

WASHINGTON FEDERAL INC  
Form 10-Q  
May 03, 2017  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

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

For the quarterly period ended March 31, 2017

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 001-34654

WASHINGTON FEDERAL, INC.  
(Exact name of registrant as specified in its charter)

Washington 91-1661606  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

425 Pike Street Seattle, Washington 98101  
(Address of principal executive offices and zip  
code)  
(206) 624-7930  
(Registrant's telephone number, including area  
code)

(Former name, former address and former fiscal year, if changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  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  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 definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

APPLICABLE ONLY TO CORPORATE ISSUERS

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

Title of class: May 2, 2017

Common stock, \$1.00 par value 89,449,655

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES

PART I

Item 1. Financial Statements (Unaudited)

The Consolidated Financial Statements of Washington Federal, Inc. and Subsidiaries filed as a part of the report are as follows:

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Consolidated Statements of Operations for the three and six months ended March 31, 2017 and March 31, 2016 4

Consolidated Statements of Comprehensive Income for the three and six months ended March 31, 2017 and March 31, 2016 5

Consolidated Statements of Stockholders' Equity for the six months ended March 31, 2017 and March 31, 2016 6

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CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION  
(UNAUDITED)

|  | March 31,<br>2017                 | September 30,<br>2016 |
|--|-----------------------------------|-----------------------|
|  | (In thousands, except share data) |                       |
| <b>ASSETS</b>  |                                   |                       |
| Cash and cash equivalents  | \$266,397                         | \$450,368             |
| Available-for-sale securities, at fair value   | 1,388,782                         | 1,922,894             |
| Held-to-maturity securities, at amortized cost   | 1,697,650                         | 1,417,599             |
| Loans receivable, net of allowance for loan losses of \$121,922 and \$113,494  | 10,463,022                        | 9,910,920             |
| Interest receivable  | 40,573                            | 37,669                |
| Premises and equipment, net  | 271,727                           | 281,951               |
| Real estate owned  | 22,543                            | 29,027                |
| FHLB and FRB stock   | 119,990                           | 117,205               |
| Bank owned life insurance  | 210,873                           | 208,123               |
| Intangible assets, including goodwill of \$291,503   | 296,070                           | 296,989               |
| Federal and state income tax assets, net   | —                                 | 16,047                |
| Other assets   | 183,049                           | 199,271               |
|  | \$14,960,676                      | \$14,888,063          |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                                   |                       |
| <b>Liabilities</b>   |                                   |                       |
| Customer accounts  |                                   |                       |
| Transaction deposit accounts   | \$6,212,699                       | \$6,005,592           |
| Time deposit accounts  | 4,418,108                         | 4,595,260             |
|  | 10,630,807                        | 10,600,852            |
| FHLB advances  | 2,150,000                         | 2,080,000             |
| Advance payments by borrowers for taxes and insurance  | 42,226                            | 42,898                |
| Accrued expenses and other liabilities   | 122,881                           | 188,582               |
|  | 12,945,914                        | 12,912,332            |
| <b>Stockholders' equity</b>  |                                   |                       |
| Common stock, \$1.00 par value, 300,000,000 shares authorized; 134,823,779 and 134,307,818 shares issued; 89,438,563 and 89,680,847 shares outstanding | 134,824                           | 134,308               |
| Paid-in capital  | 1,658,548                         | 1,648,388             |
| Accumulated other comprehensive income (loss), net of taxes  | 2,279                             | (11,156 )             |
| Treasury stock, at cost; 45,385,216 and 44,626,971 shares  | (760,087 )                        | (739,686 )            |
| Retained earnings  | 979,198                           | 943,877               |
|  | 2,014,762                         | 1,975,731             |
|  | \$14,960,676                      | \$14,888,063          |

SEE NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS



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CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

|   | Three Months Ended March<br>31,   |                  | Six Months Ended March 31,        |                  |
|---|-----------------------------------|------------------|-----------------------------------|------------------|
|   | 2017                              | 2016             | 2017                              | 2016             |
|   | (In thousands, except share data) |                  | (In thousands, except share data) |                  |
| <b>INTEREST INCOME</b>  |                                   |                  |                                   |                  |
| Loans receivable  | \$ 116,034                        | \$ 113,211       | \$ 230,869                        | \$ 226,074       |
| Mortgage-backed securities                                    | 16,226                            | 16,846           | 29,015                            | 33,833           |
| Investment securities and cash equivalents                    | 3,938                             | 5,006            | 9,078                             | 10,280           |
|   | 136,198                           | 135,063          | 268,962                           | 270,187          |
| <b>INTEREST EXPENSE</b>                                       |                                   |                  |                                   |                  |
| Customer accounts   | 12,392                            | 13,071           | 25,409                            | 25,788           |
| FHLB advances   | 16,079                            | 15,667           | 32,674                            | 31,205           |
|   | 28,471                            | 28,738           | 58,083                            | 56,993           |
| Net interest income   | 107,727                           | 106,325          | 210,879                           | 213,194          |
| Provision (release) for loan losses                           | (1,600)                           | (1,500)          | (1,600)                           | (1,500)          |
| Net interest income after provision (release) for loan losses | 109,327                           | 107,825          | 212,479                           | 214,694          |
| <b>OTHER INCOME</b>   |                                   |                  |                                   |                  |
| Gain on sale of investment securities                         | —                                 | —                | 968                               | —                |
| Loan fee income   | 1,087                             | 1,166            | 2,421                             | 2,683            |
| Deposit fee income  | 4,904                             | 5,350            | 10,089                            | 11,267           |
| Other income  | 4,145                             | 4,213            | 8,554                             | 7,414            |
|   | 10,136                            | 10,729           | 22,032                            | 21,364           |
| <b>OTHER EXPENSE</b>  |                                   |                  |                                   |                  |
| Compensation and benefits                                     | 28,833                            | 29,184           | 55,827                            | 58,883           |
| Occupancy   | 9,091                             | 8,969            | 17,541                            | 17,561           |
| FDIC insurance premiums                                       | 2,910                             | 2,785            | 5,749                             | 5,374            |
| Product delivery  | 3,489                             | 4,294            | 6,850                             | 9,817            |
| Information technology  | 6,686                             | 7,453            | 13,137                            | 16,163           |
| Other expense   | 6,458                             | 6,541            | 12,704                            | 15,937           |
|   | 57,467                            | 59,226           | 111,808                           | 123,735          |
| Gain on real estate owned, net                                | 795                               | 3,894            | 1,193                             | 5,314            |
| Income before income taxes                                    | 62,791                            | 63,222           | 123,896                           | 117,637          |
| Income tax expense  | 20,721                            | 21,499           | 40,580                            | 40,816           |
| <b>NET INCOME</b>   | <b>\$ 42,070</b>                  | <b>\$ 41,723</b> | <b>\$ 83,316</b>                  | <b>\$ 76,821</b> |
| <b>PER SHARE DATA</b>   |                                   |                  |                                   |                  |
| Basic earnings per share                                      | \$ 0.47                           | \$ 0.45          | \$ 0.93                           | \$ 0.83          |
| Diluted earnings per share                                    | 0.47                              | 0.45             | 0.93                              | 0.83             |
| Dividends paid on common stock per share                      | 0.40                              | 0.14             | 0.54                              | 0.27             |
| Basic weighted average number of shares outstanding           | 89,382,416                        | 91,777,771       | 89,346,294                        | 92,385,367       |
| Diluted weighted average number of shares outstanding         | 89,736,320                        | 92,147,998       | 89,732,042                        | 92,860,052       |

SEE NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(UNAUDITED)

|   | Three Months<br>Ended March 31, |           | Six Months Ended<br>March 31, |           |
|---|---------------------------------|-----------|-------------------------------|-----------|
|   | 2017                            | 2016      | 2017                          | 2016      |
|   | (In thousands)                  |           | (In thousands)                |           |
| Net income  | \$42,070                        | \$41,723  | \$83,316                      | \$76,821  |
| Other comprehensive income (loss) net of tax:   |                                 |           |                               |           |
| Net unrealized gain (loss) on available-for-sale investment securities  | 5,685                           | 6,916     | (11,394 )                     | (3,445 )  |
| Reclassification adjustment of net gain (loss) from sale<br>of available-for-sale securities included in net income | —                               | —         | 968                           | —         |
| Related tax benefit (expense)   | (2,089 )                        | (2,542 )  | 3,832                         | 1,266     |
|   | 3,596                           | 4,374     | (6,594 )                      | (2,179 )  |
| Net unrealized gain (loss) on long-term borrowing hedge   | 2,395                           | (13,483 ) | 31,666                        | (10,688 ) |
| Related tax benefit (expense)   | (880 )                          | 4,955     | (11,637 )                     | 3,928     |
|   | 1,515                           | (8,528 )  | 20,029                        | (6,760 )  |
| Other comprehensive income (loss) net of tax  | 5,111                           | (4,154 )  | 13,435                        | (8,939 )  |
| Comprehensive income  | \$47,181                        | \$37,569  | \$96,751                      | \$67,882  |

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
(UNAUDITED)

| (in thousands)                                 | Common<br>Stock | Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Treasury<br>Stock | Total        |
|--|-----------------|--------------------|----------------------|--|-------------------|--------------|
| Balance at October 1, 2016                     | \$ 134,308      | \$ 1,648,388       | \$ 943,877           | \$ (11,156 )   | \$(739,686)       | \$ 1,975,731 |
| Net income                                     |                 |                    | 83,316               |  |                   | 83,316       |
| Other comprehensive income (loss)              |                 |                    |                      | 13,435   |                   | 13,435       |
| Dividends on common stock                      |                 |                    | (47,995 )            |  |                   | (47,995 )    |
| Proceeds from exercise of common stock options | 282             | 6,223              |                      |  |                   | 6,505        |
| Restricted stock expense                       | 110             | 4,061              |                      |  |                   | 4,171        |
| Exercise of stock warrants                     | 124             | (124 )             |                      |  |                   | —            |
| Treasury stock acquired                        |                 |                    |                      |  | (20,401 )         | (20,401 )    |
| Balance at March 31, 2017                      | \$ 134,824      | \$ 1,658,548       | \$ 979,198           | \$ 2,279   | \$(760,087)       | \$ 2,014,762 |

| (in thousands)                                       | Common<br>Stock | Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Treasury<br>Stock | Total        |
|--|-----------------|--------------------|----------------------|--|-------------------|--------------|
| Balance at October 1, 2015                           | \$ 133,696      | \$ 1,643,712       | \$ 829,754           | \$ 353   | \$(651,836)       | \$ 1,955,679 |
| Net income   |                 |                    | 76,821               |  |                   | 76,821       |
| Other comprehensive income (loss)                    |                 |                    |                      | (8,939 )   |                   | (8,939 )     |
| Dividends on common stock                            |                 |                    | (24,735 )            |  |                   | (24,735 )    |
| Compensation expense related to common stock options |                 | 600                |                      |  |                   | 600          |
| Proceeds from exercise of common stock options       | 250             | 5,149              |                      |  |                   | 5,399        |
| Restricted stock expense                             | 146             | 1,936              |                      |  |                   | 2,082        |
| Treasury stock acquired                              |                 |                    |                      |  | (44,447 )         | (44,447 )    |
| Balance at March 31, 2016                            | \$ 134,092      | \$ 1,651,397       | \$ 881,840           | \$ (8,586 )  | \$(696,283)       | \$ 1,962,460 |

SEE NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

|   | Six Months Ended<br>March 31, |            |
|---|-------------------------------|------------|
|   | 2017                          | 2016       |
|   | (In thousands)                |            |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                       |                               |            |
| Net income  | \$83,316                      | \$76,821   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                               |            |
| Depreciation, amortization, and accretion, net                                    | 18,770                        | 11,082     |
| Cash received from (paid to) FDIC under loss share                                | 264                           | 2,153      |
| Stock based compensation  | 4,171                         | 600        |
| Provision (release) for loan losses   | (1,600 )                      | (1,500 )   |
| Loss (gain) on sale of investment securities                                      | (968 )                        | —          |
| Decrease (increase) in accrued interest receivable                                | (2,904 )                      | 2,858      |
| Decrease (increase) in federal and state income tax receivable                    | 16,047                        | 8,163      |
| Decrease (increase) in cash surrender value of bank owned life insurance          | (3,332 )                      | (2,159 )   |
| Gain on settlement of bank owned life insurance                                   | (649 )                        | —          |
| Net realized (gain) loss on sales of premises, equipment, and real estate owned   | (2,587 )                      | (6,629 )   |
| Decrease (increase) in other assets   | 15,275                        | (5,551 )   |
| Increase (decrease) in accrued expenses and other liabilities                     | (41,839 )                     | 49,710     |
| Net cash provided by (used in) operating activities                               | 83,964                        | 135,548    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                       |                               |            |
| Origination of loans and principal repayments, net                                | (477,029 )                    | (321,573 ) |
| Loans purchased   | (72,856 )                     | (51,646 )  |
| FHLB & FRB stock purchased  | (17,209 )                     | (32,329 )  |
| FHLB & FRB stock redemption   | 14,424                        | 26,340     |
| Available-for-sale securities purchased   | —                             | (50,741 )  |
| Principal payments and maturities of available-for-sale securities                | 169,937                       | 328,188    |
| Proceeds on available-for-sale securities sold                                    | 350,890                       | —          |
| Held-to-maturity securities purchased   | (415,729 )                    | —          |
| Principal payments and maturities of held-to-maturity securities                  | 131,556                       | 82,536     |
| Proceeds from sales of real estate owned  | 10,222                        | 38,347     |
| Proceeds from settlement of bank owned life insurance                             | 1,231                         | —          |
| Purchase of bank owned life insurance   | —                             | (100,000 ) |
| Proceeds from sales of premises and equipment                                     | 3,956                         | 40         |
| Premises and equipment purchased and REO improvements                             | (4,872 )                      | (34,288 )  |
| Net cash provided by (used in) investing activities                               | (305,479 )                    | (115,126 ) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                       |                               |            |
| Net increase (decrease) in customer accounts                                      | 30,107                        | (88,243 )  |
| Proceeds from borrowings  | 430,000                       | 818,000    |
| Repayments of borrowings  | (360,000 )                    | (668,000 ) |
| Proceeds from exercise of common stock options                                    | 6,505                         | 5,399      |
| Dividends paid on common stock  | (47,995 )                     | (24,735 )  |
| Treasury stock purchased  | (20,401 )                     | (44,447 )  |
| Increase (decrease) in advance payments by borrowers for taxes and insurance      | (672 )                        | (26,361 )  |
| Net cash provided by (used in) financing activities                               | 37,544                        | (28,387 )  |
| Increase (decrease) in cash and cash equivalents                                  | (183,971 )                    | (7,965 )   |

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|  |           |           |
|--|-----------|-----------|
| Cash and cash equivalents at beginning of period | 450,368   | 284,049   |
| Cash and cash equivalents at end of period       | \$266,397 | \$276,084 |

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SEE NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (UNAUDITED)

|  | Six Months<br>Ended March<br>31,<br>2017 2016<br>(In thousands) |          |
|--|---|----------|
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b> |   |          |
| Non-cash investing activities                            |   |          |
| Real estate acquired through foreclosure                 | \$2,134   | \$10,535 |
| Non-cash financing activities                            |   |          |
| Stock issued upon exercise of warrants                   | 4,036   | —        |
| Cash paid during the period for                          |   |          |
| Interest   | 55,599  | 57,325   |
| Income taxes   | 16,903  | 27,245   |

SEE NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES  
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

NOTE A – Summary of Significant Accounting Policies

Nature of Operations - Washington Federal, Inc. is a Washington corporation headquartered in Seattle, Washington. The Company is a bank holding company that conducts its operations through a federally-insured national bank subsidiary. The Bank is principally engaged in the business of holding deposits from the general public and investing these funds, together with borrowings and other funds, in one-to-four family residential mortgage and construction loans, home equity loans, lines of credit, commercial and industrial loans, multi-family and other forms of real estate loans. As used throughout this document, the terms "Washington Federal" or the "Company" refer to Washington Federal, Inc. and its consolidated subsidiaries and the term "Bank" refers to the operating subsidiary Washington Federal, National Association.

Basis of Presentation - The consolidated unaudited interim financial statements included in this report have been prepared by Washington Federal. All intercompany transactions and accounts have been eliminated in consolidation. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect amounts reported in the financial statements. Actual results could differ from these estimates. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation are reflected in the interim financial statements.

The information included in this Form 10-Q should be read in conjunction with the financial statements and related notes in the Company's 2016 Annual Report on Form 10-K ("2016 Annual Financial Statements"). Interim results are not necessarily indicative of results for a full year.

Summary of Significant Accounting Policies - The significant accounting policies used in preparation of the Company's consolidated financial statements are disclosed in its 2016 Annual Financial Statements. There have not been any material changes in our significant accounting policies compared to those contained in our 2016 Annual Financial Statements for the year ended September 30, 2016.

Off-Balance-Sheet Credit Exposures – The only material off-balance-sheet credit exposures are loans in process and unused lines of credit, which had a combined balance of \$1,669,658,000 and \$1,278,829,000 at March 31, 2017 and September 30, 2016, respectively. The Company estimates losses on off-balance-sheet credit exposures by allocating a loss percentage derived from historical loss factors for each asset class.

NOTE B – New Accounting Pronouncements

In March 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities. The ASU shortens the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The ASU is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. If an entity early adopts in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments should be applied on a modified retrospective basis, with a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company does not anticipate that this guidance will have a material impact on its consolidated financial statements.

In February 2017, the FASB issued ASU 2017-05, Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets. The ASU clarifies that a financial asset is within the scope of Subtopic 610-20 if

it meets the definition of an in substance nonfinancial asset. The amendments also define the term in substance nonfinancial asset. The amendments clarify that nonfinancial assets within the scope of Subtopic 610-20 may include nonfinancial assets transferred within a legal entity to a counterparty. A contract that includes the transfer of ownership interests in one or more consolidated subsidiaries is within the scope of Subtopic 610-20 if substantially all of the fair value of the assets that are promised to the counterparty in a contract is concentrated in nonfinancial assets. The amendments clarify that an entity should identify each distinct nonfinancial asset or in substance nonfinancial asset promised to a counterparty and derecognize each asset when a counterparty obtains control of it. The ASU is effective for public business entities for annual periods beginning after December 15, 2017 and

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES  
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

interim periods therein. Entities may use either a full or modified approach to adopt the ASU. The Company does not anticipate that this guidance will have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which eliminates Step 2 from the goodwill impairment test. The ASU also eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The ASU is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019 with early adoption being permitted for annual or interim goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not anticipate that this guidance will have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, Business Combinations Clarifying the Definition of a Business (Topic 805), for determining whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017 with early adoption permitted for transactions that occurred before the issuance date or effective date of the standard if the transactions were not reported in financial statements that have been issued or made available for issuance. The ASU must be applied prospectively and upon adoption the standard will impact how we assess acquisitions (or disposals) of assets or businesses. The Company does not anticipate that this guidance will have a material impact on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash: a Consensus of the FASB Emerging Issues Task Force. This ASU requires a company's cash flow statement to explain the changes during a reporting period of the totals for cash, cash equivalents, restricted cash, and restricted cash equivalents. Additionally, amounts for restricted cash and restricted cash equivalents are to be included with cash and cash equivalents if the cash flow statement includes a reconciliation of the total cash balances for a reporting period. This ASU is effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017, with early application permitted. The Company does not anticipate that this guidance will have a material impact on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments. The amendments in this ASU address eight specific cash flow issues with the objective of reducing diversity in practice. The specific issues identified include: debt prepayments or extinguishment costs; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (including bank-owned life insurance policies); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. This ASU is effective for fiscal years beginning after December 15, 2017 including interim periods within that reporting period; however, early adoption is permitted. The Company is currently evaluating the guidance to determine its adoption method and does not expect this guidance to have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses. The amendments in this ASU were issued to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investments in leases and other



commitments to extend credit held by a reporting entity at each reporting date. The amendments require that financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The ASU eliminates the current framework of recognizing probable incurred losses and instead requires an entity to use its current estimate of all expected credit losses over the contractual life. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the financial assets.

For purchased financial assets with a more-than-insignificant amount of credit deterioration since origination (“PCD assets”) that are measured at amortized cost, an allowance for expected credit losses is recorded as an adjustment to the cost basis of the asset. Subsequent changes in estimated cash flows would be recorded as an adjustment to the allowance and through the statement of income.

Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security's cost basis.

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The amendments in this ASU are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For most debt securities, the transition approach requires a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period the guidance is effective. For other-than-temporarily impaired debt securities and PCD assets, the guidance will be applied prospectively. The Company is currently evaluating the provisions of this ASU to determine the impact the new standard will have on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases. The amendments require lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. The guidance also simplifies the accounting for sale and leaseback transactions. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently evaluating the provisions of this ASU to determine the impact this guidance will have on the Company's consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, to require all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). The amendments in this ASU also require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. This ASU is effective for fiscal years beginning after December 15, 2017 including interim periods within that reporting period. The Company does not expect this guidance to have a material impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The guidance in this update supersedes the revenue recognition requirements in ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the industry topics of the codification. For public companies, this update was to be effective for interim and annual periods beginning after December 15, 2016. However, in August 2015, the FASB issued ASU 2015-14, which delayed the effective date of ASU 2014-09 by one year and permits companies to voluntarily adopt the new standard as of the original effective date. The Company does not expect this guidance to have a material impact on its consolidated financial statements.

NOTE C – Dividends and Share Repurchases

On February 10, 2017, the Company paid a regular dividend on common stock of \$0.15 per share, which represented the 136th consecutive quarterly cash dividend, as well as a special cash dividend on common stock of \$0.25 per share. Dividends per share were \$0.40 and \$0.14 for the quarters ended March 31, 2017 and 2016, respectively. On April 24,

2017, the Company declared a regular dividend on common stock of \$0.15 per share, which represents its 137th consecutive quarterly cash dividend. This dividend will be paid on May 19, 2017 to common shareholders of record on May 5, 2017.

For the three months ended March 31, 2017, the Company repurchased 477 shares at an average price of \$33.55. Additionally, 73,995 shares of common stock were issued during the three months ended March 31, 2017 to investors that exercised warrants previously issued as part of the 2008 Troubled Asset Relief Program ("TARP"). As of March 31, 2017, 536,152 such warrants remain outstanding. Net of warrant repurchase and exercise activity, there are 4,157,081 remaining shares authorized to be repurchased under the current Board approved share repurchase program.

NOTE D – Loans Receivable

The following table is a summary of loans receivable.

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|  | March 31, 2017 |         | September 30, 2016 |         |
|--|----------------|---------|--------------------|---------|
|  | (In thousands) |         | (In thousands)     |         |
| Gross loans by category                |                |         |                    |         |
| Single-family residential              | \$5,693,072    | 48.9 %  | \$5,658,830        | 51.7 %  |
| Construction                           | 1,311,635      | 11.3    | 1,110,411          | 10.1    |
| Construction - custom                  | 527,319        | 4.5     | 473,069            | 4.3     |
| Land - acquisition & development       | 118,726        | 1.0     | 118,497            | 1.1     |
| Land - consumer lot loans              | 101,227        | 0.9     | 104,567            | 1.0     |
| Multi-family                           | 1,266,911      | 10.9    | 1,124,290          | 10.3    |
| Commercial real estate                 | 1,296,039      | 11.1    | 1,093,639          | 10.0    |
| Commercial & industrial                | 1,071,629      | 9.2     | 978,589            | 8.9     |
| HELOC                                  | 146,172        | 1.3     | 149,716            | 1.4     |
| Consumer                               | 107,759        | 0.9     | 139,000            | 1.3     |
| Total gross loans                      | 11,640,489     | 100.0 % | 10,950,608         | 100.0 % |
| Less:                                  |                |         |                    |         |
| Allowance for loan losses              | 121,922        |         | 113,494            |         |
| Loans in process                       | 1,009,937      |         | 879,484            |         |
| Net deferred fees, costs and discounts | 45,608         |         | 46,710             |         |
| Total loan contra accounts             | 1,177,467      |         | 1,039,688          |         |
| Net loans                              | \$10,463,022   |         | \$9,910,920        |         |

The following table sets forth information regarding non-accrual loans.

|                                  | March 31, 2017 |        | September 30, 2016 |        |
|----------------------------------|----------------|--------|--------------------|--------|
|                                  | (In thousands) |        | (In thousands)     |        |
| Non-accrual loans:               |                |        |                    |        |
| Single-family residential        | \$34,373       | 60.1 % | \$33,148           | 78.2 % |
| Construction - custom            | 240            | 0.4    | —                  | —      |
| Land - acquisition & development | 80             | 0.1    | 58                 | 0.1    |
| Land - consumer lot loans        | 1,129          | 2.0    | 510                | 1.2    |
| Multi-family                     | 1,364          | 2.4    | 776                | 1.8    |
| Commercial real estate           | 10,507         | 18.4   | 7,100              | 16.7   |
| Commercial & industrial          | 8,864          | 15.5   | 583                | 1.4    |
| HELOC                            | 583            | 1.0    | 239                | 0.6    |
| Consumer                         | 55             | 0.1    | —                  | —      |
| Total non-accrual loans          | \$57,195       | 100 %  | \$42,414           | 100 %  |

The Company recognized interest income on non-accrual loans of approximately \$1,094,000 in the six months ended March 31, 2017. Had these loans been on accrual status and performed according to their original contract terms, the Company would have recognized interest income of approximately \$1,134,000 for the six months ended March 31, 2017. Interest cash flows collected on non-accrual loans varies from period to period as those loans are brought current or get paid off.

For acquired loans included in the non-accrual loan table above, interest income is still recognized on such loans through accretion of the difference between the carrying amount of the loans and the expected cash flows.

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The following tables provide details regarding delinquent loans.

| March 31, 2017<br>Type of Loan   | Loans<br>Receivable<br>Net of Loans<br>In Process<br>(In thousands) | Days Delinquent Based on \$ Amount of Loans |          |         |          |          | % based<br>on \$ |
|----------------------------------|---|---|----------|---------|----------|----------|------------------|
|                                  |   | Current                                     | 30       | 60      | 90       | Total    |                  |
| Single-family residential        | \$5,692,305   | \$5,639,158                                 | \$13,644 | \$7,660 | \$31,843 | \$53,147 | 0.93 %           |
| Construction                     | 593,479   | 592,877                                     | 601      | —       | —        | 601      | 0.10             |
| Construction - custom            | 251,906   | 251,666                                     | —        | —       | 240      | 240      | 0.10             |
| Land - acquisition & development | 103,280   | 103,018                                     | 262      | —       | —        | 262      | 0.25             |
| Land - consumer lot loans        | 101,168   | 99,907                                      | 360      | 333     | 568      | 1,261    | 1.25             |
| Multi-family                     | 1,266,845   | 1,265,622                                   | —        | —       | 1,224    | 1,224    | 0.10             |
| Commercial real estate           | 1,296,019   | 1,289,677                                   | 1,802    | 298     | 4,242    | 6,342    | 0.49             |
| Commercial & industrial          | 1,071,622   | 1,066,658                                   | 4,964    | —       | —        | 4,964    | 0.46             |
| HELOC                            | 146,169   | 145,355                                     | 124      | 20      | 670      | 814      | 0.56             |
| Consumer                         | 107,759   | 107,158                                     | 405      | 98      | 98       | 601      | 0.56             |
| Total Loans                      | \$10,630,552  | \$10,561,096                                | \$22,162 | \$8,409 | \$38,885 | \$69,456 | 0.65 %           |
| Delinquency %                    |   | 99.35%                                      | 0.21%    | 0.08%   | 0.37%    | 0.65%    |                  |

| September 30, 2016<br>Type of Loan | Loans<br>Receivable<br>Net of Loans<br>In Process<br>(In thousands) | Days Delinquent Based on \$ Amount of Loans |          |         |          |          | % based<br>on \$ |
|------------------------------------|---|---|----------|---------|----------|----------|------------------|
|                                    |   | Current                                     | 30       | 60      | 90       | Total    |                  |
| Single-family residential          | \$5,658,122   | \$5,601,457                                 | \$20,916 | \$5,271 | \$30,478 | \$56,665 | 1.00 %           |
| Construction                       | 498,450   | 498,450                                     | —        | —       | —        | —        | —                |
| Construction - custom              | 229,957   | 229,419                                     | 538      | —       | —        | 538      | 0.23             |
| Land - acquisition & development   | 94,928  | 94,928                                      | —        | —       | —        | —        | —                |
| Land - consumer lot loans          | 104,534   | 102,472                                     | 816      | 687     | 559      | 2,062    | 1.97             |
| Multi-family                       | 1,124,290   | 1,122,307                                   | 1,190    | 399     | 394      | 1,983    | 0.18             |
| Commercial real estate             | 1,093,549   | 1,088,680                                   | 69       | 325     | 4,475    | 4,869    | 0.45             |
| Commercial & industrial            | 978,582   | 978,540                                     | —        | 42      | —        | 42       | —                |
| HELOC                              | 149,713   | 148,513                                     | 763      | 164     | 273      | 1,200    | 0.80             |
| Consumer                           | 138,999   | 138,078                                     | 715      | 126     | 80       | 921      | 0.66             |
| Total Loans                        | \$10,071,124  | \$10,002,844                                | \$25,007 | \$7,014 | \$36,259 | \$68,280 | 0.68 %           |
| Delinquency %                      |   | 99.32%                                      | 0.25%    | 0.07%   | 0.36%    | 0.68%    |                  |

The percentage of total delinquent loans decreased from 0.68% as of September 30, 2016 to 0.65% as of March 31, 2017 and there are no loans greater than 90 days delinquent and still accruing interest as of either date.

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The following tables provide information related to loans that were restructured in a troubled debt restructuring ("TDR") during the periods presented:

|                               | Three Months Ended March 31,<br>2017 |                                  |   | 2016                            |                                  |   |
|-------------------------------|--------------------------------------|----------------------------------|---|---------------------------------|----------------------------------|---|
|                               | Pre-Modification<br>Outstanding      | Post-Modification<br>Outstanding | Number<br>of<br>Recorded<br>Contracts<br>(In thousands) | Pre-Modification<br>Outstanding | Post-Modification<br>Outstanding | Number<br>of<br>Recorded<br>Contracts<br>(In thousands) |
| Troubled Debt Restructurings: |                                      |                                  |   |                                 |                                  |   |
| Single-family residential     | 8                                    | \$ 1,712                         | \$ 1,712  | 7                               | \$ 1,101                         | \$ 1,101  |
|                               | 8                                    | \$ 1,712                         | \$ 1,712  | 7                               | \$ 1,101                         | \$ 1,101  |
| Six Months Ended March 31,    |                                      |                                  |   |                                 |                                  |   |
|                               | 2017                                 |                                  |   | 2016                            |                                  |   |
|                               | Pre-Modification<br>Outstanding      | Post-Modification<br>Outstanding | Number<br>of<br>Recorded<br>Contracts<br>(In thousands) | Pre-Modification<br>Outstanding | Post-Modification<br>Outstanding | Number<br>of<br>Recorded<br>Contracts<br>(In thousands) |
| Troubled Debt Restructurings: |                                      |                                  |   |                                 |                                  |   |
| Single-family residential     | 20                                   | \$ 3,846                         | \$ 3,846  | 10                              | \$ 1,830                         | \$ 1,830  |
| Land - consumer lot loans     | 1                                    | 204                              | 204   | —                               | —                                | —   |
| Commercial real estate        | —                                    | —                                | —   | 5                               | 965                              | 965   |
| HELOC                         | 1                                    | 228                              | 228   | —                               | —                                | —   |
|                               | 22                                   | \$ 4,278                         | \$ 4,278  | 15                              | \$ 2,795                         | \$ 2,795  |

The following tables provide information on payment defaults occurring during the periods presented where the loan had been modified in a TDR within 12 months of the payment default.

|                                   | Three Months Ended March<br>31,                            |  |
|-----------------------------------|--|--|
|                                   | 2017   | 2016   |
|                                   | Number<br>of<br>Recorded<br>Contracts<br>(In<br>thousands) | Number<br>of<br>Recorded<br>Contracts<br>(In<br>thousands) |
| TDRs That Subsequently Defaulted: |  |  |
| Single-family residential         | 7 \$ 1,192   | 6 \$ 871   |
| Land - consumer lot loans         | —  | 1 146  |
| Commercial real estate            | —  | 1 152  |
|                                   | 7 \$ 1,192   | 8 \$ 1,169   |





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|                                   | Six Months Ended March 31,                          |   |
|-----------------------------------|---|---|
|                                   | 2017  | 2016  |
|                                   | Number<br>of Recorded<br>Contract<br>(In thousands) | Number<br>of Recorded<br>Contract<br>(In thousands) |
| TDRs That Subsequently Defaulted: |   |   |
| Single-family residential         | 13 \$ 3,185   | 8 \$ 1,095  |
| Land - consumer lot loans         | — —   | 1 146   |
| Commercial real estate            | 2 267   | 1 152   |
|                                   | 15 \$ 3,452   | 10 \$ 1,393   |

Most loans restructured in TDRs are accruing and performing loans where the borrower has proactively approached the Company about modification due to temporary financial difficulties. As of March 31, 2017, 95.0% of the Company's \$233,901,000 in TDRs were classified as performing. Each request for modification is individually evaluated for merit and likelihood of success. The concession granted in a loan modification is typically a payment reduction through a rate reduction of between 100 to 200 basis points for a specific term, usually six to twenty four months. Interest-only payments may also be approved during the modification period. Principal forgiveness is not an available option for restructured loans. As of March 31, 2017, single-family residential loans comprised 87.6% of TDRs.

The Company reserves for restructured loans within its allowance for loan loss methodology by taking into account the following performance indicators: 1) time since modification, 2) current payment status and 3) geographic area.

The remaining outstanding balance of covered loans was \$24,428,000 at March 31, 2017 compared to \$28,974,000 as of September 30, 2016. The FDIC loss share coverage for single family residential loans related to the Horizon Bank and Home Valley Bank acquisitions will continue for another four years.

The following table shows activity for the FDIC indemnification asset:

|                                | Six<br>Months<br>Ended<br>March<br>31, 2017<br>(In thousands) | Twelve<br>Months<br>Ended<br>September<br>30, 2016 |
|--------------------------------|---|--|
| Balance at beginning of period | \$12,769  | \$16,275   |
| Payments made (received)       | (264 )  | (1,730 )   |
| Amortization                   | (802 )  | (2,012 )   |
| Accretion                      | 118   | 236  |
| Balance at end of period       | \$11,821  | \$12,769   |

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## NOTE E – Allowance for Losses on Loans

The following tables summarize the activity in the allowance for loan losses.

| Three Months Ended March 31, 2017 | Beginning Allowance | Charge-offs | Recoveries | Provision & Transfers | Ending Allowance |
|-----------------------------------|---------------------|-------------|------------|-----------------------|------------------|
|                                   | (In thousands)      |             |            |                       |                  |
| Single-family residential         | \$38,206            | \$ (381 )   | \$ 223     | \$ (884 )             | \$ 37,164        |
| Construction                      | 21,934              | —           | —          | 3,127                 | 25,061           |
| Construction - custom             | 1,110               | (3 )        | —          | 69                    | 1,176            |
| Land - acquisition & development  | 6,665               | (43 )       | 4,211      | (4,164 )              | 6,669            |
| Land - consumer lot loans         | 2,501               | —           | 180        | (168 )                | 2,513            |
| Multi-family                      | 7,629               | —           | —          | 300                   | 7,929            |
| Commercial real estate            | 10,168              | —           | 1,164      | (560 )                | 10,772           |
| Commercial & industrial           | 27,736              | (105 )      | 217        | 517                   | 28,365           |
| HELOC                             | 832                 | (53 )       | —          | 47                    | 826              |
| Consumer                          | 1,675               | (508 )      | 314        | (34 )                 | 1,447            |
|                                   | \$118,456           | \$ (1,093 ) | \$ 6,309   | \$ (1,750 )           | \$ 121,922       |
| Three Months Ended March 31, 2016 | Beginning Allowance | Charge-offs | Recoveries | Provision & Transfers | Ending Allowance |
|                                   | (In thousands)      |             |            |                       |                  |
| Single-family residential         | \$47,756            | \$ (1,026 ) | \$ 111     | \$ (5,013 )           | \$ 41,828        |
| Construction                      | 7,014               | —           | (5 )       | 8,717                 | 15,726           |
| Construction - custom             | 1,062               | —           | —          | (40 )                 | 1,022            |
| Land - acquisition & development  | 6,778               | —           | 3,371      | (2,897 )              | 7,252            |
| Land - consumer lot loans         | 3,001               | (268 )      | —          | (267 )                | 2,466            |
| Multi-family                      | 5,047               | —           | —          | 1,737                 | 6,784            |
| Commercial real estate            | 10,344              | (9 )        | 992        | (3,544 )              | 7,783            |
| Commercial & industrial           | 24,096              | (331 )      | 590        | (531 )                | 23,824           |
| HELOC                             | 820                 | (26 )       | —          | 34                    | 828              |
| Consumer                          | 1,983               | (278 )      | 397        | 304                   | 2,406            |
|                                   | \$107,901           | \$ (1,938 ) | \$ 5,456   | \$ (1,500 )           | \$ 109,919       |

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| Six Months Ended March 31, 2017  | Beginning Allowance | Charge-offs | Recoveries | Provision & Transfers | Ending Allowance |
|----------------------------------|---------------------|-------------|------------|-----------------------|------------------|
| (In thousands)                   |                     |             |            |                       |                  |
| Single-family residential        | \$37,796            | \$ (496 )   | \$ 374     | \$ (510 )             | \$ 37,164        |
| Construction                     | 19,838              | —           | —          | 5,223                 | 25,061           |
| Construction - custom            | 1,080               | (3 )        | —          | 99                    | 1,176            |
| Land - acquisition & development | 6,023               | (63 )       | 8,229      | (7,520 )              | 6,669            |
| Land - consumer lot loans        | 2,535               | (17 )       | 250        | (255 )                | 2,513            |
| Multi-family                     | 6,925               | —           | —          | 1,004                 | 7,929            |
| Commercial real estate           | 8,588               | (11 )       | 1,520      | 675                   | 10,772           |
| Commercial & industrial          | 28,008              | (163 )      | 942        | (422 )                | 28,365           |
| HELOC                            | 813                 | (90 )       | 1          | 102                   | 826              |
| Consumer                         | 1,888               | (654 )      | 693        | (480 )                | 1,447            |
|                                  | \$113,494           | \$ (1,497 ) | \$ 12,009  | \$ (2,084 )           | \$ 121,922       |
| Six Months Ended March 31, 2016  | Beginning Allowance | Charge-offs | Recoveries | Provision & Transfers | Ending Allowance |
| (In thousands)                   |                     |             |            |                       |                  |
| Single-family residential        | \$47,347            | \$ (2,165 ) | \$ 2,577   | \$ (5,931 )           | \$ 41,828        |
| Construction                     | 6,680               | —           | 150        | 8,896                 | 15,726           |
| Construction - custom            | 990                 | (60 )       | —          | 92                    | 1,022            |
| Land - acquisition & development | 5,781               | —           | 3,406      | (1,935 )              | 7,252            |
| Land - consumer lot loans        | 2,946               | (676 )      | —          | 196                   | 2,466            |
| Multi-family                     | 5,304               | —           | —          | 1,480                 | 6,784            |
| Commercial real estate           | 8,960               | (32 )       | 1,115      | (2,260 )              | 7,783            |
| Commercial & industrial          | 24,980              | (579 )      | 591        | (1,168 )              | 23,824           |
| HELOC                            | 902                 | (27 )       | 21         | (68 )                 | 828              |
| Consumer                         | 2,939               | (520 )      | 789        | (802 )                | 2,406            |
|                                  | \$106,829           | \$ (4,059 ) | \$ 8,649   | \$ (1,500 )           | \$ 109,919       |

The Company recorded a release of allowance for loan losses of \$1,600,000 during the three months ended March 31, 2017, compared to a \$1,500,000 release of allowance for loan losses recorded during the three months ended March 31, 2016. A release of allowance for loan losses of \$1,600,000 and \$1,500,000 was recorded during the six months ended March 31, 2017 or March 31, 2016, respectively. Reserving for new loan originations as the loan portfolio grows has been largely offset by recoveries of previously charged-off loans. Recoveries, net of charge-offs, totaled \$5,216,000 for the three months ended March 31, 2017, compared with \$3,518,000 of net recoveries for the same period one year ago. Recoveries, net of charge-offs, totaled \$10,512,000 for the six months ended March 31, 2017, compared with \$4,590,000 of net recoveries for the same period one year ago.

Non-performing assets were \$79,738,000, or 0.53%, of total assets at March 31, 2017, compared to \$71,441,000, or 0.48%, of total assets at September 30, 2016. Non-accrual loans were \$57,195,000 at March 31, 2017, compared to \$42,414,000 at September 30, 2016. Delinquencies, as a percent of total loans, were 0.65% at March 31, 2017, compared to 0.68% at September 30, 2016.

The reserve for unfunded commitments was \$5,050,000 as of March 31, 2017, which is an increase from \$3,235,000 at September 30, 2016.

Management believes the allowance for loan losses plus the reserve for unfunded commitments, totaling \$126,972,000, or 1.09% of gross loans as of March 31, 2017, is sufficient to absorb estimated inherent losses.

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The following tables show loans collectively and individually evaluated for impairment and the related allocation of general and specific reserves.

| March 31, 2017                   | Loans Collectively Evaluated for Impairment |                                  |       | Loans Individually Evaluated for Impairment |                                  |       |
|----------------------------------|---|----------------------------------|-------|---|----------------------------------|-------|
|                                  | Allowance Allocation                        | Recorded Investment of Loans (1) | Ratio | Allowance Allocation                        | Recorded Investment of Loans (1) | Ratio |
|                                  | (In thousands)                              |                                  |       | (In thousands)                              |                                  |       |
| Single-family residential        | \$ 37,164                                   | \$ 5,661,673                     | 0.7 % | \$ —  | \$ 25,370                        | — %   |
| Construction                     | 25,061                                      | 593,479                          | 4.2   | —   | —                                | —     |
| Construction - custom            | 1,176                                       | 251,801                          | 0.5   | —   | 105                              | —     |
| Land - acquisition & development | 6,666                                       | 102,281                          | 6.5   | 2   | 438                              | 0.1   |
| Land - consumer lot loans        | 2,513                                       | 91,402                           | 2.7   | —   | 794                              | —     |
| Multi-family                     | 7,919                                       | 1,264,130                        | 0.6   | 10  | 2,496                            | 0.3   |
| Commercial real estate           | 10,685                                      | 1,226,228                        | 0.9   | 88  | 26,112                           | 0.3   |
| Commercial & industrial          | 28,365                                      | 1,059,310                        | 2.7   | —   | 9,606                            | —     |
| HELOC                            | 826   | 137,124                          | 0.6   | —   | 722                              | —     |
| Consumer                         | 1,447                                       | 107,472                          | 1.3   | —   | 15                               | —     |
|                                  | \$ 121,822                                  | \$ 10,494,900                    | 1.2 % | \$ 100                                      | \$ 65,658                        | 0.2 % |

(1) Excludes \$70 million in acquired loans and covered loans with discounts sufficient to cover incurred losses.

| September 30, 2016               | Loans Collectively Evaluated for Impairment |                                  |       | Loans Individually Evaluated for Impairment |                                  |       |
|----------------------------------|---|----------------------------------|-------|---|----------------------------------|-------|
|                                  | Allowance Allocation                        | Recorded Investment of Loans (1) | Ratio | Allowance Allocation                        | Recorded Investment of Loans (1) | Ratio |
|                                  | (In thousands)                              |                                  |       | (In thousands)                              |                                  |       |
| Single-family residential        | \$ 37,536                                   | \$ 5,585,912                     | 0.7 % | \$ 260                                      | \$ 19,629                        | 1.3 % |
| Construction                     | 19,838                                      | 498,450                          | 4.0   | —   | —                                | —     |
| Construction - custom            | 1,080                                       | 229,298                          | 0.5   | —   | 330                              | —     |
| Land - acquisition & development | 6,022                                       | 90,850                           | 6.6   | 2   | 850                              | 0.2   |
| Land - consumer lot loans        | 2,535                                       | 92,828                           | 2.7   | —   | 558                              | —     |
| Multi-family                     | 6,911                                       | 1,091,974                        | 0.6   | 13  | 1,505                            | 0.9   |
| Commercial real estate           | 8,497                                       | 957,380                          | 0.9   | 91  | 11,157                           | 0.8   |
| Commercial & industrial          | 28,008                                      | 966,930                          | 2.9   | —   | —                                | —     |
| HELOC                            | 813   | 133,203                          | 0.6   | —   | 239                              | —     |
| Consumer                         | 1,888                                       | 137,315                          | 1.4   | —   | 3                                | —     |
|                                  | \$ 113,128                                  | \$ 9,784,140                     | 1.2 % | \$ 366                                      | \$ 34,271                        | 1.1 % |

(1) Excludes acquired impaired loans and covered loans with discounts sufficient to cover incurred losses.

As of March 31, 2017, \$121,822,000 of the allowance was calculated under the formulas contained in our general allowance methodology and the remaining \$100,000 was specific reserves on loans deemed to be individually impaired. As of September 30, 2016, \$113,128,000 of the allowance was calculated under the formulas contained in our general allowance methodology and the remaining \$366,000 was specific reserves on loans deemed to be individually impaired.

The Company has an asset quality review function that analyzes its loan portfolios and reports the results of the review to the Board of Directors on a quarterly basis. The single-family residential, HELOC and consumer portfolios are evaluated based on their performance as a pool of loans, since no single loan is individually significant or judged by its risk rating, size or potential risk of loss. The construction, land, multi-family, commercial real estate and commercial and industrial loans are risk rated on a

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loan by loan basis to determine the relative risk inherent in specific borrowers or loans. Based on that risk rating, the loans are assigned a grade and classified as follows:

Pass – the credit does not meet one of the definitions below.

Special mention – A special mention credit is considered to be currently protected from loss but is potentially weak. No loss of principal or interest is foreseen; however, proper supervision and Management attention is required to deter further deterioration in the credit. Assets in this category constitute some undue and unwarranted credit risk but not to the point of justifying a risk rating of substandard. The credit risk may be relatively minor yet constitutes an unwarranted risk in light of the circumstances surrounding a specific asset.

Substandard – A substandard credit is an unacceptable credit. Additionally, repayment in the normal course is in jeopardy due to the existence of one or more well defined weaknesses. In these situations, loss of principal is likely if the weakness is not corrected. A substandard asset is inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral pledged, if any. Assets so classified will have a well defined weakness or weaknesses that jeopardize the collection or liquidation of the debt. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets risk rated substandard.

Doubtful – A credit classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weakness makes collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The probability of loss is high, but because of certain important and reasonably specific pending factors that may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral, and refinancing plans.

Loss – Credits classified loss are considered uncollectible and of such little value that their continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this asset even though partial recovery may be affected in the future. Losses should be taken in the period in which they are identified as uncollectible. Partial charge-off versus full charge-off may be taken if the collateral offers some identifiable protection.

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The following tables provide information on loans based on risk rating categories as defined above.

| March 31, 2017                   | Internally Assigned Grade |                 |             |          |      | Total<br>Gross Loans |
|----------------------------------|---------------------------|-----------------|-------------|----------|------|----------------------|
|                                  | Pass                      | Special mention | Substandard | Doubtful | Loss |                      |
|                                  | (In thousands)            |                 |             |          |      |                      |
| Loan type                        |                           |                 |             |          |      |                      |
| Single-family residential        | \$5,643,124               | \$ —            | \$49,948    | \$ —     | \$ — | \$5,693,072          |
| Construction                     | 1,302,209                 | 5,875           | 3,551       | —        | —    | 1,311,635            |
| Construction - custom            | 527,079                   | —               | 240         | —        | —    | 527,319              |
| Land - acquisition & development | 115,816                   | —               | 2,910       | —        | —    | 118,726              |
| Land - consumer lot loans        | 100,098                   | —               | 1,129       | —        | —    | 101,227              |
| Multi-family                     | 1,251,583                 | 3,206           | 12,122      | —        | —    | 1,266,911            |
| Commercial real estate           | 1,251,520                 | 6,918           | 37,601      | —        | —    | 1,296,039            |
| Commercial & industrial          | 1,041,903                 | 8,018           | 21,708      | —        | —    | 1,071,629            |
| HELOC                            | 144,972                   | —               | 1,200       | —        | —    | 146,172              |
| Consumer                         | 107,698                   | —               | 61          | —        | —    | 107,759              |
| Total gross loans                | \$11,486,002              | \$ 24,017       | \$130,470   | \$ —     | \$ — | \$11,640,489         |

|   |      |       |       |     |     |     |
|---|------|-------|-------|-----|-----|-----|
| Total grade as a % of total gross loans | 98.7 | % 0.2 | % 1.1 | % — | % — | % — |
|---|------|-------|-------|-----|-----|-----|

| September 30, 2016               | Internally Assigned Grade |                 |             |          |      | Total<br>Gross Loans |
|----------------------------------|---------------------------|-----------------|-------------|----------|------|----------------------|
|                                  | Pass                      | Special mention | Substandard | Doubtful | Loss |                      |
|                                  | (In thousands)            |                 |             |          |      |                      |
| Loan type                        |                           |                 |             |          |      |                      |
| Single-family residential        | \$5,607,521               | \$ —            | \$51,309    | \$ —     | \$ — | \$5,658,830          |
| Construction                     | 1,098,549                 | 8,595           | 3,267       | —        | —    | 1,110,411            |
| Construction - custom            | 473,069                   | —               | —           | —        | —    | 473,069              |
| Land - acquisition & development | 111,225                   | —               | 7,272       | —        | —    | 118,497              |
| Land - consumer lot loans        | 103,528                   | —               | 1,039       | —        | —    | 104,567              |
| Multi-family                     | 1,117,437                 | 3,237           | 3,616       | —        | —    | 1,124,290            |
| Commercial real estate           | 1,033,880                 | 13,446          | 46,313      | —        | —    | 1,093,639            |
| Commercial & industrial          | 930,776                   | 7,207           | 40,606      | —        | —    | 978,589              |
| HELOC                            | 149,195                   | —               | 521         | —        | —    | 149,716              |
| Consumer                         | 138,917                   | —               | 83          | —        | —    | 139,000              |
| Total gross loans                | \$10,764,097              | \$ 32,485       | \$154,026   | \$ —     | \$ — | \$10,950,608         |

|   |      |       |       |     |     |     |
|---|------|-------|-------|-----|-----|-----|
| Total grade as a % of total gross loans | 98.3 | % 0.3 | % 1.4 | % — | % — | % — |
|---|------|-------|-------|-----|-----|-----|

The balance of loans internally graded as 'substandard' above includes \$25,668,000 as of March 31, 2017 and \$35,910,000 as of September 30, 2016 of acquired loans and covered loans.

The following tables provide information on loans (excluding acquired and covered loans) based on borrower payment activity.





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| March 31, 2017                   | Performing Loans |                              | Non-Performing Loans |                              |
|----------------------------------|------------------|------------------------------|----------------------|------------------------------|
|                                  | Amount           | % of Total<br>Gross<br>Loans | Amount               | % of Total<br>Gross<br>Loans |
|                                  | (In thousands)   |                              |                      |                              |
| Single-family residential        | \$5,626,725      | 99.4 %                       | \$ 34,373            | 0.6 %                        |
| Construction                     | 1,311,636        | 100.0                        | —                    | —                            |
| Construction - custom            | 527,079          | 100.0                        | 240                  | —                            |
| Land - acquisition & development | 116,857          | 99.9                         | 80                   | 0.1                          |
| Land - consumer lot loans        | 97,537           | 98.9                         | 1,129                | 1.1                          |
| Multi-family                     | 1,263,004        | 99.9                         | 1,364                | 0.1                          |
| Commercial real estate           | 1,173,483        | 99.1                         | 10,507               | 0.9                          |
| Commercial & industrial          | 1,021,889        | 99.1                         | 8,864                | 0.9                          |
| HELOC                            | 134,376          | 99.6                         | 583                  | 0.4                          |
| Consumer                         | 106,466          | 99.9                         | 55                   | 0.1                          |
|                                  | \$11,379,052     | 99.5 %                       | \$ 57,195            | 0.5 %                        |
|                                  |                  |                              |                      |                              |
| September 30, 2016               | Performing Loans |                              | Non-Performing Loans |                              |
|                                  | Amount           | % of Total<br>Gross<br>Loans | Amount               | % of Total<br>Gross<br>Loans |
|                                  | (In thousands)   |                              |                      |                              |
| Single-family residential        | \$5,587,919      | 99.4 %                       | \$ 33,148            | 0.6 %                        |
| Construction                     | 1,110,411        | 100.0                        | —                    | —                            |
| Construction - custom            | 473,069          | 100.0                        | —                    | —                            |
| Land - acquisition & development | 116,097          | 99.9                         | 58                   | 0.1                          |
| Land - consumer lot loans        | 101,343          | 99.5                         | 510                  | 0.5                          |
| Multi-family                     | 1,118,025        | 99.9                         | 776                  | 0.1                          |
| Commercial real estate           | 949,064          | 99.3                         | 7,100                | 0.7                          |
| Commercial & industrial          | 946,065          | 99.9                         | 583                  | 0.1                          |
| HELOC                            | 134,546          | 99.8                         | 239                  | 0.2                          |
| Consumer                         | 137,450          | 100.0                        | —                    | —                            |
|                                  | \$10,673,989     | 99.6 %                       | \$ 42,414            | 0.4 %                        |

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The following tables provide information on impaired loan balances and the related allowances by loan types.

| March 31, 2017                                     | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment |
|--|---------------------|--------------------------|-------------------|-----------------------------|
|  | (In thousands)      |                          |                   |                             |
| Impaired loans with no related allowance recorded: |                     |                          |                   |                             |
| Single-family residential                          | \$25,928            | \$28,378                 | \$ —              | \$ 14,350                   |
| Construction - custom                              | 296                 | 300                      | —                 | 99                          |
| Land - acquisition & development                   | 123                 | 8,346                    | —                 | 130                         |
| Land - consumer lot loans                          | 524                 | 587                      | —                 | 490                         |
| Multi-family                                       | 1,364               | 4,904                    | —                 | 1,100                       |
| Commercial real estate                             | 9,920               | 18,978                   | —                 | 10,182                      |
| Commercial & industrial                            | 9,606               | 16,096                   | —                 | 6,772                       |
| HELOC  | 718                 | 1,856                    | —                 | 443                         |
| Consumer   | 59                  | 1,366                    | —                 | 47                          |
|  | 48,538              | 80,811                   | —                 | 33,613                      |
| Impaired loans with an allowance recorded:         |                     |                          |                   |                             |
| Single-family residential                          | 204,955             | 209,294                  | 4,316             | 202,838                     |
| Land - acquisition & development                   | 594                 | 594                      | 3                 | 510                         |
| Land - consumer lot loans                          | 9,410               | 10,315                   | —                 | 9,324                       |
| Multi-family                                       | 1,131               | 1,131                    | 10                | 1,138                       |
| Commercial real estate                             | 16,290              | 17,930                   | 88                | 16,491                      |
| HELOC  | 1,414               | 1,487                    | —                 | 1,283                       |
| Consumer   | 107                 | 297                      | —                 | 100                         |
|  | 233,901             | 241,048                  | 4,417             | (1)231,684                  |
| Total impaired loans:                              |                     |                          |                   |                             |
| Single-family residential                          | 230,883             | 237,672                  | 4,316             | 217,188                     |
| Construction - custom                              | 296                 | 300                      | —                 | 99                          |
| Land - acquisition & development                   | 717                 | 8,940                    | 3                 | 640                         |
| Land - consumer lot loans                          | 9,934               | 10,902                   | —                 | 9,814                       |
| Multi-family                                       | 2,495               | 6,035                    | 10                | 2,238                       |
| Commercial real estate                             | 26,210              | 36,908                   | 88                | 26,673                      |
| Commercial & industrial                            | 9,606               | 16,096                   | —                 | 6,772                       |
| HELOC  | 2,132               | 3,343                    | —                 | 1,726                       |
| Consumer   | 166                 | 1,663                    | —                 | 147                         |
|  | \$282,439           | \$321,859                | \$ 4,417          | (1)\$ 265,297               |

(1)Includes \$100,000 of specific reserves and \$4,317,000 included in the general reserves.

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| September 30, 2016                                 | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment |
|--|------------------------|--------------------------------|----------------------|-----------------------------------|
|  | (In thousands)         |                                |                      |                                   |
| Impaired loans with no related allowance recorded: |                        |                                |                      |                                   |
| Single-family residential                          | \$9,627                | \$11,366                       | \$ —                 | \$ 6,511                          |
| Land - acquisition & development                   | 138                    | 9,001                          | —                    | 614                               |
| Land - consumer lot loans                          | 499                    | 609                            | —                    | 317                               |
| Multi-family                                       | 394                    | 3,972                          | —                    | 638                               |
| Commercial real estate                             | 11,741                 | 21,301                         | —                    | 6,260                             |
| Commercial & industrial                            | 1,030                  | 3,082                          | —                    | 863                               |
| HELOC  | 209                    | 315                            | —                    | 165                               |
| Consumer   | 74                     | 550                            | —                    | 111                               |
|  | 23,712                 | 50,196                         | —                    | 15,479                            |
| Impaired loans with an allowance recorded:         |                        |                                |                      |                                   |
| Single-family residential                          | 228,186                | 232,595                        | 3,809                | 216,632                           |
| Land - acquisition & development                   | 1,154                  | 2,094                          | 1                    | 1,766                             |
| Land - consumer lot loans                          | 9,630                  | 10,678                         | 1                    | 9,548                             |
| Multi-family                                       | 1,505                  | 1,505                          | 13                   | 1,522                             |
| Commercial real estate                             | 19,434                 | 22,848                         | 91                   | 19,311                            |
| HELOC  | 1,506                  | 1,521                          | —                    | 1,413                             |
| Consumer   | 116                    | 306                            | —                    | 100                               |
|  | 261,531                | 271,547                        | 3,915                | (1)250,292                        |
| Total impaired loans:                              |                        |                                |                      |                                   |
| Single-family residential                          | 237,813                | 243,961                        | 3,809                | 223,143                           |
| Land - acquisition & development                   | 1,292                  | 11,095                         | 1                    | 2,380                             |
| Land - consumer lot loans                          | 10,129                 | 11,287                         | 1                    | 9,865                             |
| Multi-family                                       | 1,899                  | 5,477                          | 13                   | 2,160                             |
| Commercial real estate                             | 31,175                 | 44,149                         | 91                   | 25,571                            |
| Commercial & industrial                            | 1,030                  | 3,082                          | —                    | 863                               |
| HELOC  | 1,715                  | 1,836                          | —                    | 1,578                             |
| Consumer   | 190                    | 856                            | —                    | 211                               |
|  | \$285,243              | \$321,743                      | \$ 3,915             | (1)\$ 265,771                     |

(1) Includes \$366,000 of specific reserves and \$3,549,000 included in the general reserves.

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NOTE F – Fair Value Measurements

ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active exchange markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

We have established and documented the Company's process for determining the fair values of the Company's assets and liabilities, where applicable. Fair value is based on quoted market prices, when available, for identical or similar assets or liabilities. In the absence of quoted market prices, fair value is determined using valuation models or third-party appraisals. The following is a description of the valuation methodologies used to measure and report the fair value of financial assets and liabilities on a recurring or nonrecurring basis:

Measured on a Recurring Basis

Securities

Securities available for sale are recorded at fair value on a recurring basis. The fair value of debt securities are priced using model pricing based on the securities' relationship to other benchmark quoted prices as provided by an independent third party, and under GAAP are considered a Level 2 input method. Securities that are traded on active exchanges, including the Company's equity securities, are measured using the closing price in an active market and are considered a Level 1 input method.

The Bank offers interest rate swaps to its variable rate borrowers who want to manage their interest rate risk. At the same time, the Bank enters into the opposite trade with a counter party to offset its interest rate risk. The Bank has also entered into a commercial loan hedge as well as long term borrowing hedges using interest rate swaps. The fair value of these interest rate swaps are estimated by a third party pricing service using a discounted cash flow technique. These are considered a Level 2 input method.

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The following tables present the balance of assets and liabilities measured at fair value on a recurring basis.

|                                       | March 31, 2017 |             |         |              |
|---------------------------------------|----------------|-------------|---------|--------------|
|                                       | Level 1        | Level 2     | Level 3 | Total        |
|                                       | (In thousands) |             |         |              |
| <b>Financial Assets</b>               |                |             |         |              |
| Available-for-sale securities:        |                |             |         |              |
| Equity securities                     | \$522          | \$—         | \$      | —\$522       |
| U.S. government and agency securities | —              | 235,618     | —       | 235,618      |
| Municipal bonds                       | —              | 26,654      | —       | 26,654       |
| Corporate debt securities             | —              | 209,981     | —       | 209,981      |
| Mortgage-backed securities            |                |             |         |              |
| Agency pass-through certificates      | —              | 863,032     | —       | 863,032      |
| Commercial MBS                        | —              | 52,975      | —       | 52,975       |
| Total available-for-sale securities   | 522            | 1,388,260   | —       | 1,388,782    |
| Interest rate contracts               | —              | 4,060       | —       | 4,060        |
| Commercial loan hedges                | —              | 175         | —       | 175          |
| Long term borrowing hedges            | —              | 319         | —       | 319          |
| Total financial assets                | \$522          | \$1,392,814 | \$      | —\$1,393,336 |
| <b>Financial Liabilities</b>          |                |             |         |              |
| Interest rate contracts               | \$—            | \$4,060     | \$      | —\$4,060     |
| Total financial liabilities           | \$—            | \$4,060     | \$      | —\$4,060     |

There were no transfers between, into and/or out of Levels 1, 2 or 3 during the six months ended March 31, 2017.

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|                                       | September 30, 2016 |             |         |              |
|---------------------------------------|--------------------|-------------|---------|--------------|
|                                       | Level 1            | Level 2     | Level 3 | Total        |
|                                       | (In thousands)     |             |         |              |
| <b>Financial Assets</b>               |                    |             |         |              |
| Available-for-sale securities:        |                    |             |         |              |
| Equity securities                     | \$101,824          | \$—         | \$      | —\$101,824   |
| U.S. government and agency securities | —                  | 259,351     | —       | 259,351      |
| Municipal bonds                       | —                  | 27,670      | —       | 27,670       |
| Corporate debt securities             | —                  | 461,138     | —       | 461,138      |
| Mortgage-backed securities            |                    |             |         |              |
| Agency pass-through certificates      | —                  | 993,041     | —       | 993,041      |
| Commercial MBS                        | —                  | 79,870      | —       | 79,870       |
| Total available-for-sale securities   | 101,824            | 1,821,070   | —       | 1,922,894    |
| Interest rate contracts               | —                  | 20,895      | —       | 20,895       |
| Total financial assets                | \$101,824          | \$1,841,965 | \$      | —\$1,943,789 |
| <b>Financial Liabilities</b>          |                    |             |         |              |
| Interest rate contracts               | \$—                | \$20,895    | \$      | —\$20,895    |
| Commercial loan hedges                | —                  | 3,312       | —       | 3,312        |
| Borrowings hedges                     | —                  | 31,347      | —       | 31,347       |
| Total financial liabilities           | \$—                | \$55,554    | \$      | —\$55,554    |

There were no transfers between, into and/or out of Levels 1, 2 or 3 during the fiscal year ended September 30, 2016.

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## Measured on a Nonrecurring Basis

## Impaired Loans &amp; Real Estate Owned

Real estate owned ("REO") consists principally of properties acquired through foreclosure. From time to time, and on a nonrecurring basis, adjustments using fair value measurements are recorded to reflect increases or decreases based on the discounted cash flows, the current appraisal or estimated value of the collateral, but only up to the fair value of the real estate owned as of the initial transfer date less selling costs.

When management determines that the fair value of the collateral or the real estate owned requires additional adjustments, either as a result of an updated appraised value or when there is no observable market price, the Company classifies the impaired loan or real estate owned as Level 3. Level 3 assets recorded at fair value on a nonrecurring basis at March 31, 2017 included loans for which a specific reserve allowance was established or a partial charge-off was recorded based on the fair value of collateral, as well as real estate owned where the fair value of the property was less than the cost basis.

The following tables present the aggregated balance of assets that were measured at fair value on a nonrecurring basis at March 31, 2017 and March 31, 2016, and the total gains (losses) resulting from those fair value adjustments for the three and six months ended March 31, 2017 and March 31, 2016. The estimated fair value measurements are shown gross of estimated selling costs.

|                          | March 31, 2017 |           |          | Three<br>Months<br>Ended<br>March<br>31, 2017 | Six<br>Months<br>Ended<br>March<br>31, 2017 |
|--------------------------|----------------|-----------|----------|---|---|
|                          | Level 1        | Level 2   | Level 3  | Total   | Total Gains<br>(Losses)                     |
|                          | (In thousands) |           |          |   |   |
| Impaired loans (1)       | \$—            | —\$5,701  | \$5,701  | \$(939 )                                      | \$(1,361 )                                  |
| Real estate owned (2)    | —              | 5,822     | 5,822    | (378 )  | (619 )                                      |
| Balance at end of period | \$—            | —\$11,523 | \$11,523 | \$(1,317)                                     | \$(1,980)                                   |

(1) The gains (losses) represent remeasurements of collateral-dependent loans.

(2) The gains (losses) represent aggregate writedowns and charge-offs on REO.

|                          | March 31, 2016 |           |          | Three<br>Months<br>Ended<br>March<br>31, 2016 | Six<br>Months<br>Ended<br>March<br>31, 2016 |
|--------------------------|----------------|-----------|----------|---|---|
|                          | Level 1        | Level 2   | Level 3  | Total   | Total Gains<br>(Losses)                     |
|                          | (In thousands) |           |          |   |   |
| Impaired loans (1)       | \$—            | —\$12,164 | \$12,164 | \$(1,389)                                     | \$(3,070)                                   |
| Real estate owned (2)    | —              | 12,804    | 12,804   | (577 )  | (2,332 )                                    |
| Balance at end of period | \$—            | —\$24,968 | \$24,968 | \$(1,966)                                     | \$(5,402)                                   |



(1) The gains (losses) represent remeasurements of collateral-dependent loans.

(2) The gains (losses) represent aggregate writedowns and charge-offs on REO.

Impaired loans - The Company adjusts the carrying amount of impaired loans when there is evidence of probable loss and the expected fair value of the loan is less than its contractual amount. The amount of the impairment may be determined based on the estimated present value of future cash flows or the fair value of the underlying collateral.

Impaired loans with a specific reserve allowance based on cash flow analysis or the value of the underlying collateral are classified as Level 3 assets.

The evaluations for impairment are prepared by the Problem Loan Review Committee, which is chaired by the Chief Credit Officer and includes the Loan Review manager and Special Credits manager, as well as senior credit officers, division managers and group executives, as applicable. These evaluations are performed in conjunction with the quarterly allowance for loan loss process.

Applicable loans that were included in the previous quarter's review are reevaluated and if their values are materially different from the prior quarter evaluation, the underlying information (loan balance and collateral value) are compared. Material differences

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are evaluated for reasonableness and discussions are held between the relationship manager and their division manager to understand the difference and determine if any adjustment is necessary.

The inputs are developed and substantiated on a quarterly basis, based on current borrower developments, market conditions and collateral values. The following methods are used to value impaired loans:

The fair value of the collateral, which may take the form of real estate or personal property, is based on internal estimates, field observations, assessments provided by third-party appraisers and other valuation models. The Company performs or reaffirms valuations of collateral-dependent impaired loans at least annually. Adjustments are made if management believes that more recent information is available and relevant with respect to the fair value of the collateral.

The present value of the expected future cash flows of the loans is used for measurement of non collateral-dependent loans to test for impairment.

Real estate owned - When a loan is reclassified from loan status to real estate owned due to the Company taking possession of the collateral, a Special Credits officer, along with the Special Credits manager, obtains a valuation, which may include appraisals or third-party price opinions, which is used to establish the fair value of the underlying collateral. The determined fair value, less selling costs, becomes the carrying value of the REO asset.

The fair value of REO assets is re-evaluated quarterly and the REO asset is adjusted to reflect the fair value as necessary. After foreclosure, the valuations are updated periodically and current market conditions may require the assets to be written down further or up to the cost basis established on the date of transfer. The carrying balance of REO assets are also written down once a bona fide offer is contractually accepted, through execution of a Purchase and Sale Agreement, where the accepted price is lower than the cost established on the transfer date.

**Fair Values of Financial Instruments**

ASC 825 requires disclosure of fair value information about financial instruments, whether or not recognized on the statement of financial condition, for which it is practicable to estimate those values. Certain financial instruments and all non-financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value estimates presented do not reflect the underlying fair value of the Company. Although management is not aware of any factors that would materially affect the estimated fair value amounts presented below, such amounts have not been comprehensively revalued for purposes of these financial statements since the dates shown, and therefore, estimates of fair value subsequent to those dates may differ significantly from the amounts presented below.

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|   | Level in Fair Value Hierarchy | March 31, 2017  |                      | September 30, 2016 |                      |
|---|-------------------------------|-----------------|----------------------|--------------------|----------------------|
|   |                               | Carrying Amount | Estimated Fair Value | Carrying Amount    | Estimated Fair Value |
| (In thousands)                              |                               |                 |                      |                    |                      |
| Financial assets                            |                               |                 |                      |                    |                      |
| Cash and cash equivalents                   | 1                             | \$266,397       | \$266,397            | \$450,368          | \$450,368            |
| Available-for-sale securities               |                               |                 |                      |                    |                      |
| Equity securities                           | 1                             | 522             | 522                  | 101,824            | 101,824              |
| U.S. government and agency securities       | 2                             | 235,618         | 235,618              | 259,351            | 259,351              |
| Municipal bonds                             | 2                             | 26,654          | 26,654               | 27,670             | 27,670               |
| Corporate debt securities                   | 2                             | 209,981         | 209,981              | 461,138            | 461,138              |
| Mortgage-backed securities                  |                               |                 |                      |                    |                      |
| Agency pass-through certificates            | 2                             | 863,032         | 863,032              | 993,041            | 993,041              |
| Commercial MBS                              | 2                             | 52,975          | 52,975               | 79,870             | 79,870               |
| Total available-for-sale securities         |                               | 1,388,782       | 1,388,782            | 1,922,894          | 1,922,894            |
| Held-to-maturity securities                 |                               |                 |                      |                    |                      |
| Mortgage-backed securities                  |                               |                 |                      |                    |                      |
| Agency pass-through certificates            | 2                             | 1,697,650       | 1,668,548            | 1,417,599          | 1,441,556            |
| Total held-to-maturity securities           |                               | 1,697,650       | 1,668,548            | 1,417,599          | 1,441,556            |
| Loans receivable                            |                               |                 |                      |                    |                      |
| FDIC indemnification asset                  | 3                             | 10,463,022      | 10,732,868           | 9,910,920          | 10,414,794           |
| FHLB and FRB stock                          | 2                             | 11,821          | 11,342               | 12,769             | 12,095               |
| Other assets - interest rate contracts      | 2                             | 119,990         | 119,990              | 117,205            | 117,205              |
| Other assets - commercial loan              | 2                             | 4,060           | 4,060                | 20,895             | 20,895               |
| hedges                                      |                               | 175             | 175                  | —                  | —                    |
| Other assets - borrowings hedges            | 2                             | 319             | 319                  | —                  | —                    |
| Financial liabilities                       |                               |                 |                      |                    |                      |
| Customer accounts                           | 2                             | 10,630,807      | 10,104,720           | 10,600,852         | 10,184,321           |
| FHLB advances                               | 2                             | 2,150,000       | 2,212,968            | 2,080,000          | 2,184,671            |
| Other liabilities - interest rate contracts | 2                             | 4,060           | 4,060                | 20,895             | 20,895               |
| Other liabilities - commercial loan hedges  | 2                             | —               | —                    | 3,312              | 3,312                |
| Other liabilities - borrowings hedges       | 2                             | —               | —                    | 31,347             | 31,347               |

The following methods and assumptions were used to estimate the fair value of financial instruments:

Cash and cash equivalents – The carrying amount of these items is a reasonable estimate of their fair value.

Available-for-sale securities and held-to-maturity securities – Securities at fair value are primarily priced using model pricing based on the securities' relationship to other benchmark quoted prices as provided by an independent third party, and are considered a Level 2 input method. Equity securities which are exchange traded are considered a Level 1 input method.

Loans receivable and covered loans – For certain homogeneous categories of loans, such as fixed- and variable-rate residential mortgages, fair value is estimated for securities backed by similar loans, adjusted for differences in loan characteristics, using the same methodology described above for AFS and HTM securities. The fair value of other loan types is estimated by discounting the future cash flows and estimated prepayments using the current rates at

which similar loans would be made to borrowers with similar credit ratings and for the same remaining term. Some loan types were valued at carrying value because of their floating rate or expected maturity characteristics. Net deferred loan fees are not included in the fair value calculation but are included in the carrying amount.

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FDIC indemnification asset – The fair value of the indemnification asset is estimated by discounting the expected future cash flows using the current rates.

FHLB and FRB stock – The fair value is based upon the par value of the stock which equates to its carrying value.

Customer accounts – The fair value of demand deposits, savings accounts, and money market accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated by discounting the estimated future cash flows using the rates currently offered for deposits with similar remaining maturities.

FHLB advances – The fair value of FHLB advances and other borrowings is estimated by discounting the estimated future cash flows using rates currently available to the Company for debt with similar remaining maturities.

Interest rate contracts – The bank offers interest rate swaps to its variable rate borrowers who want to manage their interest rate risk. At the same time, the bank enters into the opposite trade with a counterparty to offset its interest rate risk. The fair value of these interest rate swaps are estimated by a third party pricing service using a discounted cash flow technique.

Commercial loan hedge – The fair value of the interest rate swaps are estimated by a third party pricing service using a discounted cash flow technique.

Borrowings hedges – The fair value of the interest rate swaps are estimated by a third party pricing service using a discounted cash flow technique.

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The following tables provide a reconciliation of amortized cost to fair value of available-for-sale and held-to-maturity securities.

|   | March 31, 2017    |                |                      |               |       |
|---|-------------------|----------------|----------------------|---------------|-------|
|   | Amortized<br>Cost | Gross<br>Gains | Unrealized<br>Losses | Fair<br>Value | Yield |
|   | (In thousands)    |                |                      |               |       |
| Available-for-sale securities             |                   |                |                      |               |       |
| U.S. government and agency securities due |                   |                |                      |               |       |
| Within 1 year                             | \$19,019          | \$293          | \$—                  | \$19,312      | 4.24% |
| 1 to 5 years                              | 35,146            | 284            | (720 )               | 34,710        | 2.37  |
| 5 to 10 years                             | 41,235            | —              | (382 )               | 40,853        | 1.85  |
| Over 10 years                             | 142,109           | —              | (1,366 )             | 140,743       | 1.64  |
| Equity securities due                     |                   |                |                      |               |       |
| 1 to 5 years                              | 500               | 22             | —                    | 522           | 1.80  |
| Corporate debt securities due             |                   |                |                      |               |       |
| Within 1 year                             | 28,094            | 52             | —                    | 28,146        | 1.96  |
| 1 to 5 years                              | 63,552            | 1,333          | —                    | 64,885        | 2.73  |
| 5 to 10 years                             | 69,958            | —              | (1,970 )             | 67,988        | 2.15  |
| Over 10 years                             | 50,000            | —              | (1,038 )             | 48,962        | 3.00  |
| Municipal bonds due                       |                   |                |                      |               |       |
| 1 to 5 years                              | 2,329             | 1              | —                    | 2,330         | 1.23  |
| 5 to 10 years                             | 1,351             | 4              | —                    | 1,355         | 2.05  |
| Over 10 years                             | 20,353            | 2,616          | —                    | 22,969        | 6.45  |
| Mortgage-backed securities                |                   |                |                      |               |       |
| Agency pass-through certificates          | 858,755           | 8,039          | (3,762 )             | 863,032       | 2.73  |
| Commercial MBS                            | 53,097            | 13             | (135 )               | 52,975        | 2.15  |
|   | 1,385,498         | 12,657         | (9,373 )             | 1,388,782     | 2.60  |
| Held-to-maturity securities               |                   |                |                      |               |       |
| Mortgage-backed securities                |                   |                |                      |               |       |
| Agency pass-through certificates          | 1,697,650         | 3,706          | (32,808 )            | 1,668,548     | 3.18  |
|   | \$3,083,148       | \$16,363       | \$(42,181)           | \$3,057,330   | 2.89% |

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|   | September 30, 2016 |                  |            | Fair          | Yield  |
|---|--------------------|------------------|------------|---------------|--------|
|   | Amortized          | Gross Unrealized | Losses     | Value         |        |
|   | Cost               | Gains            |            |               |        |
|   | (In thousands)     |                  |            |               |        |
| Available-for-sale securities             |                    |                  |            |               |        |
| U.S. government and agency securities due |                    |                  |            |               |        |
| Within 1 year                             | \$21,284           | \$—              | \$(59)     | ) \$21,225    | 0.81 % |
| 1 to 5 years                              | 12,477             | 1,027            | (11)       | ) 13,493      | 7.94   |
| 5 to 10 years                             | 48,134             | —                | (1,589)    | ) 46,545      | 1.14   |
| Over 10 years                             | 182,051            | 27               | (3,990)    | ) 178,088     | 1.33   |
| Equity Securities                         |                    |                  |            |               |        |
| 1 to 5 years                              | 100,422            | 1,402            | —          | 101,824       | 1.90   |
| Corporate bonds due                       |                    |                  |            |               |        |
| Within 1 year                             | 278,094            | 325              | (53)       | ) 278,366     | 1.33   |
| 1 to 5 years                              | 63,481             | 928              | (113)      | ) 64,296      | 2.47   |
| 5 to 10 years                             | 69,955             | —                | (2,417)    | ) 67,538      | 1.96   |
| Over 10 years                             | 50,000             | 938              | —          | 50,938        | 3.00   |
| Municipal bonds due                       |                    |                  |            |               |        |
| 1 to 5 years                              | 2,315              | 2                | —          | 2,317         | 1.23   |
| 5 to 10 years                             | 1,335              | 38               | —          | 1,373         | 2.05   |
| Over 10 years                             | 20,363             | 3,617            | —          | 23,980        | 6.45   |
| Mortgage-backed securities                |                    |                  |            |               |        |
| Agency pass-through certificates          | 978,955            | 17,118           | (3,032)    | ) 993,041     | 2.58   |
| Commercial MBS                            | 80,318             | —                | (448)      | ) 79,870      | 1.91   |
|   | 1,909,184          | 25,422           | (11,712)   | ) 1,922,894   | 2.22   |
| Held-to-maturity securities               |                    |                  |            |               |        |
| Mortgage-backed securities                |                    |                  |            |               |        |
| Agency pass-through certificates          | 1,417,599          | 24,171           | (214)      | ) 1,441,556   | 3.18   |
|   | \$3,326,783        | \$49,593         | \$(11,926) | ) \$3,364,450 | 2.62 % |

For available-for-sale investment securities, there were sales totaling \$350,890,000 during the six months ended March 31, 2017 and no sales during the six months ended March 31, 2016. There were no purchases of available-for-sale investment securities during the six months ended March 31, 2017 and purchases of \$50,741,000 during the six months ended March 31, 2016. For held-to-maturity investment securities, there were purchases totaling \$415,729,000 during the six months ended March 31, 2017 and no purchases during the six months ended March 31, 2016. There were no sales of held-to-maturity investment securities during either period. Substantially all of the agency mortgage-backed securities have contractual due dates that exceed 10 years.

The following tables show the unrealized gross losses and fair value of securities as of March 31, 2017 and September 30, 2016, by length of time that individual securities in each category have been in a continuous loss position. The decline in fair value since purchase is attributable to changes in interest rates. Because the Company does not intend to sell these securities and does not consider it more likely than not that it will be required to sell these securities before the recovery of amortized cost basis, which may be upon maturity, the Company does not consider these investments to be other than temporarily impaired.





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| March 31, 2017                        | Less than 12 months     |            | 12 months or more       |             | Total                   |             |
|---------------------------------------|-------------------------|------------|-------------------------|-------------|-------------------------|-------------|
|                                       | Unrealized Gross Losses | Fair Value | Unrealized Gross Losses | Fair Value  | Unrealized Gross Losses | Fair Value  |
|                                       | (In thousands)          |            |                         |             |                         |             |
| Corporate debt securities             | \$(1,135)               | \$68,822   | \$(1,873 )              | \$48,128    | \$(3,008 )              | 116,950     |
| U.S. government and agency securities | (244 )                  | 24,962     | (2,224 )                | 187,760     | (2,468 )                | 212,722     |
| Agency pass-through certificates      | (7,308 )                | 715,036    | (29,397 )               | 1,064,016   | (36,705 )               | 1,779,052   |
|                                       | \$(8,687)               | \$808,820  | \$(33,494)              | \$1,299,904 | \$(42,181)              | \$2,108,724 |
| September 30, 2016                    | Less than 12 months     |            | 12 months or more       |             | Total                   |             |
|                                       | Unrealized Gross Losses | Fair Value | Unrealized Gross Losses | Fair Value  | Unrealized Gross Losses | Fair Value  |
|                                       | (In thousands)          |            |                         |             |                         |             |
| Corporate debt securities             | \$—                     | \$—        | \$(2,582 )              | \$100,467   | \$(2,582 )              | \$100,467   |
| U.S. government and agency securities | (11 )                   | 3,167      | (5,638 )                | 220,613     | (5,649 )                | 223,780     |
| Agency pass-through certificates      | (1,278 )                | 301,030    | (2,417 )                | 232,407     | (3,695 )                | 533,437     |
|                                       | \$(1,289)               | \$304,197  | \$(10,637)              | \$553,487   | \$(11,926)              | \$857,684   |

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## NOTE G – Derivatives and Hedging Activities

The Bank periodically enters into certain interest rate swap agreements in order to provide commercial loan customers the ability to convert from variable to fixed interest rate payments, while the Bank retains a variable rate loan. Under these agreements, the Bank enters into a variable rate loan agreement and a swap agreement with the client. The swap agreement effectively converts the client's variable rate loan into a fixed rate. The Bank enters into a corresponding swap agreement with a third party in order to offset its exposure on the variable and fixed components of the client's swap agreement. The Bank had \$925,365,000 and \$840,935,000 notional in interest rate swaps to hedge this exposure as of March 31, 2017 and September 30, 2016, respectively. The interest rate swaps are derivatives under FASB ASC 815, Derivatives and Hedging, with changes in fair value recorded in earnings. There was no net impact to the statement of operations for the six months ended March 31, 2017 and 2016 as the changes in value for the asset and liability side of the swaps offset each other.

The Bank has also entered into interest rate swaps to convert certain existing and future short-term borrowings to fixed rate payments. The primary purpose of these hedges is to mitigate the risk of rising interest rates, specifically LIBOR rates, which are a benchmark for the short term borrowings. The hedging program qualifies as a cash flow hedge under ASC 815, which provides for offsetting of the recognition of gains and losses of the interest rate swaps and the hedged items. The hedged item is the LIBOR portion of the series of existing or future short-term fixed rate borrowings over the term of the interest rate swap. The change in the fair value of the interest rate swaps is recorded in other comprehensive income. The Bank had \$700,000,000 and \$700,000,000 notional in interest rate swaps to hedge existing and anticipated future borrowings as of March 31, 2017 and September 30, 2016, respectively.

The Bank has also entered into an interest rate swap to hedge the interest rate risk of an individual fixed rate commercial loan and this relationship qualifies as a fair value hedge under ASC 815, which provides for offsetting of the recognition of gains and losses of the interest rate swap and the hedged item. The Bank hedges this loan using an interest rate swap with a notional amount of \$52,936,000 and \$54,155,000 as of March 31, 2017 and September 30, 2016, respectively.

The following table presents the fair value and balance sheet classification of derivatives at March 31, 2017 and September 30, 2016:

|                         | Asset Derivatives |            |                    |            | Liability Derivatives |            |                    |            |
|-------------------------|-------------------|------------|--------------------|------------|-----------------------|------------|--------------------|------------|
|                         | March 31, 2017    |            | September 30, 2016 |            | March 31, 2017        |            | September 30, 2016 |            |
|                         | Balance Sheet     | Fair Value | Balance Sheet      | Fair Value | Balance Sheet         | Fair Value | Balance Sheet      | Fair Value |
|                         | Location          |            | Location           |            | Location              |            | Location           |            |
|                         | (In thousands)    |            |                    |            |                       |            |                    |            |
| Interest rate contracts | Other assets      | \$4,060    | Other assets       | \$20,895   | Other liabilities     | \$4,060    | Other liabilities  | \$20,895   |
| Commercial loan hedges  | Other assets      | 175        | Other assets       | —          | Other liabilities     | —          | Other liabilities  | 3,312      |
| Borrowings hedges       | Other assets      | 319        | Other assets       | —          | Other liabilities     | —          | Other liabilities  | 31,347     |
|                         |                   | \$4,554    |                    | \$20,895   |                       | \$4,060    |                    | \$55,554   |



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PART I – Financial Information

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

FORWARD LOOKING STATEMENTS

In addition to historical information, this Quarterly Report on Form 10-Q includes certain “forward-looking statements,” as defined in the Securities Act of 1933 and the Securities Exchange Act of 1934 as amended (the “Exchange Act”), based on current management expectations. Actual results could differ materially from those management expectations. Such forward-looking statements include statements regarding the Company’s intentions, beliefs or current expectations as well as the assumptions on which such statements are based. Stockholders and potential stockholders are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those contemplated by such forward-looking statements. Factors that could cause future results to vary from current management expectations include, but are not limited to: general economic conditions; legislative and regulatory changes, including without limitation the potential effect of the Dodd-Frank Wall Street Reform and Consumer Protection Act and regulations being promulgated thereunder; monetary fiscal policies of the federal government; changes in tax policies; rates and regulations of federal, state and local tax authorities; changes in interest rates; deposit flows; cost of funds; demand for loan products; demand for financial services; competition; changes in the quality or composition of the Company’s loan and investment portfolios; changes in accounting principles; policies or guidelines and other economic, competitive, governmental and technological factors affecting the Company’s operations, markets, products, services and fees. The Company undertakes no obligation to update or revise any forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results over time.

GENERAL & BUSINESS DESCRIPTION

Washington Federal Inc. (“Company” or “Washington Federal”) is a bank holding company headquartered in Seattle, Washington that conducts its operations through Washington Federal, National Association (“Bank”), a federally chartered national bank subsidiary. Washington Federal and its subsidiaries are engaged primarily in providing lending, depository, insurance and other banking services to consumers, mid-sized to large businesses, and owners and developers of commercial real estate.

The Company's fiscal year end is September 30th. All references to 2016 represent balances as of September 30, 2016 or activity for the fiscal year then ended.

On April 11, 2017 the Company announced that it has entered into a definitive merger agreement with Anchor Bancorp (“Anchor”). The merger agreement calls for the merger of Anchor with and into the Company, followed by the merger of Anchor’s wholly-owned subsidiary, Anchor Bank, into the Company’s wholly-owned subsidiary, Washington Federal, National Association. The merger is an all-stock transaction, with the aggregate merger consideration consisting of shares of Washington Federal common stock having a value of approximately \$63.9 million. The merger is expected to close in the third calendar quarter of 2017, pending the receipt of requisite regulatory approvals, the approval of Anchor’s shareholders and the satisfaction of other customary closing conditions.

INTEREST RATE RISK

Based on Management's assessment of the current interest rate environment, the Bank has taken steps to reduce its interest rate risk profile compared to its historical norms, including growing shorter-term loans and transaction deposit accounts, as well as extending the maturity on borrowings. The mix of transaction and savings accounts is 58% of total deposits as of March 31, 2017 while the composition of the investment securities portfolio is 31% variable and 69% fixed rate. When interest rates rise, the fair value of the investment securities with fixed rates will decrease and vice versa when interest rates decline. The Company has \$1,697,650,000 of fixed rate mortgage-backed securities that it has designated as held-to-maturity and are carried at amortized cost. As of March 31, 2017, the net unrealized loss on these securities was \$29,102,000. The Company has \$1,388,782,000 of available-for-sale securities that are carried at fair value. As of March 31, 2017, the net unrealized gain on these securities was \$3,284,000. The Bank has executed interest rate swaps to hedge interest rates on existing and future borrowings. The unrealized gain on these interest rate swaps as of March 31, 2017 was \$319,000. All of the above are pre-tax net unrealized gains or losses.

The Company relies on various measures of interest rate risk, including an asset/liability maturity gap analysis, modeling of changes in forecasted net interest income under various rate change scenarios, and the impact of interest rate changes on the net portfolio value (“NPV”) of the Company.

Net Interest Income Sensitivity. We estimate the sensitivity of our net interest income to changes in market interest rates using an interest rate simulation model that includes assumptions related to the level of balance sheet growth, deposit repricing characteristics

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## WASHINGTON FEDERAL, INC. AND SUBSIDIARIES

## PART I – Financial Information

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

and the rate of prepayments for multiple interest rate change scenarios. Interest rate sensitivity depends on certain repricing characteristics in our interest-earnings assets and interest-bearing liabilities, including the maturity structure of assets and liabilities and their repricing characteristics during the periods of changes in market interest rates. The analysis assumes a constant balance sheet. Actual results would differ from the assumptions used in this model, as Management monitors and adjusts loan and deposit pricing and the size and composition of the balance sheet to respond to changing interest rates.

In the event of an immediate and parallel increase of 200 basis points in both short and long-term interest rates, the model estimates that net interest income would increase by 1.3% in the next year. This compares to an estimated increase of 3.2% as of the September 30, 2016 analysis. It is noted that a flattening yield curve would likely result in a decrease in net interest income. Management estimates that a gradual increase of 300 basis points in short term rates and 100 basis points in long term rates over two years would result in a net interest income increase of 1.6% in the first year and decrease of 0.8% in the second year assuming a constant balance sheet and no management intervention.

**NPV Sensitivity.** The NPV is an estimate of the market value of shareholders' equity. It is derived by calculating the difference between the present value of expected cash flows from interest-earning assets and the present value of expected cash flows from interest-paying liabilities and off-balance-sheet contracts. The sensitivity of the NPV to changes in interest rates provides a longer term view of interest rate risk as it incorporates all future expected cash flows. As of March 31, 2017, in the event of an immediate and parallel increase of 200 basis points in interest rates, the NPV is estimated to decline by \$509,930,112 or 20.8% and the NPV to total assets ratio to decline to 13.9% from a base of 16.4%. As of September 30, 2016, the NPV in the event of a 200 basis point increase in rates was estimated to decline by \$479,090,000 or 18.6% and the NPV to total assets ratio to decline to 14.8% from a base of 16.9%. The increased NPV sensitivity and higher base NPV ratio is due primarily to higher interest rates and lower prices as of March 31, 2017.

**Repricing Gap Analysis.** At March 31, 2017, the Company had approximately \$2,202,969,000 more in liabilities subject to maturity or repricing in the next year than assets, which resulted in a one-year repricing gap of (14.7)% of total assets. This was an increase from the (10.1)% gap as of September 30, 2016. A negative repricing gap implies that funding costs will change more rapidly than interest income on earning assets with movements in interest rates. A negative repricing gap typically results in lower margins when interest rates rise and higher margins when interest rates decline. This interest rate gap analysis provides management with a high-level indication of interest rate risk, but it is considered less reliable than more detailed modeling.

**Interest Rate Spread.** The interest rate spread is measured as the difference between the rate on total loans and investments and the rate on costing liabilities at the end of each period. The interest rate spread increased to 2.84% at March 31, 2017 from 2.65% at September 30, 2016. The spread increase of 19 basis points is primarily due to the rise in the Fed funds rate, which resulted in an increased rate being earned on cash. As of March 31, 2017, the weighted average rate on earning assets increased by 15 basis points to 3.73% compared to September 30, 2016, while the weighted average cost of funds decreased by 4 basis points to 0.89%. The interest rate spread increased to 2.84% at March 31, 2017 from 2.76% at March 31, 2016.

**Net Interest Margin.** The net interest margin is measured using the interest income and expense over the average assets and liabilities for the period. The net interest margin decreased to 3.15% for the quarter ended March 31, 2017 from 3.16% for the quarter ended March 31, 2016. The yield on earning assets increased 1 basis point to 4.04% and the cost of interest bearing liabilities decreased 1 basis point to 0.91%. The higher yield on earning assets is the result of the shift in mix from investment securities into a higher proportion of loans receivable which carry higher yields on average. The decrease in interest costs was due to changes in the mix of customer deposits and FHLB advances.

The following table sets forth the information explaining the changes in the net interest margin for the periods indicated compared to the same periods one year ago.

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|                                    | Three Months Ended March 31, 2017 |           |              | Three Months Ended March 31, 2016 |           |              |
|------------------------------------|-----------------------------------|-----------|--------------|-----------------------------------|-----------|--------------|
|                                    | Average Balance<br>(In thousands) | Interest  | Average Rate | Average Balance<br>(In thousands) | Interest  | Average Rate |
| <b>Assets</b>                      |                                   |           |              |                                   |           |              |
| Loans receivable                   | \$10,267,530                      | \$116,034 | 4.58 %       | \$9,469,185                       | \$113,211 | 4.80 %       |
| Mortgaged-backed securities        | 2,664,959                         | 16,226    | 2.47         | 2,804,569                         | 16,846    | 2.41         |
| Cash & Investments                 | 632,114                           | 3,068     | 1.97         | 1,065,800                         | 3,983     | 1.50         |
| FHLB & FRB stock                   | 118,092                           | 870       | 2.99         | 112,662                           | 1,023     | 3.64         |
| Total interest-earning assets      | 13,682,695                        | 136,198   | 4.04 %       | 13,452,216                        | 135,063   | 4.03 %       |
| Other assets                       | 1,161,023                         |           |              | 1,189,428                         |           |              |
| Total assets                       | \$14,843,718                      |           |              | \$14,641,644                      |           |              |
| <b>Liabilities and Equity</b>      |                                   |           |              |                                   |           |              |
| Customer accounts                  | \$10,578,631                      | \$12,392  | 0.48 %       | \$10,558,835                      | \$13,071  | 0.50 %       |
| FHLB advances                      | 2,102,556                         | 16,079    | 3.10         | 1,970,022                         | 15,667    | 3.19         |
| Total interest-bearing liabilities | 12,681,187                        | 28,471    | 0.91 %       | 12,528,857                        | 28,738    | 0.92 %       |
| Other liabilities                  | 153,105                           |           |              | 151,697                           |           |              |
| Total liabilities                  | 12,834,292                        |           |              | 12,680,554                        |           |              |
| Stockholder's equity               | 2,009,426                         |           |              | 1,961,090                         |           |              |
| Total liabilities and equity       | \$14,843,718                      |           |              | \$14,641,644                      |           |              |
| Net interest income                |                                   | \$107,727 |              |                                   | \$106,325 |              |
| Net interest margin                |                                   |           | 3.15 %       |                                   |           | 3.16 %       |

As of March 31, 2017, total assets had increased by \$72,613,000 to \$14,960,676,000 from \$14,888,063,000 at September 30, 2016. During the six months ended March 31, 2017, cash and cash equivalents decreased by \$183,971,000, loans receivable increased \$552,102,000 and investment securities declined by \$254,061,000. Cash and cash equivalents of \$266,397,000 and stockholders’ equity of \$2,014,762,000 as of March 31, 2017 provides management with flexibility in managing interest rate risk going forward.

**LIQUIDITY AND CAPITAL RESOURCES**

The principal sources of funds for the Company's activities are loan repayments (including prepayments), net deposit inflows, repayments and sales of investments and borrowings and retained earnings, if applicable. The Company's principal sources of revenue are interest on loans and interest and dividends on investments.

The Bank has a credit line with the Federal Home Loan Bank of Des Moines ("FHLB") equal to 48% of total assets, providing a substantial source of additional liquidity if needed.

The Bank has entered into borrowing agreements with the FHLB to borrow funds under a short-term floating rate cash management advance program and fixed-rate term loan agreements. All borrowings are secured by stock of the FHLB, deposits with the FHLB,





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and a blanket pledge of qualifying loans receivable as provided in the agreements with the FHLB. The Bank is also eligible to borrow under the Federal Reserve Bank's primary credit program.

The Company's cash and cash equivalents total \$266,397,000 at March 31, 2017, a decrease from \$450,368,000 at September 30, 2016. These amounts include the Bank's operating cash.

The Company’s net worth at March 31, 2017 was \$2,014,762,000, or 13.47% of total assets. This was an increase of \$39,031,000 from September 30, 2016 when net worth was \$1,975,731,000, or 13.27% of total assets. The Company’s net worth was impacted in the six months ended March 31, 2017 by net income of \$83,316,000, the payment of \$47,995,000 in cash dividends, treasury stock purchases of \$20,401,000, as well as an other comprehensive income of \$13,435,000. The ratio of tangible capital to tangible assets at March 31, 2017 was 11.72%. Management believes the Company's strong net worth position allows it to manage balance sheet risk and provide the capital support needed for controlled growth in a regulated environment.

The Company (on a consolidated basis) and its banking subsidiary are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company and the Bank's financial statements.

Federal banking agencies establish regulatory capital rules which require minimum capital ratios and establish criteria for calculating regulatory capital. Minimum capital ratios for four measures are used for assessing capital adequacy. The standards are indicated in the table below. The common equity tier 1 capital ratio recognizes common equity as the highest form of capital. The denominator for all except the leverage ratio is risk weighted assets. The rules set forth a “capital conservation buffer” of up to 2.5%. In the event that a bank’s capital levels fall below the minimum ratios plus these buffers, restrictions can be placed on the bank by its regulators. These restrictions include reducing dividend payments, share buy-backs, and staff bonus payments. The purpose of these buffers is to require banks to build up capital outside of periods of stress that can be drawn down during periods of stress. As a result, even during periods where losses are incurred, the minimum capital ratios can still be met. The capital rules that became effective in January 2015 include a phase-in period for certain minimum ratios and the capital buffers, before the full minimum ratios take effect in 2019. Management continues to monitor the financial position of the Company and its capital ratios as the rules phase in.

There are also standards for Adequate and Well Capitalized criteria that are used for “Prompt Corrective Action” purposes. To remain categorized as well capitalized, the Bank and the Company must maintain minimum common equity risk-based, tier 1 risk-based, total risk-based and tier 1 leverage ratios as set forth in the following table.

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|  | Actual<br>Capital<br>Ratio<br>(In thousands) | Minimum Capital<br>Adequacy Guidelines<br>Ratio | Minimum<br>Well-Capitalized Guidelines<br>Ratio |           |
|--|--|---|---|-----------|
| March 31, 2017                                 |  |   |   |           |
| Common Equity Tier I risk-based capital ratio: |  |   |   |           |
| The Company                                    | \$1,715,557                                  | 17.46 %   | 4.50  | % NA      |
| The Bank                                       | 1,666,608                                    | 16.95 %   | 4.50  | % 6.50 %  |
| Tier I risk-based capital ratio:               |  |   |   |           |
| The Company                                    | 1,715,557                                    | 17.46 %   | 6.00  | % NA      |
| The Bank                                       | 1,666,608                                    | 16.95 %   | 6.00  | % 8.00 %  |
| Total risk-based capital ratio:                |  |   |   |           |
| The Company                                    | 1,838,467                                    | 18.71 %   | 8.00  | % NA      |
| The Bank                                       | 1,789,603                                    | 18.20 %   | 8.00  | % 10.00 % |
| Tier 1 Leverage ratio:                         |  |   |   |           |
| The Company                                    | 1,715,557                                    | 11.79 %   | 4.00  | % NA      |
| The Bank                                       | 1,666,608                                    | 11.46 %   | 4.00  | % 5.00 %  |
| September 30, 2016                             |  |   |   |           |
| Common Equity Tier 1 risk-based capital ratio: |  |   |   |           |
| The Company                                    | 1,690,380                                    | 17.54 %   | 4.50  | % NA      |
| The Bank                                       | 1,668,828                                    | 17.32 %   | 4.50  | % 6.50 %  |
| Tier I risk-based capital ratio:               |  |   |   |           |
| The Company                                    | 1,690,380                                    | 17.54 %   | 6.00  | % NA      |
| The Bank                                       | 1,668,828                                    | 17.32 %   | 6.00  | % 8.00 %  |
| Total risk-based capital ratio:                |  |   |   |           |
| The Company                                    | 1,807,740                                    | 18.76 %   | 8.00  | % NA      |
| The Bank                                       | 1,786,188                                    | 18.54 %   | 8.00  | % 10.00 % |
| Tier 1 Leverage ratio:                         |  |   |   |           |
| The Company                                    | 1,690,380                                    | 11.60 %   | 4.00  | % NA      |
| The Bank                                       | 1,668,828                                    | 11.45 %   | 4.00  | % 5.00 %  |

**CHANGES IN FINANCIAL CONDITION**

Cash and cash equivalents: Cash and cash equivalents are \$266,397,000 at March 31, 2017, a decrease of \$183,971,000, or 40.8%, since September 30, 2016.

Available-for-sale and held-to-maturity securities: Available-for-sale securities decreased \$534,112,000, or 27.8%, during the six months ended March 31, 2017, due to sales of \$350,890,000 as well as repayments, calls and maturities. During the same period, the balance of held-to-maturity securities increased by \$280,051,000 due to purchases of \$415,729,000 partially offset by paydowns and maturities. As of March 31, 2017, the Company had an unrealized gain on available-for-sale securities of \$3,284,000, which is included on a net of tax basis in accumulated other comprehensive income (loss).

Loans receivable: Loans receivable, net of related contra accounts, increased to \$10,463,022,000 at March 31, 2017 compared to \$9,910,920,000 at September 30, 2016. This increase resulted primarily from originations of

\$2,185,129,000, partially offset by loan repayments of \$1,606,800,000. Commercial loan originations accounted for 69% of total originations and consumer loan originations were 31% during the period. The increase in the loan portfolio is consistent with management's strategy during low

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rate environments to produce more multifamily, commercial real estate, and commercial and industrial loans which generally have adjustable interest rates or a shorter duration.

The following table shows the loan portfolio by category and the change.

|  | March 31, 2017 |        | September 30, 2016 |        | Change    |        |
|--|----------------|--------|--------------------|--------|-----------|--------|
|  | (In thousands) |        | (In thousands)     |        | \$        | %      |
| Gross loans by category                |                |        |                    |        |           |        |
| Single-family residential              | \$5,693,072    | 48.9 % | \$5,658,830        | 51.7 % | \$34,242  | 0.6 %  |
| Construction                           | 1,311,635      | 11.3   | 1,110,411          | 10.1   | 201,224   | 18.1   |
| Construction - custom                  | 527,319        | 4.5    | 473,069            | 4.3    | 54,250    | 11.5   |
| Land - acquisition & development       | 118,726        | 1.0    | 118,497            | 1.1    | 229       | 0.2    |
| Land - consumer lot loans              | 101,227        | 0.9    | 104,567            | 1.0    | (3,340)   | (3.2 ) |
| Multi-family                           | 1,266,911      | 10.9   | 1,124,290          | 10.3   | 142,621   | 12.7   |
| Commercial real estate                 | 1,296,039      | 11.1   | 1,093,639          | 10.0   | 202,400   | 18.5   |
| Commercial & industrial                | 1,071,629      | 9.2    | 978,589            | 8.9    | 93,040    | 9.5    |
| HELOC                                  | 146,172        | 1.3    | 149,716            | 1.4    | (3,544)   | (2.4 ) |
| Consumer                               | 107,759        | 0.9    | 139,000            | 1.3    | (31,241)  | (22.5) |
| Total gross loans                      | 11,640,489     | 100.0% | 10,950,608         | 100.0% | 689,881   | 6.3 %  |
| Less:                                  |                |        |                    |        |           |        |
| Allowance for probable losses          | 121,922        |        | 113,494            |        | 8,428     | 7.4 %  |
| Loans in process                       | 1,009,937      |        | 879,484            |        | 130,453   | 14.8   |
| Net deferred fees, costs and discounts | 45,608         |        | 46,710             |        | (1,102)   | (2.4 ) |
| Total loan contra accounts             | 1,177,467      |        | 1,039,688          |        | 137,779   | 13.3   |
| Net Loans                              | \$10,463,022   |        | \$9,910,920        |        | \$552,102 | 5.6 %  |

Non-performing assets: Non-performing assets increased \$8,297,000 during the six months ended March 31, 2017 to \$79,738,000 from \$71,441,000 at September 30, 2016. The increase is primarily due to the \$14,781,000 rise in non-accrual loans partially offset by the \$6,484,000 decline in REO. Non-performing assets as a percentage of total assets increased to 0.53% at March 31, 2017 compared to 0.48% at September 30, 2016.

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The following table sets forth information regarding restructured loans and non-performing assets.

|   | March 31,<br>2017 |       | September 30,<br>2016 |       |
|---|-------------------|-------|-----------------------|-------|
|   | (In thousands)    |       |                       |       |
| Restructured loans:   |                   |       |                       |       |
| Single-family residential   | \$204,955         | 87.6% | \$228,185             | 87.3% |
| Land - acquisition & development  | 594               | 0.3   | 1,154                 | 0.4   |
| Land - consumer lot loans   | 9,410             | 4.0   | 9,631                 | 3.7   |
| Multi - family  | 1,131             | 0.5   | 1,505                 | 0.6   |
| Commercial real estate  | 16,290            | 7.0   | 19,434                | 7.4   |
| HELOC   | 1,414             | 0.6   | 1,506                 | 0.6   |
| Consumer  | 107               | —     | 116                   | —     |
| Total restructured loans (1)  | \$233,901         | 100 % | \$261,531             | 100 % |
| Non-accrual loans:  |                   |       |                       |       |
| Single-family residential   | \$34,373          | 60.1% | \$33,148              | 78.2% |
| Construction - custom   | 240               | 0.4   | —                     | —     |
| Land - acquisition & development  | 80                | 0.1   | 58                    | 0.1   |
| Land - consumer lot loans   | 1,129             | 2.0   | 510                   | 1.2   |
| Multi-family  | 1,364             | 2.4   | 776                   | 1.8   |
| Commercial real estate  | 10,507            | 18.4  | 7,100                 | 16.7  |
| Commercial & industrial   | 8,864             | 15.5  | 583                   | 1.4   |
| HELOC   | 583               | 1.0   | 239                   | 0.6   |
| Consumer  | 55                | 0.1   | —                     | —     |
| Total non-accrual loans (2)   | 57,195            | 100 % | 42,414                | 100 % |
| Real estate owned   | 22,543            |       | 29,027                |       |
| Total non-performing assets   | \$79,738          |       | \$71,441              |       |
| Total non-performing assets and performing restructured loans as a percentage of total assets | 2.02              | %     | 2.17                  | %     |
| (1) Restructured loans were as follows:   |                   |       |                       |       |
| Performing  | \$222,208         | 95.0% | \$251,583             | 96.2% |
| Non-performing (included in non-accrual loans above)  | 11,693            | 5.0   | 9,948                 | 3.8   |
|   | \$233,901         | 100 % | \$261,531             | 100 % |

For the six months ended March 31, 2017, the Company recognized \$1,094,000 in interest income on cash payments received from borrowers on non-accrual loans. The Company would have recognized interest income of \$1,134,000 for the same period had these loans performed according to their original contract terms. The recognized interest income may include more than six months of interest for some of the loans that were brought current. In addition to the non-accrual loans reflected in the above table, the Company had \$91,623,000 of loans that were less than 90 days delinquent at March 31, 2017 but which it had classified as substandard for one or more reasons. If these loans were deemed non-performing, the Company's ratio of total NPAs and performing restructured loans as a percent of total assets would have increased to 2.63% at March 31, 2017.

Restructured single-family residential loans are reserved for under the Company’s general reserve methodology. If any individual loan is significant in balance, the Company may establish a specific reserve as warranted.

Most restructured loans are accruing and performing loans where the borrower has proactively approached the Bank about modifications due to temporary financial difficulties. Each request is individually evaluated for merit and likelihood of success. Single-family residential loans comprised 87.6% of restructured loans as of March 31, 2017. The concession for these loans is

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typically a payment reduction through a rate reduction of 100 to 200 bps for a specific term, usually six to twenty four months. Interest-only payments may also be approved during the modification period.

For commercial loans, six consecutive payments on newly restructured loan terms are generally required prior to returning the loan to accrual status. In some instances after the required six consecutive payments are made, a management assessment will conclude that collection of the entire principal balance is still in doubt. In those instances, the loan will remain on non-accrual. Homogeneous loans may or may not be on accrual status at the time of restructuring, but all are placed on accrual status upon the restructuring of the loan. Homogeneous loans are restructured only if the borrower can demonstrate the ability to meet the restructured payment terms; otherwise, collection is pursued and the loan remains on non-accrual status until liquidated. If the homogeneous restructured loan does not perform it will be placed in non-accrual status when it is 90 days delinquent.

A loan that defaults and is subsequently modified would impact the Company’s delinquency trend, which is part of the qualitative risk factors component of the general reserve calculation. Any modified loan that re-defaults and is charged-off would impact the historical loss factors component of the Company’s general reserve calculation.

Allowance for loan losses: The following table shows the Company’s allowance for loan losses by loan category.

| March 31, 2017                   | Loans Collectively Evaluated for Impairment |                                  |       | Loans Individually Evaluated for Impairment |                                  |       |
|----------------------------------|---|----------------------------------|-------|---|----------------------------------|-------|
|                                  | Allowance Allocation                        | Recorded Investment of Loans (1) | Ratio | Allowance Allocation                        | Recorded Investment of Loans (1) | Ratio |
|                                  | (In thousands)                              |                                  |       | (In thousands)                              |                                  |       |
| Single-family residential        | \$ 37,164                                   | \$ 5,661,673                     | 0.7 % | \$ —  | \$ 25,370                        | — %   |
| Construction                     | 25,061                                      | 593,479                          | 4.2   | —   | —                                | —     |
| Construction - custom            | 1,176                                       | 251,801                          | 0.5   | —   | 105                              | —     |
| Land - acquisition & development | 6,666                                       | 102,281                          | 6.5   | 2   | 438                              | 0.1   |
| Land - consumer lot loans        | 2,513                                       | 91,402                           | 2.7   | —   | 794                              | —     |
| Multi-family                     | 7,919                                       | 1,264,130                        | 0.6   | 10  | 2,496                            | 0.3   |
| Commercial real estate           | 10,685                                      | 1,226,228                        | 0.9   | 88  | 26,112                           | 0.3   |
| Commercial & industrial          | 28,365                                      | 1,059,310                        | 2.7   | —   | 9,606                            | —     |
| HELOC                            | 826   | 137,124                          | 0.6   | —   | 722                              | —     |
| Consumer                         | 1,447                                       | 107,472                          | 1.3   | —   | 15                               | —     |
|                                  | \$ 121,822                                  | \$ 10,494,900                    | 1.2 % | \$ 100                                      | \$ 65,658                        | 0.2 % |

(1) Excludes acquired impaired loans and covered loans.



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| September 30, 2016               | Loans Collectively Evaluated for Impairment |                                  |       | Loans Individually Evaluated for Impairment |                                  |       |
|----------------------------------|---|----------------------------------|-------|---|----------------------------------|-------|
|                                  | Allowance Allocation                        | Recorded Investment of Loans (1) | Ratio | Allowance Allocation                        | Recorded Investment of Loans (1) | Ratio |
|                                  | (In thousands)                              |                                  |       | (In thousands)                              |                                  |       |
| Single-family residential        | \$ 37,536                                   | \$ 5,585,912                     | 0.7 % | \$ 260                                      | \$ 19,629                        | 1.3 % |
| Construction                     | 19,838                                      | 498,450                          | 4.0   | —   | —                                | —     |
| Construction - custom            | 1,080                                       | 229,298                          | 0.5   | —   | 330                              | —     |
| Land - acquisition & development | 6,022                                       | 90,850                           | 6.6   | 2   | 850                              | 0.2   |
| Land - consumer lot loans        | 2,535                                       | 92,828                           | 2.7   | —   | 558                              | —     |
| Multi-family                     | 6,911                                       | 1,091,974                        | 0.6   | 13  | 1,505                            | 0.9   |
| Commercial real estate           | 8,497                                       | 957,380                          | 0.9   | 91  | 11,157                           | 0.8   |
| Commercial & industrial          | 28,008                                      | 966,930                          | 2.9   | —   | —                                | —     |
| HELOC                            | 813   | 133,203                          | 0.6   | —   | 239                              | —     |
| Consumer                         | 1,888                                       | 137,315                          | 1.4   | —   | 3                                | —     |
|                                  | \$ 113,128                                  | \$ 9,784,140                     | 1.2 % | \$ 366                                      | \$ 34,271                        | 1.1 % |

(1) Excludes acquired impaired loans and covered loans.

Reserve for losses on unfunded commitments: Unfunded commitments tend to vary depending on our loan mix and the proportion share of commercial loans. The reserve for unfunded commitments was \$5,050,000 as of March 31, 2017, which is an increase from \$3,235,000 at September 30, 2016. Management believes the allowance for loan losses plus the reserve for unfunded commitments, totaling \$126,972,000, or 1.09% of gross loans, is sufficient to absorb estimated losses inherent in the portfolio. See Note E for further discussion and analysis of the allowance for loan losses as of and for the period ended March 31, 2017.

Real estate owned: Real estate owned decreased during the six months ended March 31, 2017 by \$6,484,000 to \$22,543,000. The decrease is primarily due to sales of REO properties during the period.

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Customer accounts: Customer accounts increased \$29,955,000, or 0.3%, to \$10,630,807,000 at March 31, 2017 compared with \$10,600,852,000 at September 30, 2016.

The following table shows the composition of the Bank’s customer accounts by deposit type.

|                              | March 31, 2017                         |                          |           |           | September 30, 2016                     |                          |           |           |
|------------------------------|--|--------------------------|-----------|-----------|--|--------------------------|-----------|-----------|
|                              | Deposit Account Balance (In thousands) | As a % of Total Deposits | Wtd. Rate | Avg. Rate | Deposit Account Balance (In thousands) | As a % of Total Deposits | Wtd. Rate | Avg. Rate |
| Non-interest checking        | \$1,142,372                            | 10.7 %                   | —         | %         | \$1,091,738                            | 10.3 %                   | —         | %         |
| Interest checking            | 1,731,737                              | 16.3                     | 0.15      |           | 1,629,983                              | 15.4                     | 0.10      |           |
| Savings (passbook/statement) | 871,722                                | 8.2                      | 0.10      |           | 820,980                                | 7.7                      | 0.10      |           |
| Money market                 | 2,466,868                              | 23.2                     | 0.15      |           | 2,462,891                              | 23.2                     | 0.15      |           |
| Time deposits                | 4,418,108                              | 41.6                     | 0.98      |           | 4,595,260                              | 43.3                     | 1.02      |           |
| Total                        | \$10,630,807                           | 100 %                    | 0.47      | %         | \$10,600,852                           | 100 %                    | 0.50      | %         |

FHLB advances and other borrowings: Total borrowings increased to \$2,150,000,000 as of March 31, 2017 from \$2,080,000,000 as of September 30, 2016.

**RESULTS OF OPERATIONS**

Net Income: The Company recorded net income of \$42,070,000 for the quarter ended March 31, 2017 compared to \$41,723,000 for the prior year quarter. Net income was \$83,316,000 for the six months ended March 31, 2017 compared to \$76,821,000 for the same period one year ago.

Net Interest Income: For the quarter ended March 31, 2017, net interest income was \$107,727,000 which is \$1,402,000 higher than the same quarter of the prior year. Net interest margin was 3.15% for the quarter ended March 31, 2017 compared to 3.16% for the quarter ended March 31, 2016. The increase in net interest income was primarily due to average earning assets increasing by \$230,479,000. For the six months ended March 31, 2017, net interest income was \$210,879,000 which is \$2,315,000 lower than the same period of the prior year, primarily due to the decrease in interest income on mortgage-backed securities. Net interest margin was 3.08% for the six months ended March 31, 2017 compared to 3.17% for the six months ended March 31, 2016. The decreases in net interest margin are primarily due to the relatively low interest rate environment that has led to new loan originations having lower yields than the loans that repaid.

The following table sets forth certain information explaining changes in interest income and interest expense for the period indicated compared to the same period one year ago. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to (1) changes in volume (changes in volume multiplied by old rate) and (2) changes in rate (changes in rate multiplied by old volume). The change in interest income and interest expense attributable to changes in both volume and rate has been allocated proportionately to the change due to volume and the change due to rate.

Rate / Volume Analysis:

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## WASHINGTON FEDERAL, INC. AND SUBSIDIARIES

## PART I – Financial Information

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

|                                    | Comparison of Three<br>Months Ended |           |          | Comparison of Six Months<br>Ended |            |           |
|------------------------------------|-------------------------------------|-----------|----------|-----------------------------------|------------|-----------|
|                                    | 03/31/17 and 03/31/16               |           |          | 03/31/17 and 03/31/16             |            |           |
|                                    | Volume                              | Rate      | Total    | Volume                            | Rate       | Total     |
|                                    | (In thousands)                      |           |          | (In thousands)                    |            |           |
| Interest income:                   |                                     |           |          |                                   |            |           |
| Loans receivable                   | \$8,379                             | \$(5,556) | \$2,823  | \$17,351                          | \$(12,556) | \$4,795   |
| Mortgaged-backed securities        | (975 )                              | 355       | (620 )   | (2,930 )                          | (1,888 )   | (4,818 )  |
| Investments (1)                    | (2,125 )                            | 1,057     | (1,068 ) | (2,788 )                          | 1,586      | (1,202 )  |
| All interest-earning assets        | 5,279                               | (4,144 )  | 1,135    | 11,633                            | (12,858 )  | (1,225 )  |
| Interest expense:                  |                                     |           |          |                                   |            |           |
| Customer accounts                  | 16                                  | (695 )    | (679 )   | 16                                | (395 )     | (379 )    |
| FHLB advances and other borrowings | 916                                 | (504 )    | 412      | 2,794                             | (1,325 )   | 1,469     |
| All interest-bearing liabilities   | 932                                 | (1,199 )  | (267 )   | 2,810                             | (1,720 )   | 1,090     |
| Change in net interest income      | \$4,347                             | \$(2,945) | \$1,402  | \$8,823                           | \$(11,138) | \$(2,315) |

(1)Includes interest on cash equivalents and dividends on FHLB & FRB stock

Provision (Release) for Loan Losses: The Company recorded a release of allowance for loan losses of \$1,600,000 during the three months ended March 31, 2017, compared to a \$1,500,000 release of allowance for loan losses recording during the three months ended March 31, 2016. A release of allowance for loan losses of \$1,600,000 and \$1,500,000 was recorded during the six months ended March 31, 2017 and March 31, 2016, respectively. Reserving for new loan originations as the loan portfolio grows has been largely offset by recoveries of previously charged-off loans. Recoveries, net of charge-offs, totaled \$10,512,000 for the six months ended March 31, 2017, compared with \$4,590,000 of net recoveries for the same period one year ago.

Other Income: The three months ended March 31, 2017 results include total other income of \$10,136,000 compared to \$10,729,000 for the same period one year ago. The six months ended March 31, 2017 results include total other income of \$22,032,000 compared to \$21,364,000 for the same period one year ago. The increase during the six months ended March 31, 2017 is primarily due to \$968,000 gain on sale of investment securities. Deposit fee income was \$10,089,000 for the six months ended March 31, 2017 compared to \$11,267,000 for the six months ended March 31, 2016.

Other Expense: The three months ended March 31, 2017 results include total other expense of \$57,467,000 compared to \$59,226,000 for the same period one year ago. The six months ended March 31, 2017 results include total other expense of \$111,808,000 compared to \$123,735,000 for the same period one year ago, a \$11,927,000 or 9.6% decrease. The decrease for the six months ended March 31, 2017 is primarily due to approximately \$6,600,000 of expenses recognized during the quarter ended December 31, 2016 that related to the Company's November 2015 conversion of its core systems. Additionally, product delivery costs declined by \$2,967,000 from the prior year and this was mostly attributable to benefits from the new system and related process efficiencies. The number of staff, including part-time employees on a full-time equivalent basis, was 1,797 and 1,837 at March 31, 2017 and 2016, respectively. Total other expense for the six months ended March 31, 2017 and 2016 equaled 1.50% and 1.70%, respectively, of average assets.

Gain (Loss) on Real Estate Owned: Gains recognized on real estate owned was a net gain of \$795,000 for the three months ended March 31, 2017, compared to \$3,894,000 for the same period one year ago. Gains recognized on real estate owned was a net gain of \$1,193,000 for the six months ended March 31, 2017, compared to \$5,314,000 for the

same period one year ago. The decreases during these periods were due to fewer REO sales.

**Income Tax Expense:** Income tax expense totaled \$20,721,000 for the three months ended March 31, 2017, as compared to \$21,499,000 for the same period one year ago. Income tax expense totaled \$40,580,000 for the six months ended March 31, 2017, as compared to \$40,816,000 for the same period one year ago. The effective tax rate for the six months ended March 31, 2017 was 32.75% while for the period ended March 31, 2016 it was 34.70%. The decline in the effective tax rate from the prior period is primarily due to increased investments in bank owned life insurance, low income housing tax credit partnerships and tax exempt loans.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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Management believes that there have been no material changes in the Company's quantitative and qualitative information about market risk since September 30, 2016. For a complete discussion of the Company's quantitative and qualitative market risk, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's 2016 Form 10-K.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. The Company maintains a set of disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) that are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Management has evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this quarterly report (the "Evaluation Date"). Based on the evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures are effective.

(b) Changes in Internal Control over Financial Reporting. During the period to which this report relates, there have not been any changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that have materially affected, or that are reasonably likely to materially affect, such controls.

## WASHINGTON FEDERAL, INC. AND SUBSIDIARIES

## PART II – Other Information

## Item 1. Legal Proceedings

From time to time the Company and its subsidiaries are engaged in legal proceedings in the ordinary course of business, none of which are considered to have a material impact on the Company's consolidated financial statements.

## Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed under "Part I--Item 1A--Risk Factors" in the 2016 Form 10-K for the year ended September 30, 2016. These factors could materially and adversely affect the Company's business, financial condition, liquidity, results of operations and capital position, and could cause its actual results to differ materially from our historical results or the results contemplated by the forward-looking statements contained in this report.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information with respect to purchases made by or on behalf of the Company of the Company's common stock during the three months ended March 31, 2017.

| Period                                | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plan (1) | Maximum Number of Shares That May Yet Be Purchased Under the Plan at the End of the Period (2) |
|---------------------------------------|----------------------------------|------------------------------|---|--|
| January 1, 2017 to January 31, 2017   | —                                | \$ —                         | —   | 4,231,553  |
| February 1, 2017 to February 28, 2017 | 477                              | 33.55                        | 477   | 4,231,076  |
| March 1, 2017 to March 31, 2017       | —                                | —                            | —   | 4,231,076  |
| Total                                 | 477                              | \$ 33.55                     | 477   | 4,231,076  |

(1) The Company's stock repurchase program was publicly announced by its Board of Directors on February 3, 1995 and has no expiration date. Under this ongoing program, a total of 51,956,264 shares have been authorized for repurchase. This includes the authorization of an additional 5,000,000 shares that may be repurchased under Washington Federal's share repurchase program that was approved in September 2016.

(2) Does not reflect TARP warrants that were repurchased during the six months ended March 31, 2017 that Management also counts against the maximum number of shares that may be repurchased under the Plan. Net of such repurchased warrants, there are 4,157,081 shares remaining under the Plan for repurchase.

## Item 3. Defaults Upon Senior Securities

Not applicable

## Item 4. Mine Safety Disclosures

Not applicable

## Item 5. Other Information

Not applicable

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Item 6. Exhibits

(a) Exhibits

31.1 Section 302 Certification by the Chief Executive Officer

31.2 Section 302 Certification by the Chief Financial Officer

32 Section 906 Certification by the Chief Executive Officer and Chief Financial Officer

101 Financial Statements from the Company's Form 10-Q for the three months ended March 31, 2017 formatted in XBRL

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WASHINGTON FEDERAL, INC. AND SUBSIDIARIES

SIGNATURES

Pursuant to the requirements of the Exchange Act, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

May 3, 2017 /S/ BRENT J. BEARDALL  
BRENT J. BEARDALL  
President & Chief Executive Officer

May 3, 2017 /S/ VINCENT L. BEATTY  
VINCENT L. BEATTY  
Senior Vice President and Chief Financial Officer

May 3, 2017 /S/ CORY D. STEWART  
CORY D. STEWART  
Senior Vice President and Principal Accounting Officer