TIMBERLAND BANCORP INC
Form 10-K
December 11, 2014
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended September 30, 2014 OR

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

Commission File Number: 0-23333

TIMBERLAND BANCORP, INC.
(Exact name of registrant as specified in its charter)

Washington	91-1863696
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
624 Simpson Avenue, Hoquiam, Washington	98550
(Address of principal executive offices)	(Zip Code)
Registrant’s telephone number, including area code:	(360) 533-4747

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

Common Stock, par value $.01 per share	The Nasdaq Stock Market LLC
(Title of Each Class)	(Name of Each Exchange on Which Registered)

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO X

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 of Section 15(d) of the Act. YES NO X

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

Indicate by check mark 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 X NO

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company X

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

As of November 30, 2014, the registrant had 7,052,036 shares of common stock issued and outstanding. The aggregate market value of the common stock held by nonaffiliates of the registrant, based on the closing sales price of the registrant's common stock as quoted on the NASDAQ Global Market on March 31, 2014, was $71.4 million (6,670,537 shares at $10.70). For purposes of this calculation, common stock held by officers and directors of the registrant was excluded.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of Definitive Proxy Statement for the 2015 Annual Meeting of Stockholders (Part III).

TIMBERLAND BANCORP, INC.
2014 ANNUAL REPORT ON FORM 10-K
TABLE OF CONTENTS

		Page
PART I.		
Item 1.	Business	
	General	3
	Corporate Overview	3
	Market Area	4
	Lending Activities	5
	Investment Activities	21
	Deposit Activities and Other Sources of Funds	22
	Bank Owned Life Insurance	25
	How We Are Regulated	25
	Taxation	33
	Competition	33
	Subsidiary Activities	33
	Personnel	33
	Executive Officers of the Registrant	33
Item 1A.	Risk Factors	34
Item 1B.	Unresolved Staff Comments	45
Item 2.	Properties	45
Item 3.	Legal Proceedings	46
Item 4.	Mine Safety Disclosures	46
PART II.		
Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	47
Item 6.	Selected Financial Data	49
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	51
	General	51
	Special Note Regarding Forward-Looking Statements	51
	Critical Accounting Policies and Estimates	52
	New Accounting Pronouncements	53
	Operating Strategy	53
	Market Risk and Asset and Liability Management	55
	Comparison of Financial Condition at September 30, 2014 and September 30, 2013	56
	Comparison of Operating Results for Years Ended September 30, 2014 and 2013	58
	Comparison of Operating Results for Years Ended September 30, 2013 and 2012	60
	Average Balances, Interest and Average Yields/Cost	62
	Rate/Volume Analysis	64
	Liquidity and Capital Resources	64
	Effect of Inflation and Changing Prices	65
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	66
Item 8.	Financial Statements and Supplementary Data	66
Item 9.	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	125
Item 9A.	Controls and Procedures	125
Item 9B.	Other Information	126
PART III.		126
Item 10.	Directors, Executive Officers and Corporate Governance	126

Item 11.	Executive Compensation	126
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	126
Item 13.	Certain Relationships and Related Transactions, and Director Independence	127
Item 14.	Principal Accounting Fees and Services	127
PART IV.		
Item 15.	Exhibits and Financial Statement Schedules	128

As used throughout this report, the terms "we," "our," or "us," refer to Timberland Bancorp, Inc. and its consolidated subsidiary, unless the context otherwise requires.

PART I

Item 1. Business

General

Timberland Bancorp, Inc. (“Timberland Bancorp", or the "Company”), a Washington corporation, was organized on September 8, 1997 for the purpose of becoming the holding company for Timberland Savings Bank, SSB (“Bank”) upon the Bank’s conversion from a Washington-chartered mutual savings bank to a Washington-chartered stock savings bank (“Conversion”). The Conversion was completed on January 12, 1998 through the sale and issuance of 13,225,000 shares of common stock by the Company. At September 30, 2014, on a consolidated basis, the Company had total assets of $745.6 million, total deposits of $615.1 million and total shareholders’ equity of $82.8 million. The Company’s business activities generally are limited to passive investment activities and oversight of its investment in the Bank. Accordingly, the information set forth in this report, including consolidated financial statements and related data, relates primarily to the Bank and its subsidiary, Timberland Service Corporation.

The Bank was established in 1915 as “Southwest Washington Savings and Loan Association.” In 1935, the Bank converted from a state-chartered mutual savings and loan association to a federally chartered mutual savings and loan association, and in 1972, changed its name to “Timberland Federal Savings and Loan Association.” In 1990, the Bank converted to a federally chartered mutual savings bank under the name “Timberland Savings Bank, FSB.” In 1991, the Bank converted to a Washington-chartered mutual savings bank and changed its name to “Timberland Savings Bank, SSB.” On December 29, 2000, the Bank changed its name to “Timberland Bank.” The Bank’s deposits are insured up to applicable legal limits by the Federal Deposit Insurance Corporation (“FDIC”). The Bank has been a member of the Federal Home Loan Bank (“FHLB”) System since 1937. The Bank is regulated by the Washington Department of Financial Institutions, Division of Banks (“Division” or “DFI”) and the FDIC.

The Bank is a community-oriented bank which has traditionally offered a variety of savings products to its retail customers while concentrating its lending activities on real estate mortgage loans and commercial business loans. Lending activities have historically been focused primarily on the origination of loans secured by real estate, including construction and land development, one- to four-family residential, multi-family, commercial real estate and land loans. During the past several years, the Bank adjusted its lending strategy and began reducing its exposure to speculative construction and land development lending.

The Company maintains a website at www.timberlandbank.com. The information contained on that website is not included as a part of, or incorporated by reference into, this Annual Report on Form 10-K. Other than an investor’s own internet access charges, the Company makes available free of charge through that website the Company’s Annual Report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after these materials have been electronically filed with, or furnished to, the Securities and Exchange Commission (“SEC”).

Corporate Overview

Preferred Stock Received in the Troubled Asset Relief Program (“TARP”) Capital Purchase Program (“CPP”). On December 23, 2008, the Company received $16.64 million from the U.S. Treasury Department ("Treasury") as a part of the Treasury's CPP, which was established as part of the TARP. The Company sold 16,641 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A ("Series A Preferred Stock"), with a liquidation value of $1,000 per share and a related warrant to purchase 370,899 shares of the Company's common stock at an exercise price of $6.73 per share (subject to anti-dilution adjustments) at any time through December 23, 2018. The Series A Preferred Stock paid a 5.0% dividend through December 20, 2013, the date of its redemption.

On November 13, 2012, the Company's outstanding 16,641 shares of Series A Preferred Stock were sold by the Treasury as part of its efforts to manage and recover its investments under the TARP. While the sale of these preferred shares to new owners did not result in any proceeds to the Company and did not change the Company's capital position or accounting for these shares, it did eliminate restrictions put in place by the Treasury on TARP recipients.

On June 12, 2013, the Treasury sold, to private investors, the warrant to purchase 370,899 shares of the Company's common stock. The sale of the warrant to new owners did not result in any proceeds to the Company and did not change the Company's capital position or accounting for the warrant.

During the year ended September 30, 2013, the Company purchased and retired 4,576 shares of its Series A Preferred Stock for $4.32 million; a $255,000 discount from the liquidation value. The discount from the liquidation value on the repurchased shares was recorded as an increase to retained earnings and included in net income to common shareholders in the computation

of net income per common share. On December 20, 2013, the Company redeemed the remaining 12,065 shares of its Series A Preferred Stock at the liquidation value of $12.07 million.

Market Area

The Bank considers Grays Harbor, Pierce, Thurston, Kitsap, King and Lewis counties, Washington as its primary market areas. The Bank conducts operations from:

- its main office in Hoquiam (Grays Harbor County);
- five branch offices in Grays Harbor County (Ocean Shores, Montesano, Elma, and two branches in Aberdeen);
- five branch offices in Pierce County (Edgewood, Puyallup, Spanaway, Tacoma, and Gig Harbor);
- five branch offices in Thurston County (Olympia, Yelm, Tumwater, and two branches in Lacey);
- two branch offices in Kitsap County (Poulsbo and Silverdale);
- a branch office in King County (Auburn); and
- three branch offices in Lewis County (Winlock, Toledo and Chehalis).

For additional information, see “Item 2. Properties.”

Hoquiam, with a population of approximately 8,500, is located in Grays Harbor County which is situated along Washington State’s central Pacific coast. Hoquiam is located approximately 110 miles southwest of Seattle and 145 miles northwest of Portland, Oregon.

The Bank considers its primary market area to include six sub-markets: primarily rural Grays Harbor County with its historical dependence on the timber and fishing industries; Thurston and Kitsap counties with their dependence on state and federal government; Pierce and King counties with their broadly diversified economic bases; and Lewis County with its dependence on retail trade, manufacturing, industrial services and local government. Each of these markets presents operating risks to the Bank. The Bank’s expansion into Pierce, Thurston, Kitsap, King and Lewis counties represents the Bank’s strategy to diversify its primary market area to become less reliant on the economy of Grays Harbor County.

Grays Harbor County has a population of 71,000 according to the U.S. Census Bureau 2013 estimates and a median family income of $58,300 according to 2014 estimates from the Department of Housing and Urban Development (“HUD”). The economic base in Grays Harbor County has been historically dependent on the timber and fishing industries. Other industries that support the economic base are tourism, agriculture, shipping, transportation and technology. According to the Washington State Employment Security Department, the unemployment rate in Grays Harbor County decreased to 8.8% at September 30, 2014 from 11.0% at September 30, 2013. The median price of a resale home in Grays Harbor County for the quarter ended September 30, 2014 increased 0.9% to $128,100 from $126,900 for the comparable prior year period. The number of home sales increased 0.7% for the quarter ended September 30, 2014 compared to the same quarter one year earlier. The Bank has six branches (including its home office) located throughout the county. The downturn in Grays Harbor County’s economy and the decline in real estate values since 2008 have had a negative effect on the Bank’s profitability in this market area.

Pierce County is the second most populous county in the state and has a population of 820,000 according to the U.S. Census Bureau 2013 estimates. The county’s median family income is $67,000 according to 2014 HUD estimates. The economy in Pierce County is diversified with the presence of military related government employment (Joint Base Lewis-McChord), transportation and shipping employment (Port of Tacoma), and aerospace related employment (Boeing). According to the Washington State Employment Security Department, the unemployment rate for the Pierce County area decreased to 6.0% at September 30, 2014 from 7.7% at September 30, 2013. The median price of a resale home in Pierce County for the quarter ended September 30, 2014 increased 3.0% to $235,200 from $228,300 for the comparable prior year period. The number of home sales decreased 1.2% for the quarter ended

September 30, 2014 compared to the same quarter one year earlier. The Bank has five branches in Pierce County and these branches have historically been responsible for a substantial portion of the Bank's construction lending activities. The downturn in Pierce County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

Thurston County has a population of 262,000 according to the U.S. Census Bureau 2013 estimates and a median family income of $74,200 according to 2014 HUD estimates. Thurston County is home of Washington State's capital (Olympia) and its economic base is largely driven by state government related employment. According to the Washington State Employment Security

Department, the unemployment rate for the Thurston County area decreased to 5.4% at September 30, 2014 from 6.7% at September 30, 2013. The median price of a resale home in Thurston County for the quarter ended September 30, 2014 increased 4.6% to $238,700 from $228,300 for the same quarter one year earlier. The number of home sales increased 8.8% for the quarter ended September 30, 2014 compared to the same quarter one year earlier. The Bank has five branches in Thurston County. This county has historically had a stable economic base primarily attributable to the state government presence; however the downturn in Thurston County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

Kitsap County has a population of 254,000 according to the U.S. Census Bureau 2013 estimates and a median family income of $74,000 according to 2014 HUD estimates. The Bank has two branches in Kitsap County. The economic base of Kitsap County is largely supported by military related government employment through the United States Navy. According to the Washington State Employment Security Department, the unemployment rate for the Kitsap County area decreased to 5.3% at September 30, 2014 from 6.4% at September 30, 2013. The median price of a resale home in Kitsap County for the quarter ended September 30, 2014 increased 1.0% to $250,700 from $248,200, for the same quarter one year earlier. The number of home sales increased 2.5% for the quarter ended September 30, 2014 compared to the same quarter one year earlier. The downturn in Kitsap County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

King County is the most populous county in the state and has a population of 2.0 million according to the U.S. Census Bureau 2013 estimates. The Bank has one branch in King County. The county's median family income is $88,200 according to 2014 HUD estimates. King County's economic base is diversified with many industries including shipping, transportation, aerospace (Boeing), computer technology and biotech industries. According to the Washington State Employment Security Department, the unemployment rate for the King County area decreased to 4.8% at September 30, 2014 from 5.6% at September 30, 2013. The median price of a resale home in King County for the quarter ended September 30, 2014 increased 5.5% to $462,100 from $438,000, for the same quarter one year earlier. The number of home sales decreased 7.6% for the quarter ended September 30, 2014 compared to the same quarter one year earlier.

Lewis County has a population of 75,000 according to the U.S. Census Bureau 2013 estimates and a median family income of $58,300 according to 2014 HUD estimates. The economic base in Lewis County is supported by manufacturing, retail trade, local government and industrial services. According to the Washington State Employment Security Department, the unemployment rate in Lewis County decreased to 8.3% at September 30, 2014 from 10.5% at September 30, 2013. The median price of a resale home in Lewis County for the quarter ended September 30, 2014 increased 9.0% to $160,000 from $146,800, for the same quarter one year earlier. The number of home sales increased 6.3% for the quarter ended September 30, 2014 compared to the same quarter one year earlier. The Bank currently has three branches located in Lewis County. The downturn in Lewis County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

Lending Activities

General. Historically, the principal lending activity of the Bank has consisted of the origination of loans secured by first mortgages on owner-occupied, one- to four-family residences, or by commercial real estate and loans for the construction of one- to four-family residences. During the past several years, the Bank adjusted its lending strategy and began reducing its exposure to speculative construction and land development lending as well as land loans. The Bank's net loans receivable, including loans held for sale, totaled $565.8 million at September 30, 2014, representing 75.9% of consolidated total assets, and at that date commercial real estate, construction and land development loans (including undisbursed loans in process), and land loans were $392.4 million, or 64.6%, of total loans. Construction and land development loans, land loans and commercial real estate loans typically have higher rates of return than one- to four-family loans; however, they also present a higher degree of risk. See "-Lending Activities - Commercial Real Estate Lending," "- Lending Activities - Construction and Land Development Lending" and "- Lending Activities -

Land Lending.”

The Bank’s internal loan policy limits the maximum amount of loans to one borrower to 20% of its capital plus surplus. According to the Washington Administrative Code, capital and surplus are defined as a bank's Tier 1 capital, Tier 2 capital and the balance of a bank's allowance for loan losses not included in the bank's Tier 2 capital as reported in the bank's call report. At September 30, 2014, the maximum amount which the Bank could have lent to any one borrower and the borrower’s related entities was approximately $17.3 million under this policy. At September 30, 2014, the largest amount outstanding to any one borrower and the borrower’s related entities was $15.5 million which was secured by commercial buildings located in Pierce and Kitsap counties. These loans were all performing according to their loan repayment terms at September 30, 2014. The next largest amount outstanding to any one borrower and the borrower’s related entities was $8.3 million. These loans were secured by commercial buildings located in Thurston County and were performing according to their loan repayment terms at September 30, 2014.

Loan Portfolio Analysis. The following table sets forth the composition of the Bank's loan portfolio by type of loan as of the dates indicated.

	At September 30,									
	2014		2013		2012		2011		2010	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Mortgage Loans:										
One- to four-family(1)	$98,534	16.22 %	$104,298	18.00 %	$106,979	18.82 %	$114,680	20.47 %	$121,014	21.65 %
Multi-family	46,206	7.61	51,108	8.82	47,521	8.36	30,982	5.53	32,267	5.77
Commercial	294,354	48.47	291,297	50.27	256,254	45.08	246,037	43.92	208,002	37.21
Construction and land development	68,479	11.28	45,136	7.79	56,406	9.92	52,484	9.37	69,271	12.39
Land	29,589	4.87	31,144	5.37	39,655	6.98	49,236	8.79	62,999	11.27
Total mortgage loans	537,162	88.45	522,983	90.25	506,815	89.16	493,419	88.08	493,553	88.29
Consumer Loans:										
Home equity and second mortgage	34,921	5.75	33,014	5.70	32,814	5.77	36,008	6.43	38,418	6.87
Other	4,699	0.77	5,981	1.03	6,183	1.10	8,240	1.47	9,086	1.62
Total consumer loans	39,620	6.52	38,995	6.73	38,997	6.87	44,248	7.90	47,504	8.49
Commercial business loans	30,559	5.03	17,499	3.02	22,588	3.97	22,510	4.02	17,979	3.22
Total loans	607,341	100.00%	579,477	100.00%	568,400	100.00%	560,177	100.00%	559,036	100.00%
Less:										
Undisbursed portion of construction loans in process	(29,416)		(18,527)		(16,325)		(18,265)		(17,952)	
Deferred loan origination fees	(1,746)		(1,710)		(1,770)		(1,942)		(2,229)	
Allowance for loan losses	(10,427)		(11,136)		(11,825)		(11,946)		(11,264)	
Total loans receivable, net	$565,752		$548,104		$538,480		$528,024		$527,591	

(1) Includes loans held-for-sale of $899,000, $1.9 million, $1.4 million, $4.0 million and $3.0 million at September 30, 2014, 2013, 2012, 2011 and 2010, respectively.

6

Residential One- to Four-Family Lending. At September 30, 2014, $98.5 million, or 16.2%, of the Bank’s loan portfolio consisted of loans secured by one- to four-family residences. The Bank originates both fixed-rate loans and adjustable-rate loans.

Generally, one- to four-family fixed-rate loans and five and seven year balloon reset loans (which are loans that are originated with a fixed interest rate for the initial five or seven years, and thereafter incur one interest rate change in which the new rate remains in effect for the remainder of the loan term) are originated to meet the requirements for sale in the secondary market to the Federal Home Loan Mortgage Corporation ("Freddie Mac"). From time to time, however, a portion of these fixed-rate loans and five and seven year balloon reset loans, may be retained in the loan portfolio to meet the Bank’s asset/liability management objectives. The Bank uses an automated underwriting program, which preliminarily qualifies a loan as conforming to Freddie Mac underwriting standards when the loan is originated. At September 30, 2014, $37.7 million, or 38.3%, of the Bank’s one- to four-family loan portfolio consisted of fixed-rate and five and seven year balloon reset mortgage loans.

The Bank also offers adjustable-rate mortgage (“ARM”) loans. All of the Bank’s ARM loans are retained in its loan portfolio. The Bank offers several ARM products which adjust annually after an initial period ranging from one to five years and are typically subject to a limitation on the annual interest rate increase of 2% and an overall limitation of 6%. These ARM products generally are priced utilizing the weekly average yield on one year U.S. Treasury securities adjusted to a constant maturity of one year plus a margin of 2.88% to 4.00%. The Bank also offers ARM loans tied to the prime rate or to the London Inter-Bank Offered Rate (“LIBOR”) indices which typically do not have periodic, or lifetime adjustment limits. Loans tied to these indices normally have margins ranging up to 3.5%. ARM loans held in the Bank’s portfolio do not permit negative amortization of principal. Borrower demand for ARM loans versus fixed-rate mortgage loans is a function of the level of interest rates, the expectations of changes in the level of interest rates and the difference between the initial interest rates and fees charged for each type of loan. The relative amount of fixed-rate mortgage loans and ARM loans that can be originated at any time is largely determined by the demand for each in a competitive environment. At September 30, 2014, $60.8 million, or 61.7%, of the Bank’s one- to four- family loan portfolio consisted of ARM loans.

A portion of the Bank’s ARM loans are “non-conforming” because they do not satisfy acreage limits, or various other requirements imposed by Freddie Mac. Some of these loans are also originated to meet the needs of borrowers who cannot otherwise satisfy Freddie Mac credit requirements because of personal and financial reasons (i.e., divorce, bankruptcy, length of time employed, etc.), and other aspects, which do not conform to Freddie Mac’s guidelines. Such borrowers may have higher debt-to-income ratios, or the loans are secured by unique properties in rural markets for which there are no sales of comparable properties to support the value according to secondary market requirements. These loans are known as non-conforming loans and the Bank may require additional collateral or lower loan-to-value ratios to reduce the risk of these loans. The Bank believes that these loans satisfy a need in its local market area. As a result, subject to market conditions, the Bank intends to continue to originate these types of loans.

The retention of ARM loans in the Bank’s loan portfolio helps reduce the Bank’s exposure to changes in interest rates. There are, however, unquantifiable credit risks resulting from the potential of increased interest to be paid by the customer as a result of increases in interest rates. It is possible that during periods of rising interest rates the risk of default on ARM loans may increase as a result of repricing and the increased costs to the borrower. The Bank attempts to reduce the potential for delinquencies and defaults on ARM loans by qualifying the borrower based on the borrower’s ability to repay the ARM loan assuming that the maximum interest rate that could be charged at the first adjustment period remains constant during the loan term. Another consideration is that although ARM loans allow the Bank to increase the sensitivity of its asset base due to changes in the interest rates, the extent of this interest sensitivity is limited by the periodic and lifetime interest rate adjustment limits. Because of these considerations, the Bank has no assurance that yield increases on ARM loans will be sufficient to offset increases in the Bank’s cost of

funds.

While fixed-rate, single-family residential mortgage loans are normally originated with 15 to 30 year terms, these loans typically remain outstanding for substantially shorter periods because borrowers often prepay their loans in full upon sale of the property pledged as security or upon refinancing the original loan. In addition, substantially all mortgage loans in the Bank's loan portfolio contain due-on-sale clauses providing that the Bank may declare the unpaid amount due and payable upon the sale of the property securing the loan. Typically, the Bank enforces these due-on-sale clauses to the extent permitted by law and as business judgment dictates. Thus, average loan maturity is a function of, among other factors, the level of purchase and sale activity in the real estate market, prevailing interest rates and the interest rates received on outstanding loans.

The Bank requires that fire and extended coverage casualty insurance be maintained on the collateral for all of its real estate secured loans and flood insurance, if appropriate.

The Bank's lending policies generally limit the maximum loan-to-value ratio on mortgage loans secured by owner-occupied properties to 95% of the lesser of the appraised value or the purchase price. However, the Bank usually obtains private mortgage insurance ("PMI") on the portion of the principal amount that exceeds 80% of the appraised value of the security property. The maximum loan-to-value ratio on mortgage loans secured by non-owner-occupied properties is generally 80% (90% for loans originated for sale in the secondary market to Freddie Mac). At September 30, 2014, 21 one- to four-family loans totaling $4.4 million were on non-accrual status. See "- Lending Activities - Non-performing Loans and Delinquencies."

Construction and Land Development Lending. Prompted by unfavorable economic conditions in its primary market area in the 1980s, the Bank sought to establish a market niche and, as a result, began originating construction loans outside of Grays Harbor County. In recent periods, construction lending activities have been primarily in the Pierce, King, Thurston, Grays Harbor, and Kitsap County markets and as a result of the current economic environment, the Bank has sharply curtailed speculative construction and eliminated land development lending. At September 30, 2014, the Bank's construction and land development loans totaled $68.5 million or 11.28% of the Bank's total loan portfolio.

The Bank currently originates three types of residential construction loans: (i) custom construction loans, (ii) owner/builder construction loans and (iii) speculative construction loans (on a limited basis). The Bank believes that its computer tracking system has enabled it to establish processing and disbursement procedures to meet the needs of its borrowers while reducing many of the risks inherent with construction lending. The Bank also originates construction loans for the development of multi-family and commercial properties. Our construction loans generally provide for the payment of interest only during the construction phase.

At September 30, 2014 and 2013, the composition of the Bank's construction and land development loan portfolio was as follows:

	At September 30,					
	2014			2013		
	Outstanding Balance	Percent of Total		Outstanding Balance	Percent of Total	
	(Dollars in thousands)					
Custom and owner/builder	$59,752	87.26	%	$40,811	90.42	%
Speculative one-to four-family	2,577	3.76		1,428	3.16	
Multi-family (including condominium)	2,840	4.15		143	0.32	
Commercial real estate	3,310	4.83		2,239	4.96	
Land development	—	—		515	1.14	
Total	$68,479	100.00	%	$45,136	100.00	%

Custom construction loans are made to home builders who, at the time of construction, have a signed contract with a home buyer who has a commitment to purchase the finished home. Custom construction loans are generally originated for a term of six to 12 months, with fixed interest rates currently ranging from 4.50% to 9.00% and with loan-to-value ratios of 80% of the appraised estimated value of the completed property or sales price, whichever is less.

Owner/builder construction loans are originated to home owners rather than home builders and are typically converted to or refinanced into permanent loans at the completion of construction. The construction phase of an owner/builder construction loan generally lasts up to 12 months with fixed interest rates currently ranging from 4.50% to 9.00%, and with loan-to-value ratios of 80% (or up to 95% with PMI) of the appraised estimated value of the completed property. At the completion of construction, the loan is converted to or refinanced into either a fixed-rate mortgage loan, which conforms to secondary market standards, or an ARM loan for retention in the Bank's portfolio. At September 30, 2014, custom and owner/builder construction loans totaled $59.8 million, or 87.3%, of the total construction and land development loan portfolio. At September 30, 2014, the largest outstanding custom and

owner/builder construction loan had an outstanding balance of $1.5 million (including $14,000 of undisbursed loans in process) and was performing according to its repayment terms.

Speculative one-to four-family construction loans are made to home builders and are termed "speculative" because the home builder does not have, at the time of loan origination, a signed contract with a home buyer who has a commitment for permanent financing with either the Bank or another lender for the finished home. The home buyer may be identified either during or after the construction period, with the risk that the builder will have to debt service the speculative construction loan and finance real estate taxes and other carrying costs of the completed home for a significant time after the completion of construction until the home buyer is identified and a sale is consummated. Historically, the Bank has originated loans to approximately 50 builders

8

located in the Bank's primary market areas, each of which generally would have one to eight speculative loans outstanding from the Bank during a 12 month period. Rather than originating lines of credit to home builders to construct several homes at once, the Bank generally originates and underwrites a separate loan for each home. Speculative construction loans are generally originated for a term of 12 months, with current rates averaging 6.00%, and with a loan-to-value ratio of no more than 80% of the appraised estimated value of the completed property. The Bank is currently originating speculative construction loans on a limited basis. At September 30, 2014, speculative construction loans totaled $2.6 million, or 3.8%, of the total construction and land development loan portfolio. At September 30, 2014 the largest aggregate outstanding balance to one borrower for speculative construction loans, totaled $458,000 (including $450,000 of undisbursed loans in process) and was comprised of two loans that were performing according to their repayment terms.

The Bank historically originated loans to real estate developers with whom it had established relationships for the purpose of developing residential subdivisions (i.e., installing roads, sewers, water and other utilities; generally with ten to 50 lots). The Bank is not currently originating any new land development loans and at September 30, 2014, the Bank had no land development loans outstanding. Land development loans were secured by a lien on the property and typically were made for a period of two to five years with fixed or variable interest rates, and were made with loan-to-value ratios generally not exceeding 75%. Land development loans were generally structured so that the Bank was repaid in full upon the sale by the borrower of approximately 80% of the subdivision lots. In addition, in the case of a corporate borrower, the Bank also generally obtained personal guarantees from corporate principals and reviewed their personal financial statements.

Land development loans secured by land under development involve greater risks than one- to four-family residential mortgage loans because these loans are advanced upon the predicted future value of the developed property upon completion. If the estimate of the future value proves to be inaccurate, in the event of default and foreclosure the Bank may be confronted with a property the value of which is insufficient to assure full repayment. The Bank has historically attempted to minimize this risk by generally limiting the maximum loan-to-value ratio on land loans to 75% of the estimated developed value of the secured property.

The Bank also provides construction financing for multi-family and commercial properties. At September 30, 2014, these loans amounted to $6.2 million, or 9.0% of construction and land development loans. These loans are typically secured by condominiums, apartment buildings, mini-storage facilities, office buildings, hotels and retail rental space predominantly located in the Bank's primary market area. At September 30, 2014, the largest outstanding multi-family construction loan was secured by an apartment building project in Pierce County and had a balance of $2.4 million (including $2.3 million of undisbursed construction loan proceeds) and was performing according to its repayment terms. At September 30, 2014, the largest outstanding commercial real estate construction loan had a balance of $1.4 million. This loan was secured by a mixed use building being constructed in Thurston County and was performing according to its repayment terms.

All construction loans must be approved by a member of one of the Bank's Loan Committees or the Bank's Board of Directors, or in the case of one- to four-family construction loans meeting Freddie Mac guidelines, by a qualified Bank underwriter. See "- Lending Activities - Loan Solicitation and Processing." Prior to preliminary approval of any construction loan application, an independent fee appraiser inspects the site and the Bank reviews the existing or proposed improvements, identifies the market for the proposed project and analyzes the pro-forma data and assumptions on the project. In the case of a speculative or custom construction loan, the Bank reviews the experience and expertise of the builder. After preliminary approval has been given, the application is processed, which includes obtaining credit reports, financial statements and tax returns on the borrowers and guarantors, an independent appraisal of the project, and any other expert reports necessary to evaluate the proposed project. In the event of cost overruns, the Bank generally requires that the borrower increase the funds available for construction by depositing its own funds into a secured savings account, the proceeds of which are used to pay construction costs.

Loan disbursements during the construction period are made to the builder, materials supplier or subcontractor, based on a line item budget. Periodic on-site inspections are made by qualified independent inspectors to document the reasonableness of draw requests. For most builders, the Bank disburses loan funds by providing vouchers to borrowers, which when used by the borrower to purchase supplies are submitted by the supplier to the Bank for payment.

The Bank originates construction loan applications primarily through customer referrals, contacts in the business community and occasionally real estate brokers seeking financing for their clients.

Construction lending affords the Bank the opportunity to achieve higher interest rates and fees with shorter terms to maturity than does its single-family permanent mortgage lending. Construction lending, however, is generally considered to involve a higher degree of risk than single-family permanent mortgage lending because of the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost of the project. The nature of these loans is such that they are generally more difficult to evaluate and monitor. If the estimate of construction cost proves to be inaccurate, the Bank

may be required to advance funds beyond the amount originally committed to permit completion of the project. If the estimate of value upon completion proves to be inaccurate, the borrower may be confronted with a project whose value is insufficient to assure full repayment and the Bank may incur a loss. Projects may also be jeopardized by disagreements between borrowers and builders and by the failure of builders to pay subcontractors. Loans to builders to construct homes for which no purchaser has been identified carry more risk because the payoff for the loan depends on the builder's ability to sell the property prior to the time that the construction loan is due. The Bank has sought to address these risks by adhering to strict underwriting policies, disbursement procedures, and monitoring practices. The Bank's construction loans are primarily secured by properties in its primary market area, and changes in the local and state economies and real estate markets have adversely affected the Bank's construction loan portfolio.

Multi-Family Lending. At September 30, 2014, the Bank had $46.2 million, or 7.6% of the Bank's total loan portfolio, secured by multi-family dwelling units (more than four units) located primarily in the Bank's primary market area. Multi-family loans are generally originated with variable rates of interest ranging from 2.00% to 3.50% over the one-year constant maturity U.S. Treasury Bill Index or a matched term FHLB advance, with principal and interest payments fully amortizing over terms of up to 30 years. At September 30, 2014 the Bank's largest multi-family loan had an outstanding principal balance of $7.9 million and was secured by an apartment building located in Thurston County. At September 30, 2014, this loan was performing according to its restructured repayment terms.

The maximum loan-to-value ratio for multi-family loans is generally limited to not more than 80%. The Bank generally requests its multi-family loan borrowers with loan balances in excess of $750,000 to submit financial statements and rent rolls on the properties securing such loans. The Bank also inspects such properties annually. The Bank generally imposes a minimum debt coverage ratio of approximately 1.20 for loans secured by multi-family properties.

Multi-family mortgage lending affords the Bank an opportunity to receive interest at rates higher than those generally available from one- to four- family residential lending. However, loans secured by multi-family properties usually are greater in amount, more difficult to evaluate and monitor and, therefore, may involve a greater degree of risk than one- to four-family residential mortgage loans. Because payments on loans secured by multi-family properties are often dependent on the successful operation and management of the properties, repayment of such loans may be affected by adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks by scrutinizing the financial condition of the borrower, the quality of the collateral and the management of the property securing the loan. If the borrower is other than an individual, the Bank also generally obtains personal guarantees from the principals based on a review of personal financial statements.

Commercial Real Estate Lending. Commercial real estate loans totaled $294.4 million, or 48.5% of the total loan portfolio at September 30, 2014. The Bank originates commercial real estate loans generally at variable interest rates with principal and interest payments fully amortizing over terms of up to 30 years. These loans are secured by properties, such as restaurants, motels, mini-storage facilities, office buildings and retail/wholesale facilities, located in the Bank's primary market area. At September 30, 2014, the largest commercial real estate loan was secured by an office building in Grays Harbor County and had a balance of $6.2 million and was performing according to its repayment terms. At September 30, 2014, three commercial real estate loans totaling $1.5 million were on non-accrual status. See "- Lending Activities - Non-performing Loans and Delinquencies."

The Bank typically requires appraisals of properties securing commercial real estate loans. For loans that are less than $250,000, the Bank may use the tax assessed value and a property inspection in lieu of an appraisal. Appraisals are performed by independent appraisers designated by the Bank. The Bank considers the quality and location of the real estate, the credit history of the borrower, the cash flow of the project and the quality of management involved with the property. The Bank generally imposes a minimum debt coverage ratio of approximately 1.20 for originated loans secured by income producing commercial properties. Loan-to-value ratios on commercial real estate loans are generally limited to not more than 80%. If the borrower is other than an individual, the Bank also generally obtains

personal guarantees from the principals based on a review of personal financial statements.

Commercial real estate lending affords the Bank an opportunity to receive interest at rates higher than those generally available from one- to four-family residential lending. However, loans secured by such properties usually are greater in amount, more difficult to evaluate and monitor and, therefore, involve a greater degree of risk than one- to four-family residential mortgage loans. Because payments on loans secured by commercial properties often depend upon the successful operation and management of the properties, repayment of these loans may be affected by adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks by generally limiting the maximum loan-to-value ratio to 80% and scrutinizing the financial condition of the borrower, the quality of the collateral and the management of the property securing the loan. The Bank also generally requests annual financial information and rent rolls on the subject property from the borrowers on loans over $750,000.

Land Lending. The Bank has historically originated loans for the acquisition of land upon which the purchaser can then build or make improvements necessary to build or to sell as improved lots. Currently the Bank is originating land loans on a limited basis. At September 30, 2014, land loans totaled $29.6 million, or 4.9% of the Bank's total loan portfolio as compared to $31.1 million, or 5.4% of the Bank's total loan portfolio at September 30, 2013. Land loans originated by the Bank generally have maturities of five to ten years. The largest land loan is secured by land in Grays Harbor County, had an outstanding balance of $3.7 million and was on non-accrual status at September 30, 2014. At September 30, 2014, nine land loans totaling $4.6 million were on non-accrual status. See "- Lending Activities - Non-performing Loans and Delinquencies."

Loans secured by undeveloped land or improved lots involve greater risks than one- to four-family residential mortgage loans because these loans are more difficult to evaluate. If the estimate of value proves to be inaccurate, in the event of default and foreclosure the Bank may be confronted with a property the value of which is insufficient to assure full repayment. The Bank attempts to minimize this risk by generally limiting the maximum loan-to-value ratio on land loans to 75%.

Consumer Lending. Consumer loans generally have shorter terms to maturity and higher interest rates than mortgage loans. Consumer loans include home equity lines of credit, second mortgage loans, savings account loans, automobile loans, boat loans, motorcycle loans, recreational vehicle loans and unsecured loans. Consumer loans are made with both fixed and variable interest rates and with varying terms. At September 30, 2014, consumer loans amounted to $39.6 million, or 6.5%, of the Bank's total loan portfolio.

At September 30, 2014, the largest component of the consumer loan portfolio consisted of second mortgage loans and home equity lines of credit, which totaled $34.9 million, or 5.7% of the Bank's total loan portfolio. Home equity lines of credit and second mortgage loans are made for purposes such as the improvement of residential properties, debt consolidation and education expenses, among others. The majority of these loans are made to existing customers and are secured by a first or second mortgage on residential property. The loan-to-value ratio is typically 80% or less, when taking into account both the first and second mortgage loans. Second mortgage loans typically carry fixed interest rates with a fixed payment over a term between five and 15 years. Home equity lines of credit are generally made at interest rates tied to the prime rate or the 26 week Treasury Bill. Second mortgage loans and home equity lines of credit have greater credit risk than one- to four-family residential mortgage loans because they are generally secured by mortgages subordinated to the existing first mortgage on the property, which may or may not be held by the Bank.

Consumer loans entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans. The Bank believes that these risks are not as prevalent in the case of the Bank's consumer loan portfolio because a large percentage of the portfolio consists of second mortgage loans and home equity lines of credit that are underwritten in a manner such that they result in credit risk that is substantially similar to one- to four-family residential mortgage loans. At September 30, 2014, consumer loans totaling $501,000 were on non-accrual status. See "- Lending Activities - Non-performing Loans and Delinquencies."

Commercial Business Lending. Commercial business loans totaled $30.6 million, or 5.0% of the loan portfolio at September 30, 2014. Commercial business loans are generally secured by business equipment, accounts receivable, inventory or other property and are made at variable rates of interest equal to a negotiated margin above the prime

rate. The Bank also generally obtains personal guarantees from the principals based on a review of personal financial statements. The largest commercial business loan had an outstanding balance of $2.0 million at September 30, 2014 and was performing according to its repayment terms. At September 30, 2014, all commercial business loans were performing according to their repayment terms. See "- Lending Activities - Non-performing Loans and Delinquencies."

Commercial business lending generally involves greater risk than residential mortgage lending and involves risks that are different from those associated with residential and commercial real estate lending. Real estate lending is generally considered to be collateral based lending with loan amounts based on predetermined loan to collateral values and liquidation of the underlying real estate collateral is viewed as the primary source of repayment in the event of borrower default. Although commercial business loans are often collateralized by equipment, inventory, accounts receivable or other business assets, the liquidation of collateral in the event of a borrower default is often an insufficient source of repayment because accounts receivable may be uncollectible and inventories and equipment may be obsolete or of limited use, among other things. Accordingly, the repayment of a commercial

business loan depends primarily on the creditworthiness of the borrower (and any guarantors), while liquidation of collateral is a secondary and often insufficient source of repayment.

Loan Maturity. The following table sets forth certain information at September 30, 2014 regarding the dollar amount of loans maturing in the Bank's portfolio based on their contractual terms to maturity, but does not include scheduled payments or potential prepayments. Loans having no stated maturity and overdrafts are reported as due in one year or less.

	Within 1 Year	After 1 Year Through 3 Years	After 3 Years Through 5 Years	After 5 Years Through 10 Years	After 10 Years	Total
		(In thousands)				
Mortgage loans:						
One- to four-family (1)	$2,941	$2,790	$2,511	$10,923	$79,369	$98,534
Multi-family	3,592	1,471	13,979	26,400	764	46,206
Commercial	13,134	38,910	59,367	171,205	11,738	294,354
Construction and land development (2)	68,479	—	—	—	—	68,479
Land	9,722	11,044	5,292	2,664	867	29,589
Consumer loans:						
Home equity and second mortgage	4,690	4,061	3,782	11,858	10,530	34,921
Other	1,236	393	294	906	1,870	4,699
Commercial business loans	5,395	12,362	6,050	5,737	1,015	30,559
Total	$109,189	$71,031	$91,275	$229,693	$106,153	607,341
Less:						
Undisbursed portion of construction loans in process						(29,416)
Deferred loan origination fees						(1,746)
Allowance for loan losses						(10,427)
Loans receivable, net						$565,752

(1) Includes $899,000 of loans held-for-sale.
(2) Includes construction/permanent loans that convert to permanent mortgage loans once construction is completed.

The following table sets forth the dollar amount of all loans due after one year from September 30, 2014, which have fixed interest rates and have floating or adjustable interest rates.

	Fixed Rates	Floating or Adjustable Rates	Total
	(In thousands)		
Mortgage loans:			
One- to four-family (1)	$35,068	$60,525	$95,593
Multi-family	1,328	41,286	42,614
Commercial	54,557	226,663	281,220
Land	11,631	8,236	19,867
Consumer loans:			
Home equity and second mortgage	13,658	16,573	30,231
Other	3,281	182	3,463
Commercial business loans	13,656	11,508	25,164

Total	$133,179	$364,973	$498,152

(1) Includes $899,000 of loans held-for-sale.

Scheduled contractual principal repayments of loans do not reflect the actual life of these assets. The average life of loans is substantially less than their contractual terms because of prepayments. In addition, due-on-sale clauses on loans generally give the Bank the right to declare loans immediately due and payable in the event, among other things, that the borrower sells the real property subject to the mortgage and the loan is not repaid. The average life of mortgage loans tends to increase when current mortgage loan interest rates are substantially higher than interest rates on existing mortgage loans and, conversely, decrease when interest rates on existing mortgage loans are substantially higher than current mortgage loan interest rates.

Loan Solicitation and Processing. Loan originations are obtained from a variety of sources, including walk-in customers, and referrals from builders and realtors. Upon receipt of a loan application from a prospective borrower, a credit report and other data are obtained to verify specific information relating to the loan applicant's employment, income and credit standing. An appraisal of the real estate offered as collateral generally is undertaken by a certified appraiser retained by the Bank.

Loan applications are initiated by loan officers and are required to be approved by an authorized loan underwriter, one of the Bank's Loan Committees or the Bank's Board of Directors. The Bank's Consumer Loan Committee consists of two underwriters, each of whom can approve one- to four-family mortgage loans and other consumer loans up to and including the current Freddie Mac single-family limit. Certain consumer loans up to and including $25,000 may be approved by individual loan officers and the Bank's Consumer Lending Department Manager and Loan Supervisor may approve consumer loans up to and including $75,000. The Bank's Commercial Loan Committee, which consists of the Bank's President, Chief Credit Administrator, Executive Vice President of Lending and Regional Manager of Community Lending, may approve commercial real estate loans and commercial business loans up to and including $1.5 million. The Bank's President, Chief Credit Administrator and Executive Vice President of Lending also have individual lending authority for loans up to and including $750,000. The Bank's Board Loan Committee, which consists of two rotating non-employee Directors and the Bank's President, may approve loans up to and including $3.0 million. Loans in excess of $3.0 million, as well as loans of any amount granted to a single borrower whose aggregate loans exceed $3.0 million, must be approved by the Bank's Board of Directors.

Loan Originations, Purchases and Sales. During the years ended September 30, 2014, 2013 and 2012, the Bank's total gross loan originations were $185.8 million, $217.8 million and $228.3 million, respectively. Periodically, the Bank purchases participation interests in construction, commercial real estate, and multi-family loans, secured by properties generally located in Washington State, from other lenders. These purchases are underwritten to the Bank's underwriting guidelines and are without recourse to the seller other than for fraud. During the years ended September 30, 2014, 2013 and 2012, the Bank purchased loan participation interests of $1.9 million, $43,000 and $2.0 million, respectively. See "- Lending Activities - Construction and Land Development Lending" and "- Lending Activities - Multi-Family Lending."

Consistent with its asset/liability management strategy, the Bank's policy generally is to retain in its portfolio all ARM loans originated and to sell fixed rate one- to four-family mortgage loans in the secondary market to Freddie Mac; however, from time to time, a portion of fixed-rate loans may be retained in the Bank's portfolio to meet its asset-liability objectives. Loans sold in the secondary market are generally sold on a servicing retained basis. At September 30, 2014, the Bank's loan servicing portfolio, which is not included in the Company's consolidated financial statements, totaled $327.6 million.

The Bank also periodically sells participation interests in construction and land development loans, commercial real estate loans, and land loans to other lenders. These sales are usually made to avoid concentrations in a particular loan type or concentrations to a particular borrower. During the year ended September 30, 2014 the Bank did not sell any loan participation interests. During the 2013 and 2012 fiscal years the Bank sold loan participation interests to other lenders of $4.3 million and $3.6 million, respectively.

13

The following table shows total loans originated, purchased, sold and repaid during the periods indicated.

	Year Ended September 30,		
	2014	2013	2012
Loans originated:	(In thousands)		
Mortgage loans:			
One- to four-family	$44,015	$104,879	$103,887
Multi-family	701	7,530	20,882
Commercial	45,215	50,314	48,450
Construction and land development	61,246	38,491	39,907
Land	4,174	1,853	1,858
Consumer	13,143	11,237	8,856
Commercial business loans	17,273	3,499	4,415
Total loans originated	185,767	217,803	228,255
Loans purchased:			
Mortgage loans:			
Commercial	1,911	—	—
Multi-family	—	43	56
Commercial business	—	—	1,955
Total loans purchased	1,911	43	2,011
Total loans originated and purchased	187,678	217,846	230,266
Loans sold:			
Partial loans sold	—	(4,263)	(3,600)
Whole loans sold	(33,345)	(89,352)	(97,357)
Total loans sold	(33,345)	(93,615)	(100,957)
Loan principal repayments	(126,469)	(113,154)	(121,086)
Other items, net	(10,216)	(1,453)	2,233
Net increase in loans receivable	$17,648	$9,624	$10,456

Loan Origination Fees. The Bank receives loan origination fees on many of its mortgage loans and commercial business loans. Loan fees are a percentage of the loan which are charged to the borrower for funding the loan. The amount of fees charged by the Bank is generally up to 2.0% of the loan amount. Current accounting principles generally accepted in the United States of America require fees received and certain loan origination costs for originating loans to be deferred and amortized into interest income over the contractual life of the loan. Net deferred fees or costs associated with loans that are prepaid are recognized as income/expense at the time of prepayment. Unamortized deferred loan origination fees totaled $1.7 million at September 30, 2014.

Non-performing Loans and Delinquencies. The Bank assesses late fees or penalty charges on delinquent loans of approximately 5% of the monthly loan payment amount. A majority of loan payments are due on the first day of the month; however, the borrower is given a 15 day grace period to make the loan payment. When a mortgage loan borrower fails to make a required payment when due, the Bank institutes collection procedures. A notice is mailed to the borrower 16 days after the date the payment is due. Attempts to contact the borrower by telephone generally begin on or before the 30th day of delinquency. If a satisfactory response is not obtained, continuous follow-up contacts are attempted until the loan has been brought current. Before the 90th day of delinquency, attempts are made to establish (i) the cause of the delinquency, (ii) whether the cause is temporary, (iii) the attitude of the borrower toward repaying the debt, and (iv) a mutually satisfactory arrangement for curing the default.

If the borrower is chronically delinquent and all reasonable means of obtaining payment on time have been exhausted, foreclosure is initiated according to the terms of the security instrument and applicable law. Interest income on loans in foreclosure is reduced by the full amount of accrued and uncollected interest.

When a consumer loan borrower or commercial business borrower fails to make a required payment on a loan by the payment due date, the Bank institutes similar collection procedures as for its mortgage loan borrowers. All loans becoming 90 days or more past due are placed on non-accrual status, with any accrued interest reversed against interest income, unless they are well secured and in the process of collection.

The Bank's Board of Directors is informed monthly as to the status of loans that are delinquent by more than 30 days, and the status of all foreclosed and repossessed property owned by the Bank.

The following table sets forth information with respect to the Company's non-performing assets at the dates indicated.

	At September 30,				
	2014	2013	2012	2011	2010
Loans accounted for on a non-accrual basis:	(Dollars in thousands)				
Mortgage loans:					
One- to four-family	$4,376	$6,985	$3,382	$2,150	$3,691
Multi-Family	—	—	1,449	—	—
Commercial	1,468	3,435	6,049	6,571	7,252
Construction and land development	—	659	1,570	3,522	7,609
Land	4,564	2,146	8,613	8,935	5,460
Consumer loans	501	385	268	367	806
Commercial business loans	—	—	—	44	46
Total	10,909	13,610	21,331	21,589	24,864
Accruing loans which are contractually past due 90 days or more	812	436	1,198	1,754	1,325
Total of non-accrual and 90 days past due loans	11,721	14,046	22,529	23,343	26,189
Non-accrual investment securities	1,101	2,187	2,442	2,796	3,390
Other real estate owned and other repossessed assets	9,092	11,720	13,302	10,811	11,519
Total non-performing assets (1)	$21,914	$27,953	$38,273	$36,950	$41,098
Troubled debt restructured loans on accrual status (2)	$16,804	$18,573	$13,410	$18,166	$8,995
Non-accrual and 90 days or more past due loans as a percentage of loans receivable, net	2.03 %	2.51 %	4.09 %	4.32 %	4.86 %
Non-accrual and 90 days or more past due loans as a percentage of total assets	1.57 %	1.88 %	3.06 %	3.16 %	3.53 %
Non-performing assets as a percentage of total assets	2.94 %	3.75 %	5.19 %	5.01 %	5.53 %
Loans receivable, net (3)	$576,179	$559,240	$550,305	$539,970	$538,855

Total assets	$745,565	$745,648	$736,954	$738,224	$742,687

(1) Does not include troubled debt restructured loans on accrual status.
(2) Does not include troubled debt restructured loans totaling $2.3 million, $4.0 million, $10.1 million, $7.4 million and $7.4 million reported as non-accrual loans at September 30, 2014, 2013, 2012, 2011 and 2010, respectively.
(3) Includes loans held-for-sale and is before the allowance for loan losses.

The Bank’s non-accrual loans decreased by $2.7 million to $10.9 million at September 30, 2014 from $13.6 million at September 30, 2013, primarily as a result of a $2.6 million decrease in one- to four-family loans, a $2.0 million decrease in commercial real estate loans, and a $659,000 decrease in construction and land development loans on non-accrual status. These decreases were partially offset by a $2.4 million increase in land loans on non-accrual status, due to a single $3.7 million land loan secured by land in Grays Harbor County and which is also the Company's largest non-performing loan at September 30, 2014. A discussion of our largest non-performing loans is set forth below under “Asset Classification.”

Additional interest income which would have been recorded for the year ended September 30, 2014 had non-accruing loans been current in accordance with their original terms totaled $3.6 million.

Other Real Estate Owned and Other Repossessed Assets. Real estate acquired by the Bank as a result of foreclosure or by deed-in-lieu of foreclosure is classified as other real estate owned (“OREO”) until sold. When property is acquired, it is recorded at the estimated fair market value less estimated costs to sell. At September 30, 2014, the Bank had $9.1 million of OREO and other repossessed assets consisting of 40 individual properties, a decrease of $2.6 million from $11.7 million at September 30, 2013. The OREO properties consisted of 21 land parcels totaling $3.8 million, four commercial real estate properties totaling $2.2 million, one multi-family property of $142,000 and 14 single family homes totaling $2.9 million. The largest OREO property at September 30, 2014 was a land development property with a balance of $1.2 million located in Lewis County.

Restructured Loans. Under accounting principles generally accepted in the United States of America, the Bank is required to account for certain loan modifications or restructurings as “troubled debt restructurings” or "troubled debt restructured loans." In general, the modification or restructuring of a debt constitutes a troubled debt restructuring if the Bank for economic or legal reasons related to the borrower’s financial difficulties grants a concession to the borrower that the Bank would not otherwise consider. Debt restructuring or loan modifications for a borrower does not necessarily always constitute troubled debt restructuring, however, and troubled debt restructurings do not necessarily result in non-accrual loans. Troubled debt restructured loans are classified as non-performing loans unless they have been performing in accordance with modified terms for a period of least six months. The Bank had troubled debt restructured loans at September 30, 2014 and 2013, totaling $19.1 million and $22.6 million, respectively, of which $2.3 million and $4.0 million, respectively, were on non-accrual status. The allowance for loan losses allocated to troubled debt restructured loans at September 30, 2014 and 2013 was $973,000 and $2.4 million, respectively.

Impaired Loans. A loan is considered impaired when it is probable the Bank will be unable to collect all contractual principal and interest payments due in accordance with the original or modified terms of the loan agreement. To determine specific valuation allowances, impaired loans are measured based on the estimated fair value of the collateral less estimated cost to sell if the loan is considered collateral dependent. Impaired loans not considered to be collateral dependent are measured based on the present value of expected future cash flows.

The categories of non-accrual loans and impaired loans overlap, although they are not identical. The Bank considers all circumstances regarding the loan and borrower on an individual basis when determining whether an impaired loan should be placed on non-accrual status, such as the financial strength of the borrower, the collateral value, reasons for delay, payment record, the amount past due and the number of days past due. At September 30, 2014, the Bank had $33.5 million in impaired loans. For additional information on impaired loans, see Note 4 of the Notes to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Other Loans of Concern. Loans not reflected in the table above as non-performing, but where known information about possible credit problems of borrowers causes management to have doubts as to the ability of the borrower to comply with present repayment terms and that may result in disclosure of such loans as non-performing assets in the future are commonly referred to as “other loans of concern” or “potential problem loans.” The amount included in potential problem loans results from an evaluation, on a loan-by-loan basis, of loans classified as “substandard” and

"special mention," as those terms are defined under "Asset Classification" below. The amount of potential problem loans (not included in the table above as non-performing) was $33.4 million at September 30, 2014. The vast majority of these loans are collateralized by real estate. See "- Asset Classification" below for additional information regarding our problem loans.

Asset Classification. Applicable regulations require that each insured institution review and classify its assets on a regular basis. In addition, in connection with examinations of insured institutions, regulatory examiners have authority to identify problem assets and, if appropriate, require them to be classified. There are three classifications for problem assets: substandard, doubtful and loss. Substandard loans are classified as those loans that are inadequately protected by the current net worth, and paying capacity of the obligor, or of the collateral pledged. Assets classified as substandard have a well-defined weakness, or weaknesses that jeopardize the repayment of the debt. If the weakness, or weaknesses are not corrected there is the distinct possibility that some loss will be sustained. Doubtful assets have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and

values questionable, and there is a high possibility of loss. An asset classified as loss is considered uncollectible and of such little value that continuance as an asset of the Bank is not warranted. When the Bank classifies problem assets as either substandard or doubtful, it is required to establish allowances for loan losses in an amount deemed prudent by management. These allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities and the risks associated with particular problem assets. When the Bank classifies problem assets as loss, it charges off the balance of the asset against the allowance for loan losses. Assets which do not currently expose the Bank to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are designated by the Bank as special mention. The Bank's determination of the classification of its assets and the amount of its valuation allowances is subject to review by the FDIC and the Division which can require the establishment of additional loss allowances.

Special mention loans are defined as those credits deemed by management to have some potential weakness that deserve management's close attention. If left uncorrected these potential weaknesses may result in the deterioration of the payment prospects of the loan. Assets in this category are not adversely classified and currently do not expose the Bank to sufficient risk to warrant a substandard classification.

The aggregate amounts of the Bank's classified and special mention loans (as determined by the Bank), and of the Bank's allowances for loan losses at the dates indicated, were as follows:

	At September 30,		
	2014	2013	2012
	(In thousands)		
Loss	$—	$—	$—
Doubtful	—	—	—
Substandard (1)(2)	18,056	27,978	33,082
Special mention (1)	27,106	22,916	32,944
Total classified and special mention loans	$45,162	$50,894	$66,026
Allowance for loan losses	$10,427	$11,136	$11,825

(1) For further information concerning the change in classified assets, see "- Lending Activities - Non-performing Loans and Delinquencies."
(2) Includes non-performing loans.

Loans classified as special mention increased by $4.2 million to $27.1 million at September 30, 2014 from $22.9 million at September 30, 2013, primarily as a result of loans being upgraded from substandard to special mention during the year ended September 30, 2014. Eleven individual loans comprised $21.8 million, or 80.6%, of the $27.1 million in loans classified as special mention at September 30, 2014. They include six commercial real estate loans totaling $14.2 million, three multi-family loans totaling $5.7 million and two land loans totaling $1.9 million. All of these loans were current and paying in accordance with their required loan repayment terms at September 30, 2014, except for one commercial real estate loan with a balance of $812,000 that was 90 days past due and still accruing interest.

Loans classified as substandard decreased by $9.9 million to $18.1 million at September 30, 2014 from $28.0 million at September 30, 2013. At September 30, 2014, 51 loans were classified as substandard compared to 84 loans at September 30, 2013. Of the $18.1 million in loans classified as substandard at September 30, 2014, $10.9 million were on non-accrual status. The largest loan classified as substandard at September 30, 2014 had a balance of $3.7 million and was secured by ocean front land in Grays Harbor County. This loan was on non-accrual status at September 30, 2014. The next largest loan classified as substandard at September 30, 2014 had a balance of $2.4 million and was secured by a mini-storage facility in King County. This loan was performing according to its

restructured loan repayment terms at September 30, 2014.

Allowance for Loan Losses. The allowance for loan losses is maintained to absorb estimated losses in the loan portfolio. The Bank has established a comprehensive methodology for the determination of provisions for loan losses that takes into consideration the need for an overall general valuation allowance. The Bank's methodology for assessing the adequacy of its allowance for loan losses is based on its historic loss experience for various loan segments; adjusted for changes in economic conditions, delinquency rates, and other factors. Using these loss estimate factors, management develops a range of probable loss for each loan category. Certain individual loans for which full collectibility may not be assured are evaluated individually with loss exposure based on estimated discounted cash flows or net realizable collateral values. The total estimated range of loss based

on these two components of the analysis is compared to the loan loss allowance balance. Based on this review, management will adjust the allowance as necessary.

In originating loans, the Bank recognizes that losses will be experienced and that the risk of loss will vary with, among other things, the type of loan being made, the creditworthiness of the borrower over the term of the loan, general economic conditions and, in the case of a secured loan, the quality of the security for the loan. The Bank increases its allowance for loan losses by charging provisions for loan losses against the Bank's operations.

The Board of Directors reviews the adequacy of the allowance for loan losses at least quarterly based on management's assessment of current economic conditions, past loss and collection experience, and risk characteristics of the loan portfolio.

At September 30, 2014, the Bank’s allowance for loan losses totaled $10.4 million. The Bank’s allowance for loan losses as a percentage of total loans receivable and non-performing loans was 1.81% and 88.96%, respectively, at September 30, 2014 and 1.99% and 79.28%, respectively, at September 30, 2013.

Management believes that the amount maintained in the allowance is adequate to absorb probable losses in the portfolio. Although management believes that it uses the best information available to make its determinations, future adjustments to the allowance for loan losses may be necessary and results of operations could be significantly and adversely affected if circumstances differ substantially from the assumptions used in making the determinations.

While the Bank believes it has established its existing allowance for loan losses in accordance with accounting principles generally accepted in the United States of America, there can be no assurance that regulators, in reviewing the Bank's loan portfolio, will not request the Bank to increase significantly its allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that substantial increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses may adversely affect the Bank's financial condition and results of operations.

The following table sets forth an analysis of the Bank's allowance for loan losses for the periods indicated.

	Year Ended September 30,				
	2014	2013	2012	2011	2010
	(Dollars in thousands)				
Allowance at beginning of year	$11,136	$11,825	$11,946	$11,264	$14,172
Provision for loan losses	—	2,925	3,500	6,758	10,550
Recoveries:					
Mortgage loans:					
One- to four-family	194	95	74	151	—
Multi-family	—	—	14	41	—
Commercial	4	55	—	—	13
Construction	538	172	505	109	104
Land	418	54	97	46	153
Consumer loans:					
Home equity and second mortgage	7	5	14	42	86
Other	2	—	—	2	6
Commercial business loans	24	105	2	1	—
Total recoveries	1,187	486	706	392	362
Charge-offs:					
Mortgage loans:					
One- to four-family	1,106	769	276	543	200
Multi-family	—	—	14	—	—
Commercial	463	667	1,215	47	1,888
Construction	—	159	885	3,972	8,012
Land	260	2,307	1,251	1,704	3,285
Consumer loans:					
Home equity and second mortgage	47	184	232	150	399
Other	6	14	24	30	36
Commercial business loans	14	—	430	22	—
Total charge-offs	1,896	4,100	4,327	6,468	13,820
Net charge-offs	709	3,614	3,621	6,076	13,458
Allowance at end of year	$10,427	$11,136	$11,825	$11,946	$11,264
Allowance for loan losses as a percentage of total loans receivable (net) outstanding at the end of the year (1)	1.81 %	1.99 %	2.15 %	2.21 %	2.09 %
Net charge-offs as a percentage of average loans outstanding during the year	0.12 %	0.65 %	0.66 %	1.13 %	2.45 %
Allowance for loan losses as a percentage of non-performing loans at end of year	88.96 %	79.28 %	52.48 %	51.18 %	43.01 %

(1) Total loans receivable (net) includes loans held for sale and is before the allowance for loan losses.

The following table sets forth the allocation of the allowance for loan losses by loan category at the dates indicated.

	At September 30,									
	2014		2013		2012		2011		2010	
	Amount	Percent of Loans in Category to Total Loans	Amount	Percent of Loans in Category to Total Loans	Amount	Percent of Loans in Category to Total Loans	Amount	Percent of Loans in Category to Total Loans	Amount	Percent of Loans in Category to Total Loans
	(Dollars in thousands)									
Mortgage loans:										
One- to four-family	$1,650	16.22 %	$1,449	18.00 %	$1,558	18.82 %	$760	20.47 %	$530	21.65 %
Multi-family	387	7.61	749	8.82	1,156	8.36	1,076	5.53	392	5.77
Commercial	4,836	48.47	5,275	50.27	4,247	45.08	4,035	43.92	3,173	37.21
Construction and land development	605	11.28	414	7.79	943	9.92	1,618	9.37	1,626	12.39
Land	1,434	4.87	1,940	5.37	2,392	6.98	2,795	8.79	3,709	11.27
Non-mortgage loans:										
Consumer loans	1,055	6.52	982	6.73	1,013	6.87	875	7.90	461	8.49
Commercial business loans	460	5.03	327	3.02	516	3.97	787	4.02	1,373	3.22
Total allowance for loan losses	$10,427	100.00 %	$11,136	100.00 %	$11,825	100.00 %	$11,946	100.00 %	$11,264	100.00 %

Investment Activities

The investment policies of the Bank are established and monitored by the Board of Directors. The policies are designed primarily to provide and maintain liquidity, to generate a favorable return on investments without incurring undue interest rate and credit risk, and to compliment the Bank's lending activities. These policies dictate the criteria for classifying securities as either available-for-sale or held-to-maturity. The policies permit investment in various types of liquid assets permissible under applicable regulations, which includes U.S. Treasury obligations, securities of various federal agencies, certain certificates of deposit of insured banks, banker's acceptances, federal funds, mortgage-backed securities, and mutual funds. The Company's investment policy also permits investment in equity securities in certain financial service companies.

At September 30, 2014, the Bank's investment portfolio totaled $8.2 million, primarily consisting of $1.9 million of mortgage-backed securities available-for-sale, $958,000 of mutual funds available-for-sale, $2.3 million of mortgage-backed securities held-to-maturity and $3.0 million of U.S. Agency securities held-to-maturity. The Bank does not maintain a trading account for any investments. This compares with a total investment portfolio of $6.8 million at September 30, 2013, primarily consisting of $3.1 million of mortgage-backed securities available-for-sale, $958,000 of mutual funds available-for-sale, and $2.7 million of mortgage-backed securities held-to-maturity. The composition of the portfolios by type of security, at the dates indicated is presented in the following table.

	At September 30,								
	2014			2013			2012		
	Recorded Amount	Percent of Total		Recorded Amount	Percent of Total		Recorded Amount	Percent of Total	
	(Dollars in thousands)								
Held-to-Maturity:									
U.S. agency securities	$3,016	36.98	%	$14	0.20	%	$27	0.33	%
Mortgage-backed securities	2,282	27.98		2,723	39.82		3,312	39.98	
Available-for-Sale:									
Mortgage-backed securities	1,899	23.29		3,143	45.97		3,932	47.46	
Mutual funds	958	11.75		958	14.01		1,013	12.23	
Total portfolio	$8,155	100.00	%	$6,838	100.00	%	$8,284		