408)
Total comprehensive income								17,229
ESOP activity, net		2,470	2,020					4,490
RRP activity, net		(4)						(4)
Stock based compensation - stock options and RRP		89		100				189
Stock options exercised		42						42
Dividends on common stock to stockholders $1.55 per share					(138,004)			(138,004)
Corporate reorganization:								
Merger of Capitol Federal Savings Bank MHC	(522)	1,997			(1,223)			252
Retirement of treasury stock	(175)	(204,199)			(118,987)		323,361	--

Exchange of common stock	276	(323)						(47)
Proceeds from stock offering, net of offering expenses	1,181	1,133,993						1,135,174
Purchase of common stock by ESOP			(47,260)					(47,260)
Balance at June 30, 2011	$ 1,675	$ 1,391,860	$ (51,290)	$ (155)	$ 564,467	$ 27,454	$ --	$ 1,934,011

See accompanying notes to consolidated financial statements.

<Index>

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in thousands)

	For the Nine Months Ended June 30, 2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$21,637	$52,393
Adjustments to reconcile net income to net cash provided by operating activities:		
operating activities:		
FHLB stock dividends	(2,710)	(2,991)
Provision for credit losses	2,410	8,131
Originations of loans receivable held-for-sale (“LHFS”)	(9,611)	(32,811)
Proceeds from sales of LHFS	11,590	28,505
Amortization and accretion of premiums and discounts on securities	5,548	4,449
Depreciation and amortization of premises and equipment	3,297	3,487
Amortization of deferred amounts related to FHLB advances, net	5,271	4,942
Common stock committed to be released for allocation - ESOP	4,490	5,027
Stock based compensation - stock options and RRP	189	370
Gain on the sale of trading securities received in the loan swap transaction	--	(6,454)
Changes in:		
Prepaid federal insurance premium	3,774	(22,285)
Accrued interest receivable	(1,131)	1,062
Other assets, net	1,228	(9,908)
Income taxes payable/receivable	(296)	(2,002)
Accounts payable and accrued expenses	(5,763)	(4,249)
Net cash provided by operating activities	39,923	27,666
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of trading securities received in the loan swap transaction	--	199,144
Purchase of AFS securities	(480,815)	--
Purchase of HTM securities	(1,775,436)	(1,060,474)
Proceeds from calls, maturities and principal reductions of AFS securities	261,366	462,020
Proceeds from calls, maturities and principal reductions of HTM securities	959,066	247,611
Proceeds from the redemption of capital stock of FHLB	4,941	--
Purchases of capital stock of FHLB	(7,162)	--
Loan originations and purchases, net of principal collected and deferred loan fees	(7,705)	76,889
Purchases of premises and equipment	(8,360)	(6,735)
Proceeds from sales of REO	10,060	9,538
Net cash (used in) investing activities	(1,044,045)	(72,007)

(Continued)

7

	For the Nine Months Ended June 30,	
	2011	2010
CASH FLOWS FROM FINANCING ACTIVITIES:		
Dividends paid	(138,004)	(37,904)
Deposits, net of withdrawals	189,954	145,235
Deferred FHLB prepayment penalty	--	(875)
Proceeds from borrowings	644,062	300,000
Repayments of borrowings	(647,671)	(300,000)
Change in advance payments by borrowers for taxes and insurance	(24,017)	(23,630)
Acquisitions of treasury stock	--	(4,019)
Net proceeds from common stock offering	1,076,411	--
Stock options exercised	34	178
Excess tax benefits from stock options	8	88
Net cash provided by financing activities	1,100,777	79,073
NET INCREASE IN CASH AND CASH EQUIVALENTS	96,655	34,732
CASH AND CASH EQUIVALENTS:		
Beginning of period	65,217	41,154
End of period	$161,872	$75,886
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Income tax payments	$10,371	$30,757
Interest payments	$131,371	$152,855
SUPPLEMENTAL DISCLOSURE OF NON-CASH		
INVESTING AND FINANCING ACTIVITIES:		
Note received from ESOP in exchange for common stock	$47,260	$--
Customer deposit holds related to common stock offering	$17,690	$--
Loans transferred to REO	$11,186	$9,014
Swap of loans for trading securities	$--	$193,889

(Concluded)

See accompanying notes to consolidated financial statements.

<Index>

Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation - In December 2010, Capitol Federal Financial completed its conversion from a mutual holding company form of organization to a stock form of organization ("corporate reorganization"). Capitol Federal Financial, which owned 100% of Capitol Federal Savings Bank (the "Bank"), was succeeded by Capitol Federal Financial, Inc. ("the Company"), a new Maryland corporation. As part of the corporate reorganization, Capitol Federal Savings Bank MHC's ("MHC") ownership interest in Capitol Federal Financial was sold in a public offering. Gross proceeds from the offering were $1.18 billion and related offering expenses were $46.7 million, of which $6.0 million were incurred and deferred in fiscal year 2010. The publicly held shares of Capitol Federal Financial were exchanged for new shares of common stock of the Company. The exchange ratio was 2.2637 and ensured that immediately after the corporate reorganization the public stockholders of Capitol Federal Financial owned the same aggregate percentage of Capitol Federal Financial, Inc. common stock that they owned of Capitol Federal Financial common stock immediately prior to the reorganization. All share information used to calculate earnings per share in the consolidated financial statements prior to the corporate reorganization has been revised to reflect the 2.2637 exchange ratio. In conjunction with the corporate reorganization, the Company contributed $40.0 million of cash to the Bank's charitable foundation, Capitol Federal Foundation. Additionally, a "liquidation account" has been established for the benefit of certain depositors of the Bank in an amount equal to MHC's ownership interest in the retained earnings of Capitol Federal Financial as of June 30, 2010. Under Office of Thrift Supervision ("OTS") regulations, neither the Company nor the Bank is permitted to pay dividends on its capital stock to its stockholders if stockholders' equity would be reduced below the total of the current amount of the liquidation account at that time. As of July 21, 2011, the Office of the Comptroller of the Currency (the "OCC") assumed the responsibilities and powers of the Office of Thrift Supervision (the "OTS") with respect to the Bank, and the Board of Governors of the Federal Reserve System (the "FRB") assumed the responsibilities and powers of the OTS with respect to the Company. See Note 7 "Subsequent Events."

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, the Bank. The Bank has a wholly-owned subsidiary, Capitol Funds, Inc. Capitol Funds, Inc. has a wholly-owned subsidiary, Capitol Federal Mortgage Reinsurance Company. All intercompany accounts and transactions have been eliminated in consolidation. The financial information presented is derived from the consolidated financial statements of the Company after the corporate reorganization in December 2010 and from the consolidated financial statements of Capitol Federal Financial prior to the corporate reorganization.

Capitol Federal Financial's treasury shares were retired in connection with the corporate reorganization. As noted above, the Company is a Maryland corporation. Under Maryland law, there is no concept of "treasury shares." Instead, shares purchased by the Company constitute authorized but unissued shares under Maryland law. There were no treasury shares at June 30, 2011.

The accompanying consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2010, filed with the Securities and Exchange Commission ("SEC"). Interim results are not necessarily indicative of results for a full year. In preparing the financial statements, management is required 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 and revenues and expenses during the reporting periods. Significant estimates include the ACL and fair value measurements. Actual results could differ from those estimates.

Loans Receivable - Loans receivable that management has the intent and ability to hold for the foreseeable future are carried at the amount of unpaid principal, net of the ACL, undisbursed loan funds, unamortized premiums and discounts, and deferred loan origination fees and costs. Net loan origination fees and costs and premiums and discounts are amortized as yield adjustments to interest income using the level-yield method, adjusted for the estimated prepayment speeds of the related loans when applicable. Interest on loans is credited to income as earned and accrued only if deemed collectible.

Existing loan customers, whose loans have not been sold to third parties and who have been current on their contractual loan payments for the previous 12 months, have the opportunity, for a fee, to modify their original loan terms to current loan terms being offered. The fee assessed for modifying the mortgage loan is deferred and amortized over the life of the modified loan using the level-yield method and is reflected as an adjustment to interest income. Each modification is examined on a loan-by-loan basis and if the modification of terms represents more than a minor change to the loan, then the unamortized balance of the pre-modification deferred fees or costs associated with the mortgage loan are recognized in interest income at the time of the modification. If the modification of terms does not represent more than a minor change to the loan, then the unamortized balance of the pre-modification deferred fees or costs continue to be deferred.

A loan is considered delinquent when payment has not been received within 30 days of its contractual due date. The accrual of income on loans is discontinued when interest or principal payments are 90 days in arrears. Loans on which the accrual of income has been discontinued are designated as non-accrual loans and outstanding interest previously credited beyond 90 days delinquent is reversed. A non-accrual loan is returned to accrual status once the contractual payments have been made to bring the loan less than 90 days past due.

A condition in which the Bank grants a concession that it would not otherwise consider to a borrower due to financial difficulties is a troubled debt restructuring ("TDR"). The majority of the Bank's TDRs involve a modification in loan terms such as a temporary reduction in the payment amount requiring only interest and escrow payments (if required) and extending the maturity date of the loan.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement. Interest income on impaired loans is recognized in the period collected unless the ultimate collection of principal is considered doubtful. Management considers the following loans to be impaired loans: all non-accrual loans, loans classified as substandard, loans with specific valuation allowances ("SVA"), and TDRs that have not been performing under the new terms for 12 consecutive months or are required by the accounting literature to be classified as a TDR for the life of the loan.

Allowance for Credit Losses - The ACL represents management's best estimate of the amount of known and inherent losses in the loan portfolio as of the balance sheet date. Management's methodology for assessing the appropriateness of the ACL consists of a formula analysis for general valuation allowances and the establishment of SVAs for identified problem loans. Management maintains the ACL through provisions for credit losses that are charged to income.

For one- to four-family loans, losses are charged-off when a loan is transferred to REO or if there is a short-sale of the collateral. For consumer home equity loans where the Bank holds the first mortgage, if the loan balance is in excess of the fair value and the loan is in foreclosure, the difference between the loan balances and the fair value is charged-off. Estimated selling costs are also taken into consideration when calculating the amount to charge-off for home equity loans. For consumer home equity loans where the Bank does not hold the first mortgage, foreclosure is pursued or the loan balance is charged-off. Other consumer loans that are unsecured are entirely charged-off once the loan is 120 days past due. For multi-family and commercial loans, the Bank records an SVA when it is determined that the collection of all or a portion of a loan may not be collected and the amount of that loss is reasonably estimated.

The Bank's primary lending emphasis is the origination and purchase of one- to four-family first mortgage loans on residential properties and, to a lesser extent, second mortgage loans on one- to four-family residential properties, resulting in a loan concentration in residential mortgage loans. The Bank has a concentration of loans secured by residential property located in Kansas and Missouri. Based on the composition of the Bank's loan portfolio, the primary risks inherent in the one- to four-family and consumer loan portfolios are the continued weakened economic conditions, continued high levels of unemployment or underemployment, and a continuing decline in residential real estate values. Any one or a combination of these events may adversely affect borrowers' ability to repay their loans, resulting in increased delinquencies, non-performing assets, loan losses, and future loan loss provisions. Although the multi-family and commercial loan portfolio also shares the risk of continued weakened economic conditions, the primary risks for the portfolio include the ability of the borrower to sustain sufficient cash flows from leases and to control expenses to satisfy their contractual debt payments, or the ability to utilize personal and/or business resources to pay their contractual debt payments if the cash flows are not sufficient. Additionally, if the Bank were to repossess the secured collateral of a multi-family or commercial loan, the pool of potential buyers is limited more than that for a residential property; therefore, the Bank could hold the property for an extended period of time and potentially be forced to sell at a discounted price, resulting in additional losses.

Management considers several quantitative and qualitative factors quarterly while monitoring the credit quality of the loan portfolio and evaluating the adequacy of the ACL. Such factors include the trend and composition of delinquent and non-performing loans, results of foreclosed property and short-sale transactions (historical losses and net charge-offs), the current status and trends of local and national economies, particularly levels of unemployment, trends and current conditions in the residential real estate markets, and loan portfolio growth and concentrations. Since the Bank's loan portfolio is primarily concentrated in one- to four-family real estate, management monitors residential real estate market value trends in the Bank's local market areas and geographic sections of the U.S. by reference to various industry and market reports, economic releases and surveys, and management's general and specific knowledge of the real estate markets in which the Bank lends, in order to determine what impact, if any, such trends may have on the level of ACL. Reviewing these quantitative and qualitative factors assists management in evaluating the overall credit quality of the loan portfolio and the reasonableness of the ACL on an ongoing basis, and whether changes need to be made to the Bank's allowance for credit loss methodology. Management seeks to apply the ACL methodology in a consistent manner; however, the methodology can be modified in response to changing conditions. There were no significant modifications to the formula analysis methodology during the current quarter. The formula analysis for general valuation allowances is updated each quarter. Within the formula analysis, the loan portfolio is segregated into the following categories: one- to four-family loans, multi-family and commercial loans, consumer home equity loans, and other consumer loans. Home equity loans with the same underlying collateral as a one- to four-family loan are combined with the one- to four-family loan in the formula analysis to calculate a combined loan-to-value ("LTV") ratio. Impaired loans are excluded from the formula analysis as they are individually evaluated for SVAs. The one- to four-family loan portfolio and related home equity loans are segregated into additional categories based on the following risk characteristics: originated or purchased from nationwide lender, interest payments (fixed-rate, adjustable-rate, and interest-only), LTV ratios, borrower's credit scores, and certain states where the Bank has experienced measurable losses on REO and short-sales. The additional categories were derived by management based on reviewing the historical performance of the one- to four-family loan portfolio and taking into consideration current economic conditions, such as trends in residential real estate values in certain areas of the U.S. and unemployment rates.

Quantitative loss factors are applied to each loan category in the formula analysis based on the historical loss experience and current SVAs, adjusted for loan delinquency trends, for each respective loan category. Each quarter, management reviews the historical loss time periods and utilizes the historical loss time periods believed to be the most reflective of the current economic conditions and recent charge-off experience for each respective loan category.

Qualitative loss factors are applied to each loan category in the formula analysis. The qualitative factors for the one- to four-family and consumer loan portfolios are: unemployment rate trends, collateral value trends, credit score trends, and delinquent loan trends. The qualitative factors for the multi-family and commercial loan portfolio are: unemployment rate trends, collateral value trends, and delinquent loan trends. As loans are classified as special mention or become 30 to 89 days delinquent, the qualitative loss factors increase based upon delinquent loan trends. As with the additional categories in the formula analysis for one- to four-family loans, the qualitative factors were derived by management based on a review of the historical performance of the respective loan portfolios and consideration of current economic conditions and their likely impact to the loan portfolio.

SVAs are established in connection with individual loan reviews of impaired loans. Since the majority of the Bank's loan portfolio is composed of residential real estate, determining the estimated fair value of the underlying collateral is important in evaluating the amount of SVAs required for impaired one- to four-family loans. If the estimated fair value of the collateral, less estimated costs to sell and anticipated private mortgage insurance ("PMI") proceeds, is less than the current loan balance, an SVA is established for the difference. Once a purchased one- to four-family loan is 90 days delinquent, new collateral values are obtained through automated valuation models ("AVMs") or broker price opinions ("BPOs"). An updated AVM or BPO is then requested approximately every six months while the loan is greater than 90 days delinquent. Due to the relatively stable home values in Kansas and Missouri, new appraisals on originated one- to four- family loans are not obtained until a loan enters foreclosure. For originated one- to four-family loans and home equity loans that are impaired and the most recent appraisal is more than one year old, management estimates the fair value of the collateral using the most recently published Federal Housing Finance Agency ("FHFA") index. If the Bank holds the first and second mortgage, both loans are combined when evaluating the need for an SVA.

Loans with an outstanding balance of $1.5 million or more are reviewed annually if secured by property in one of the following categories: multi-family (five or more units) property, unimproved land, other improved commercial property, acquisition and development of land projects, developed building lots, office building, single-use building, or retail building. SVAs are established if necessary, or management may charge-off such losses if deemed appropriate.

Assessing the adequacy of the ACL is inherently subjective. Actual results could differ from estimates as a result of changes in economic or market conditions. Changes in estimates could result in a material change in the ACL. In the opinion of management, the ACL, when taken as a whole, is adequate to absorb estimated losses inherent in the loan portfolio. However, future adjustments may be necessary if loan portfolio performance or economic or market conditions differ substantially from the conditions that existed at the time of the initial determinations.

Recent Accounting Pronouncements - Effective October 1, 2010, the Company adopted new authoritative accounting guidance under Accounting Standards Codification ("ASC") 860, Transfers of Servicing Assets. The objective of this standard is to improve the relevance, representational faithfulness, and comparability of the information provided in the financial statements related to the transfer of financial assets; the effects of a transfer on the company's financial position, financial performance, and cash flows; and a transferor's continuing involvement in transferred financial assets. The adoption of this standard did not have an impact on the Company's financial condition or results of operations.

Effective October 1, 2010, the Company also adopted new authoritative accounting guidance under ASC 810, Consolidation. The new guidance did not change many of the key principles for determining whether an entity is a variable interest entity consistent with the ASC on "Consolidation", but does amend many important provisions of the existing guidance on "Consolidation." The adoption of this standard did not have an impact on the Company's financial condition, results of operations, or financial statement disclosures.

In July 2010, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2010-20, Disclosures about Credit Quality of Financing Receivables and the Allowance for Credit Losses, which amends ASC 310, Receivables, by requiring more robust and disaggregated disclosures about the credit quality of an entity's financing receivables and its ACL. The objective of enhancing these disclosures is to improve financial statement users' understanding of (1) the nature of an entity's credit risk associated with its financing receivables and (2) the entity's assessment of that risk in estimating its ACL as well as changes in the allowance and the reasons for those changes. The new and amended disclosures that relate to information as of the end of a reporting period were effective for the Company at March 31, 2011. The disclosures that include information for activity that occurs during a reporting period were effective beginning January 1, 2011 for the Company. Since the provisions of ASU 2010-20 are disclosure-related, the Company's adoption of this guidance did not have an impact to its financial condition or results of operations.

In January 2011, the FASB issued ASU 2011-01, Deferral of the Effective Date of Disclosures About Troubled Debt Restructurings in Update No. 2010-20, which temporarily deferred the effective date in ASU 2010-20 for disclosures about TDRs by creditors until the FASB finalized its project on determining what constitutes a TDR for a creditor. In April 2011, the FASB issued ASU 2011-02, Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring, which amends the content in ASC 310 related to identifying TDRs and effectively nullifies ASU 2011-01. ASU 2011-02 removes the deferral of the TDR disclosure requirements of ASU 2010-20 for public entities and thus establishes the effective date for those disclosures. ASU 2011-02 is effective for the first interim or annual period beginning on or after June 15, 2011, which is July 1, 2011 for the Company. 2011-02 is to be applied retrospectively to modifications occurring on or after the beginning of the fiscal year of adoption, which is October 1, 2010 for the Company. The adoption of ASU 2011-02 is not expected to have a significant impact on the Company's financial condition, results of operations, or financial statement disclosures.

In April 2011, the FASB issued ASU 2011-03, Reconsideration of Effective Control for Repurchase Agreements. The primary objective of this ASU is to improve the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. This ASU eliminates the requirement for entities to consider whether a transferor has the ability to repurchase the financial assets in a repurchase agreement, which may result in more repurchase agreements to be accounted for as secured borrowings rather than as a sale. ASU 2011-03 is effective for the first interim or annual period beginning on or after December

15, 2011, which is January 1, 2012 for the Company, and should be applied prospectively. The Company accounts for its repurchase agreements as secured borrowings; therefore, the adoption of ASU 2011-03 is not expected to have a material impact on its financial condition, results of operations, or financial statement disclosures.

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU is a result of joint efforts by the FASB and the International Accounting Standards Board ("IASB") to develop a single, converged fair value framework for measuring fair value and for disclosing information about fair value measurements in accordance with GAAP and International Financial Reporting Standards ("IFRSs). This ASU is largely consistent with existing fair value measurement principles in U.S. GAAP; however, some of the components of this ASU could change how fair value measurement guidance in ASC 820, Fair Value Measurements and Disclosures, is applied. This ASU does not require additional fair value measurements and is not intended to establish valuation standards or affect valuation practices outside of financial reporting. ASU 2011-04 is effective during interim and annual periods beginning after December 15, 2011, which is January 1, 2012 for the Company, and should be applied retrospectively. The Company is already disclosing its fair value measurements in compliance with the converged guidance. Additionally, since the applicable provisions of ASU 2011-04 are disclosure-related, the Company's adoption of this guidance is not expected to have an impact to its financial condition or results of operations.

In June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income, which revises how entities present comprehensive income in their financial statements. The ASU requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. In a continuous statement of comprehensive income, an entity would be required to present the components of the income statement as presented today, along with the components of other comprehensive income. In the two-statement approach, an entity would be required to present a statement that is consistent with the income statement format used today, along with a second statement, which would immediately follow the income statement, that would include the components of other comprehensive income. The ASU does not change the items that an entity must report in other comprehensive income. ASU 2011-05 is effective for fiscal years, and interim periods within those years, beginning December 15, 2011, which is October 1, 2012 for the Company, and should be applied retrospectively for all periods presented in the financial statements. The Company has not yet decided which statement format it will adopt.

2. Earnings Per Share

The Company accounts for the shares acquired by its ESOP and the shares awarded pursuant to its RRP in accordance with ASC 260, which requires that unvested RRP awards that contain nonforfeitable rights to dividends be treated as participating securities in the computation of earnings per share pursuant to the two-class method. The two-class method is an earnings allocation that determines earnings per share for each class of common stock and participating security. Shares acquired by the ESOP are not considered in the basic average shares outstanding until the shares are committed for allocation or vested to an employee's individual account. All share information prior to the corporate reorganization in December 2010 has been revised to reflect the 2.2637 exchange ratio.

	For the Three Months Ended June 30,		For the Nine Months Ended June 30,	
	2011	2010	2011	2010
	(in thousands, except share and per share data)			
Net income (1)	$17,259	$16,758	$21,637	$52,393
Average common shares outstanding	161,385,084	165,639,678	162,783,841	165,704,508
Average committed ESOP shares outstanding	256,546	229,480	125,032	114,948
Total basic average common shares outstanding	161,641,630	165,869,158	162,908,873	165,819,456
Effect of dilutive RRP shares	1,313	4,593	2,516	7,203
Effect of dilutive stock options	4,971	48,952	4,990	42,356
Total diluted average common shares outstanding	161,647,914	165,922,703	162,916,379	165,869,015
Net earnings per share:				
Basic	$0.10	$0.10	$0.13	$0.32
Diluted	$0.10	$0.10	$0.13	$0.32
Antidilutive stock options and RRP shares, excluded from the diluted average common shares outstanding calculation	901,816	230,557	895,025	496,320

(1) Net income available to participating securities (unvested RRP shares) was inconsequential for the three and nine months ended June 30, 2011 and 2010.

3. Securities

The following tables reflect the amortized cost, estimated fair value, and gross unrealized gains and losses of AFS and HTM securities at June 30, 2011 and September 30, 2010. The majority of the MBS and investment portfolios are composed of securities issued by U.S. government-sponsored enterprises ("GSEs").

	June 30, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(Dollars in thousands)			
AFS:				
GSE debentures	$478,535	$661	$217	$478,979
Municipal bonds	2,633	126	--	2,759
Trust preferred securities	3,700	--	640	3,060
MBS	740,980	44,209	--	785,189
	1,225,848	44,996	857	1,269,987
HTM:				
GSE debentures	1,077,156	3,445	929	1,079,672
Municipal bonds	59,207	1,984	12	61,179
MBS	1,557,356	43,018	2,209	1,598,165
	2,693,719	48,447	3,150	2,739,016
	$3,919,567	$93,443	$4,007	$4,009,003

	September 30, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(Dollars in thousands)			
AFS:				
GSE debentures	$50,151	$104	$--	$50,255
Municipal bonds	2,649	170	--	2,819
Trust preferred securities	3,721	--	925	2,796
MBS	952,621	51,881	6	1,004,496
	1,009,142	52,155	931	1,060,366
HTM:				
GSE debentures	1,208,829	4,441	--	1,213,270
Municipal bonds	67,957	2,654	1	70,610
MBS	603,368	26,209	3	629,574
	1,880,154	33,304	4	1,913,454
	$2,889,296	$85,459	$935	$2,973,820

At June 30, 2011 and September 30, 2010, the MBS held within our portfolio were issued by Federal National Mortgage Association ("FNMA"), Federal Home Loan Mortgage Corporation ("FHLMC"), or Government National Mortgage Association ("GNMA"), with the exception of $2.1 million and $2.9 million at those respective dates, which were issued by a private issuer. The following table presents the carrying value of the MBS in our portfolio by issuer at June 30, 2011 and September 30, 2010.

	June 30, 2011	September 30, 2010
	(Dollars in thousands)	
FNMA	$ 1,346,189	$ 890,216
FHLMC	788,891	712,253
GNMA	205,344	2,452
Private Issuer	2,121	2,943
	$ 2,342,545	$ 1,607,864

The following table presents the taxable and non-taxable components of interest income on investment securities for the three and nine months ended June 30, 2011 and 2010:

	For the Three Months Ended June 30,		For the Nine Months Ended June 30,	
	2011	2010	2011	2010
	(Dollars in thousands)			
Taxable	$ 4,639	$ 4,031	$ 13,176	$ 9,243
Non-taxable	464	534	1,445	1,607
	$ 5,103	$ 4,565	$ 14,621	$ 10,850

16

The following tables summarize the estimated fair value and gross unrealized losses of those securities on which an unrealized loss at June 30, 2011 and September 30, 2010 was reported and the continuous unrealized loss position for at least 12 months or less than 12 months as of June 30, 2011 and September 30, 2010.

	June 30, 2011					
		Less Than 12 Months			Equal to or Greater Than 12 Months	
	Count	Estimated Fair Value	Unrealized Losses	Count	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)					
AFS:						
GSE debentures	3	$74,783	$217	--	$--	$--
Trust preferred securities	--	--	--	1	3,060	640
MBS	--	--	--	--	--	--
	3	$74,783	$217	1	$3,060	$640
HTM:						
GSE debentures	6	$168,497	$929	--	$--	$--
Municipal bonds	--	--	--	1	864	12
MBS	9	227,538	2,209	--	--	--
	15	$396,035	$3,138	1	$864	$12

	September 30, 2010					
		Less Than 12 Months			Equal to or Greater Than 12 Months	
	Count	Estimated Fair Value	Unrealized Losses	Count	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)					
AFS:						
GSE debentures	--	$--	$--	--	$--	$--
Trust preferred securities	--	--	--	1	2,796	925
MBS	4	1,678	5	3	359	1
	4	$1,678	$5	4	$3,155	$926
HTM:						
GSE debentures	--	$--	$--	--	$--	$--
Municipal bonds	--	--	--	1	878	1
MBS	1	48,392	3	--	--	--
	1	$48,392	$3	1	$878	$1

On a quarterly basis, management conducts a formal review of securities for the presence of an other-than-temporary impairment. Management assesses whether an other-than-temporary impairment is present when the fair value of a security is less than its amortized cost basis at the balance sheet date. For such securities, other-than-temporary impairment is considered to have occurred if the Company intends to sell the security, if it is more likely than not the Company will be required to sell the security before recovery of its amortized cost basis, or if the present value of expected cash flows is not sufficient to recover the entire amortized cost.

The unrealized losses at June 30, 2011 and September 30, 2010 are primarily a result of increases in market yields from the time of purchase. In general, as market yields rise, the fair value of securities will decrease; as market yields fall, the fair value of securities will increase. Management generally views changes in fair value caused by changes in interest rates as temporary; therefore, these securities have not been classified as other-than-temporarily impaired. Additionally, the impairment is also considered temporary because scheduled coupon payments have been made, it is anticipated that the entire principal balance will be collected as scheduled, and management neither intends to sell the securities, nor is it more likely than not that the Company will be required to sell the securities before the recovery of the remaining amortized cost amount, which could be at maturity.

The amortized cost and estimated fair value of securities by remaining contractual maturity without consideration for call features or pre-refunding dates as of June 30, 2011 are shown below. Actual maturities of MBS may differ from contractual maturities because borrowers have the right to prepay obligations, generally without penalty. Maturities of MBS depend on the repayment characteristics and experience of the underlying financial instruments.

	AFS		HTM	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	(Dollars in thousands)			
One year or less	$282,428	$282,661	$2,376	$2,389
One year through five years	197,800	198,138	1,104,950	1,108,401
Five years through ten years	174,623	188,512	468,340	485,297
Ten years and thereafter	570,997	600,676	1,118,053	1,142,929
	$1,225,848	$1,269,987	$2,693,719	$2,739,016

Issuers of certain investment securities have the right to call and prepay obligations with or without prepayment penalties. As of June 30, 2011, the amortized cost of the securities in our portfolio which are callable or have pre-refunding dates within one year totaled $1.04 billion.

The following table summarizes the amortized cost and estimated fair value of securities pledged as collateral as of the dates indicated.

	June 30, 2011		September 30, 2010	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	(Dollars in thousands)			
Repurchase agreements	$637,523	$657,269	$671,852	$709,919
Retail deposits	46,910	46,315	--	--
Public unit deposits	131,504	140,957	120,241	128,621
Federal Reserve Bank	28,264	29,582	34,720	36,363
	$844,201	$874,123	$826,813	$874,903

During fiscal year 2010, the Bank swapped originated fixed-rate mortgage loans with FHLMC for MBS (“loan swap transaction”). The MBS received in the loan swap transaction were classified as trading securities prior to their subsequent sale by the Bank. Proceeds from the sale of these securities were $199.1 million, resulting in a gross realized gain of $6.5 million. The gain is included in gain on securities, net in the consolidated statements of income for the year ended September 30, 2010. All other dispositions of securities during fiscal year 2010 were the result of principal repayments, maturities, or calls.

4. Loans Receivable and Allowance for Credit Losses

Loans receivable, net at June 30, 2011 and September 30, 2010 is summarized as follows:

	June 30, 2011	September 30, 2010
	(Dollars in thousands)	
Mortgage loans:		
One- to four-family	$4,931,401	$4,915,651
Multi-family and commercial	61,114	66,476
Construction	45,578	33,168
Total real estate loans	5,038,093	5,015,295
Consumer loans:		
Home equity	166,798	186,347
Other	7,100	7,671
Total consumer loans	173,898	194,018
Total loans receivable	5,211,991	5,209,313
Less:		
Undisbursed loan funds	26,250	15,489
Unearned loan fees and deferred costs	8,039	10,730
ACL	14,856	14,892
	$5,162,846	$5,168,202

Lending Practices and Underwriting Standards - Originating and purchasing loans secured by one- to four-family residential properties is the Bank's primary business, resulting in a loan concentration in residential first mortgage loans. One- to four-family loans are purchased from a select group of correspondent lenders in our current local market areas in Kansas and Missouri, and also from a select group of correspondent lenders in Oklahoma, Texas, Nebraska, Tennessee, Arkansas, and Alabama. As a result of originating loans in our branches, along with the correspondent lenders in our local markets, the Bank has a concentration of loans secured by real property located in Kansas and Missouri. Additionally, the Bank purchases whole one- to four-family loans in bulk packages from nationwide lenders. The servicing rights for these loans are generally retained by the sellers. The Bank also makes consumer loans, construction loans secured by residential or commercial properties, and real estate loans secured by multi-family dwellings. During the quarter and year-to-date period ended June 30, 2011, the Bank completed a bulk nationwide purchase of $89.2 million of one- to four-family loans.

One- to four-family loans - One- to four-family loans are underwritten manually or by an automated underwriting system developed by a third party. The system's components closely resemble the Bank's manual underwriting standards which are generally in accordance with FHLMC and FNMA manual underwriting guidelines. The automated underwriting system analyzes the applicant's data, with emphasis on credit history, employment and income history, qualifying ratios reflecting the applicant's ability to repay, asset reserves, and LTV ratio. Full documentation to support the applicant's credit, income, and sufficient funds to cover all applicable fees and reserves at closing is required on all loans. Loans that do not meet the automated underwriting standards are referred to a staff underwriter for manual underwriting. Properties securing one- to four-family loans are appraised by either staff appraisers or fee appraisers, both of which are independent of the loan origination function.

The underwriting standards for loans purchased from correspondent and nationwide lenders are generally similar to the Bank's internal underwriting standards. The underwriting of loans purchased from correspondent lenders is generally performed by the Bank's underwriters and the Bank services these loans. Before committing to purchase a pool of loans from a nationwide lender, the Bank's Chief Lending Officer or Secondary Marketing Manager reviews specific criteria such as loan amount, credit scores, LTV ratios, geographic location, and debt ratios of each loan in the pool. If the specific criteria do not meet the Bank's underwriting standards and compensating factors are not sufficient, then a loan will be removed from the pool. Before the pool is funded, an internal Bank underwriter or a third party reviews at least 25% of the loan files to confirm loan terms, credit scores, debt service ratios, property appraisals, and other underwriting related documentation. The Bank does not currently service the loans purchased from nationwide lenders. For the tables within this footnote, loans purchased from correspondent lenders are included with originated loans, and loans purchased in bulk from nationwide lenders are reported as purchased loans.

The Bank also originates construction-to-permanent loans secured by one- to four-family residential real estate. The majority of the one- to four-family construction loans are secured by property located within the Bank's Kansas City market area. Construction loans are obtained by homeowners who will occupy the property when construction is complete. Construction loans to builders for speculative purposes are not permitted. The application process includes submission of complete plans, specifications, and costs of the project to be constructed. All construction loans are manually underwritten using the Bank's internal underwriting standards. Construction draw requests and the supporting documentation are reviewed and approved by management. The Bank also performs regular documented inspections of the construction project to ensure the funds are being used for the intended purpose and the project is being completed according to the plans and specifications provided.

For a conventional mortgage with an LTV ratio in excess of 80% at the time of origination, PMI is required in order to reduce the Bank's loss exposure to less than 80% of either the appraised value or the purchase price of the property, whichever is less. The Bank will lend up to 97% of the lesser of the appraised value or purchase price for conventional one- to four-family loans, provided PMI is obtained.

Multi-family and commercial loans - The Bank's multi-family and commercial real estate loans are secured primarily by multi-family dwellings and small commercial buildings generally located in the Bank's market areas. These loans are granted based on the income producing potential of the property and the financial strength of the borrower. At the time of origination, LTV ratios on multi-family and commercial real estate loans cannot exceed 80% of the appraised value of the property securing the loans. The net operating income, which is the income derived from the operation of the property less all operating expenses, must be sufficient to cover the payments related to the outstanding debt at the time of origination. The Bank generally requires personal guarantees of the borrowers covering a portion of the debt in addition to the security property as collateral for these loans. Appraisals on properties securing these loans are performed by independent state certified fee appraisers. Bank policy permits a limited amount of construction-to-permanent loans secured by multi-family dwellings and commercial real estate. Currently there are no construction-to-permanent loans in the multi-family and commercial portfolio.

Consumer loans -The Bank offers a variety of secured consumer loans, including home equity loans and lines of credit, home improvement loans, auto loans, and loans secured by savings deposits. The Bank also originates a very limited amount of unsecured loans. The Bank does not originate any consumer loans on an indirect basis, such as contracts purchased from retailers of goods or services which have extended credit to their customers. The majority of the consumer loan portfolio is comprised of home equity lines of credit.

The underwriting standards for consumer loans include a determination of the applicant's payment history on other debts and an assessment of their ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the security in relation to the proposed loan amount.

Credit quality indicators – Based on the Bank's lending emphasis and underwriting standards, management has segmented the loan portfolio into three segments: one- to four-family loans, consumer loans, and multi-family and commercial loans. The one- to four-family and consumer segments are further grouped into classes for purposes of providing disaggregated information about the credit quality of the loan portfolio. The classes are: one- to four-family loans – originated, one- to four-family loans – purchased, consumer loans – home equity, and consumer loans – other. The Bank's primary credit quality indicators for the one- to four-family loan and consumer - home equity loan portfolios are delinquency status, asset classifications in accordance with applicable regulations, LTV ratios and borrower credit scores. The Bank's primary credit quality indicators for the multi-family and commercial loan and consumer – other loan portfolios are delinquency status and asset classifications in accordance with applicable regulations.

The following table presents the recorded investment of loans, defined as the unpaid loan principal balance (net of unadvanced funds related to loans in process) inclusive of unearned loan fees and deferred costs, of the Company's 30 to 89 day delinquent loans, 90 or more day delinquent loans, total delinquent loans, total current loans, and the total loans receivable balance at June 30, 2011 by class. In the general valuation allowance model, loans in the 30 to 89 day delinquent category are assigned a higher loss factor than corresponding performing loans. Loans 90 or more days delinquent are considered impaired loans and are individually evaluated for impairment. At June 30, 2011, all loans in the 90 or more days delinquent category were on nonaccrual status and represented the entire balance of nonaccrual loans. At June 30, 2011, there were no loans 90 or more days delinquent that were still accruing interest.

	30 to 89 Days Delinquent	90 or More Days Delinquent	Total Delinquent Loans	Current Loans	Total Recorded Investment
	(Dollars in thousands)				
One- to four-family loans - originated	$17,634	$12,011	$29,645	$4,341,407	$4,371,052
One- to four-family loans - purchased	6,174	15,735	21,909	549,759	571,668
Multi-family and commercial loans	--	--	--	61,084	61,084
Consumer - home equity	837	322	1,159	165,639	166,798
Consumer - other	77	52	129	6,971	7,100
	$24,722	$28,120	$52,842	$5,124,860	$5,177,702

In connection with the filing of the Bank's periodic reports with the OTS and in accordance with the Bank's asset classification policy, management regularly reviews the problem loans in the Bank's portfolio to determine whether any assets require classification in accordance with applicable regulations. Loan classifications, other than pass loans, are defined as follows:

- Special mention - These loans are performing loans on which known information about the collateral pledged or the possible credit problems of the borrowers have caused management to have doubts as to the ability of the borrowers to comply with present loan repayment terms and which may result in the future inclusion of such loans in the non-performing loan categories.
- Substandard - A loan 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 loans include those characterized by the distinct possibility the Bank will sustain some loss if the deficiencies are not corrected.
    - Doubtful - Loans classified as doubtful have all the weaknesses inherent as those classified as substandard, with the added characteristic that the weaknesses present make collection or liquidation in full on the basis of currently existing facts and conditions and values highly questionable and improbable.
- Loss - Loans classified as loss are considered uncollectible and of such little value that their continuance as loans without the establishment of specific loss allowance is not warranted.

Special mention loans are included with loans 30 to 89 days delinquent in the general valuation allowance model, if the loan is not considered impaired. Loans classified as substandard, doubtful, or loss are considered impaired loans and are individually evaluated for impairment.

The following table sets forth the recorded investment in loans, less SVAs, classified at June 30, 2011 by class. At June 30, 2011, there were no loans classified as doubtful or loss that were not fully reserved. In addition to the classified loans below, at June 30, 2011, the Bank had other assets totaling $10.9 million, comprised of municipal bonds and a trust preferred security, also classified per its asset classification policy and applicable regulations.

	Special Mention	Substandard
	(Dollars in thousands)	
One- to four-family - originated	$19,360	$ 17,992
One- to four-family - purchased	801	17,337
Multi-family and commercial	8,172	--
Consumer - home equity	25	547
Consumer - other	--	55
	$28,358	$ 35,931

The following tables show the LTV and credit score information for originated and purchased one- to four-family loans and originated consumer home equity loans at June 30, 2011. Borrower credit scores are intended to provide an indication as to the likelihood that a borrower will repay their debts. Credit scores were most recently updated in June 2011 and were obtained from a nationally recognized consumer rating agency. The LTV ratios provide an estimate of the extent to which the Bank may incur a loss on any given loan that may go into foreclosure. The LTV ratios were based on the current loan balance and either the lesser of the purchase price or original appraisal, or the most recent bank appraisal, BPO or AVM, if available. In most cases, the most recent appraisal was obtained at the time of origination.

One- to Four-Family - Originated	Credit Score									
	Less than 660		661 to 700		701 to 750		751 and above		Total	
LTV ratio	Recorded Investment	% of total	Recorded Investment	% of total	Recorded Investment	% of total	Recorded Investment	% of total	Recorded Investment	% of total
	(Dollars in thousands)									
Less than 70%	$67,494	1.5 %	$94,293	2.2%	$268,376	6.2 %	$999,794	22.9%	$1,429,957	32.8 %
70% to 80%	56,799	1.3	51,278	1.2	172,252	3.9	388,877	8.9	669,206	15.3
More than 80%	95,482	2.2	110,221	2.5	320,023	7.3	1,746,163	39.9	2,271,889	51.9
	$219,775	5.0 %	$255,792	5.9%	$760,651	17.4%	$3,134,834	71.7%	$4,371,052	100.0%
Weighted average LTV ratio	66 %									
Weighted average credit score	770									

One- to Four-Family - Purchased	Credit Score									
	Less than 660		661 to 700		701 to 750		751 and above		Total	
LTV ratio	Recorded Investment	% of total	Recorded Investment	% of total	Recorded Investment	% of total	Recorded Investment	% of total	Recorded Investment	% of total
	(Dollars in thousands)									
Less than 70%	$21,099	3.7 %	$20,864	3.7%	$37,072	6.5 %	$84,265	14.8%	$163,300	28.7 %
70% to 80%	14,775	2.6	3,197	0.6	5,970	1.0	7,575	1.3	31,517	5.5
More than 80%	27,150	4.7	28,812	5.0	77,252	13.5	243,637	42.6	376,851	65.8
	$63,024	11.0 %	$52,873	9.3%	$120,294	21.0%	$335,477	58.7%	$571,668	100.0%

Weighted average LTV ratio	60	%
Weighted average credit score	734	

Consumer - Home Equity	Credit Score									
	Less than 660		661 to 700		701 to 750		751 and above		Total	
LTV ratio	Recorded Investment	% of total	Recorded Investment	% of total	Recorded Investment	% of total	Recorded Investment	% of total	Recorded Investment	% of total
	(Dollars in thousands)									
Less than 70%	$30	0.0 %	$177	0.1%	$75	0.0 %	$721	0.4 %	$1,003	0.5 %
70% to 80%	83	0.1	109	0.1	209	0.1	309	0.2	710	0.5
More than 80%	15,044	9.0	12,815	7.7	32,195	19.3	105,031	63.0	165,085	99.0
	$15,157	9.1 %	$13,101	7.9%	$32,479	19.4%	$106,061	63.6%	$166,798	100.0%
Weighted average LTV ratio	19 %									
Weighted average credit score	743									

24

Impaired loans - Impaired loans are defined as non-accrual loans, loans classified as substandard, loans with SVAs, and TDRs that have not yet performed under the restructured terms for 12 consecutive months or are required by the accounting literature to be classified as a TDR for the life of the loan. Substantially all of the impaired loans at June 30, 2011 were secured by residential real estate. Impaired loans related to residential real estate are individually evaluated to ensure that the carrying value of the loan is not in excess of the fair value of the collateral, less estimated selling costs. Fair values of residential real estate are estimated through such methods as current appraisals, AVMs, BPOs, or listing prices. Fair values may be adjusted by management to reflect current economic and market conditions. If the outstanding loan balance is in excess of the estimated fair value determined by management, less estimated costs to sell, then a specific valuation allowance is recorded for the difference. The following is a summary of information pertaining to impaired loans by class at June 30, 2011.

	Recorded Investment	Unpaid Principal Balance	Related ACL	Current Quarter Average Recorded Investment	Fiscal Year-to-Date Average Recorded Investment	Current Quarter Interest Income Recognized	Fiscal Year-to-Date Interest Income Recognized
	(Dollars in thousands)						
With no related allowance recorded							
One- to four-family - originated	$33,114	$33,183	$--	$34,358	$ 33,292	$ 298	$ 855
One- to four-family - purchased	6,709	6,688	--	7,287	7,708	13	50
Multi-family and commercial	572	574	--	577	582	9	27
Consumer - home equity	547	547	--	600	723	5	13
Consumer - other	55	55	--	59	56	--	1
	40,997	41,047	--	42,881	42,361	325	946
With an allowance recorded							
One- to four-family - originated	3,360	3,363	316	2,917	2,200	22	72
One- to four-family - purchased	14,907	14,802	3,478	13,925	14,810	38	133
Multi-family and commercial	--	--	--	--	--	--	--
Consumer - home equity	34	34	34	53	35	--	--
Consumer - other	--	--	--	--	--	--	--
	18,301	18,199	3,828	16,895	17,045	60	205
Total							

One- to four-family - originated	36,474	36,546	316	37,275	35,492	320	927
One- to four-family - purchased	21,616	21,490	3,478	21,212	22,518	51	183
Multi-family and commercial	572	574	--	577	582	9	27
Consumer - home equity	581	581	34	653	758	5	13
Consumer - other	55	55	--	59	56	--	1
	$59,298	$59,246	$3,828	$59,776	$ 59,406	$ 385	$ 1,151

Allowance for credit losses - The following is a summary of the activity in the ACL by segment for the three and nine months ended June 30, 2011 and the ending balance of the ACL at June 30, 2011, based on the Company's impairment methodology.

	One- to Four-Family - Originated	One- to Four-Family - Purchased	One- to Four-Family - Total	Multi-family and Commercial	Consumer	Total
			(Dollars in thousands)			
Year-to-Date						
Beginning balance	$3,813	$10,425	$14,238	$ 275	$379	$14,892
Charge-offs	(299)	(2,006)	(2,305)	--	(141)	(2,446)
Recoveries	--	--	--	--	--	--
Provision for credit losses	944	1,493	2,437	(3)	(24)	2,410
Ending balance	$4,458	$9,912	$14,370	$ 272	$ 214	$14,856
Ratio of net charge-offs to average loans outstanding year-to-date						0.05 %
Ratio of net charge-offs year-to-date to average non-performing assets						6.12 %

	One- to Four-Family - Originated	One- to Four-Family - Purchased	One- to Four-Family - Total	Multi-family and Commercial	Consumer	Total
			(Dollars in thousands)			
Quarter						
Beginning balance	$4,216	$9,037	$13,253	$ 268	$293	$13,814
Charge-offs	(133)	(26)	(159)	--	(39)	(198)
Recoveries	--	--	--	--	--	--
Provision (recovery) for credit losses	375	901	1,276	4	(40)	1,240
Ending balance	$4,458	$9,912	$14,370	$ 272	$ 214	$14,856
Ratio of net charge-offs to average loans outstanding during the quarter						0.00 %
Ratio of net charge-offs during the quarter to average non-performing assets						0.50 %
ACL for loans collectively evaluated for impairment	$4,142	$6,434	$10,576	$ 272	$ 180	$11,028
ACL for loans individually evaluated for impairment	$316	$3,478	$3,794	$ --	$ 34	$3,828

27

The following is a summary of the loan portfolio at June 30, 2011 by loan portfolio segment disaggregated by the Company's impairment method.

	One- to Four-Family - Originated	One- to Four-Family - Purchased	One- to Four-Family - Total	Multi-family and Commercial	Consumer	Total
			(Dollars in thousands)			
Recorded investment of loans collectively evaluated for impairment	$4,334,578	$550,052	$4,884,630	$ 60,512	$173,262	$5,118,404
Recorded investment of loans individually evaluated for impairment	36,474	21,616	58,090	572	636	59,298
	$4,371,052	$571,668	$4,942,720	$ 61,084	$173,898	$5,177,702

As noted above, the Bank has a loan concentration in residential first mortgage loans. Continued declines in residential real estate values could adversely impact the property used as collateral for the Bank's loans. Adverse changes in the economic conditions and increasing unemployment rates may have a negative effect on the ability of the Bank's borrowers to make timely loan payments, which would likely increase delinquencies and have an adverse impact on the Bank's earnings. Further increases in delinquencies will decrease interest income on loans receivable and will likely adversely impact the Bank's loan loss experience, resulting in an increase in the Bank's ACL and provision for credit losses. Although management believes the ACL was at an adequate level to absorb known and inherent losses in the loan portfolio at June 30, 2011, the level of the ACL remains an estimate that is subject to significant judgment and short-term changes. Additions to the ACL may be necessary if future economic and other conditions differ substantially from the current environment.

5. Fair Value of Financial Instruments

Fair Value Measurements - ASC 820, Fair Value Measurements and Disclosures, defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. ASC 820 applies only to fair value measurements already required or permitted by other accounting standards and does not impose requirements for additional fair value measures. ASC 820 was issued to increase consistency and comparability in reporting fair values.

The Company uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. The Company did not have any liabilities that were measured at fair value at June 30, 2011 and September 30, 2010. The Company's AFS securities are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets or liabilities on a non-recurring basis, such as REO, LHFS, and impaired loans. These non-recurring fair value adjustments involve the application of lower-of-cost-or-fair value accounting or write-downs of individual assets.

In accordance with ASC 820, the Company groups its assets at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1 — Valuation is based upon quoted prices for identical instruments traded in active markets.

- Level 2 — Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

- Level 3 — Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company's own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models, and similar techniques. The results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability.

The Company bases its fair values on the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. As required by ASC 820, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

The following is a description of valuation methodologies used for assets measured at fair value on a recurring basis.

AFS Securities - The Company's AFS securities portfolio is carried at estimated fair value, with any unrealized gains and losses, net of taxes, reported as AOCI in stockholders' equity. The Company's major security types based on the nature and risks of the securities are included in the table below. The majority of the securities within the AFS portfolio are issued by U.S. GSEs. The fair values for all AFS securities are based on quoted prices for similar securities. Various modeling techniques are used to determine pricing for the Company's securities, including option pricing and discounted cash flow models. The inputs to these models may include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, benchmark securities, bids, offers and reference data. There is an AFS security in the AFS portfolio that has significant unobservable inputs requiring the independent pricing services to use some judgment in pricing it. This AFS security is classified as Level 3. All other AFS securities are classified as Level 2.

The following table provides the level of valuation assumption used to determine the carrying value of the Company's assets measured at fair value on a recurring basis, which consists of AFS securities, at June 30, 2011 and September 30, 2010.

	June 30, 2011			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)(1)
	(Dollars in thousands)			
GSE debentures	$ 478,979	$ --	$ 478,979	$ --
Municipal bonds	2,759	--	2,759	--
Trust preferred securities	3,060	--	--	3,060
MBS	785,189	--	785,189	--
	$ 1,269,987	$ --	$ 1,266,927	$ 3,060

	September 30, 2010			
		Quoted Prices in Active Markets	Significant	Significant