Kaiser Federal Financial Group, Inc.
Form 10-K
September 13, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended: June 30, 2011

OR

o 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: 001-34979

KAISER FEDERAL FINANCIAL GROUP, INC.
(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation)	26-1500698 (I.R.S. Employer Identification No.)
1359 N. Grand Avenue, Covina, CA (Address of principal executive offices)	91724 (Zip Code)

(800) 524-2274
(Registrant's telephone number, including area code)

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

Title of each class	Name of exchange on which registered
Common Stock, $.01 par value per share	The NASDAQ Stock Market LLC

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

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Sections 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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months(or for such shorter period that the registrant was required to submit and post such files).
Yes o No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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 o	Accelerated filer x
Non-accelerated filer o	Smaller Reporting Company o

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

The aggregate market value of the voting stock held by non-affiliates of the registrant, computed by reference to the average bid and asked price of such common equity as of December 31, 2010 was $99.1 million. There were 9,605,154 shares of the registrant's common stock, $.01 par value per share, outstanding at September 9, 2011.

KAISER FEDERAL FINANCIAL GROUP, INC.

Annual Report on Form 10-K
For the Fiscal Year Ended June 30, 2011
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Part I.

SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS

Certain statements in this report, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements generally are identified by the words "believe," "expect," "intend," "anticipate," "estimat "project," "strategy," "plan," or future conditional verbs such as "will," "should," "could," or "may" and similar expression negative thereof. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in the section entitled "Risk Factors" in Item 1A of this report. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Accordingly, there can be no assurance that our expectations will be realized.

Item 1. Business.

General

Kaiser Federal Financial Group, Inc. (the "Company") is a Maryland corporation that owns all of the outstanding common stock of Kaiser Federal Bank (the "Bank"). It is the successor to K-Fed Bancorp following the completion of the second-step conversion and offering in November 2010. On November 19, 2010, the Company completed the conversion from a mutual holding company structure to a fully public stock holding company form of organization and related public offering. The Company sold a total of 6,375,000 shares of common stock in the offering at a purchase price of $10.00 per share. The offering raised capital of $59.1 million, which is net of costs of $4.7 million. Concurrent with the completion of the offering, shares of K-Fed Bancorp common stock owned by public stockholders were exchanged for 0.7194 of a share of the Company's common stock. All share and per share information in this report for years prior to the conversion has been revised to reflect the 0.7194:1 conversion ratio on shares outstanding, including shares of the former mutual holding company that were not publically traded.

The Company's business activities generally are limited to passive investment activities and oversight of its investment in the Bank. Unless the context otherwise requires, all references to the Company include the Bank and the Company on a consolidated basis, and prior to November 19, 2010, the Company refers to K-Fed Bancorp and the Bank on a consolidated basis.

At June 30, 2011, the Company had consolidated assets of $856.4 million, deposits of $634.7 million and stockholders' equity of $157.4 million. The Company does not maintain offices separate from those of the Bank or utilize persons other than certain of the Bank's officers. Our executive offices are located at 1359 North Grand Avenue, Covina, California 91724 and our telephone number is (626) 339-9663.

The Bank is a community oriented financial institution offering a variety of financial services to meet the needs of the communities it serves. The Bank is headquartered in Covina, California, with branches or financial service centers in Pasadena, Covina, Downey, Harbor City, Los Angeles and Panorama City to serve Los Angeles County, financial service centers in Fontana and Riverside to serve San Bernardino and Riverside counties, and one financial service center in Santa Clara to serve Santa Clara County. Financial service centers provide all of the services as our full service branches except they do not disburse cash; however, there is an on-site Automated Teller Machine ("ATM") that dispenses cash. We have a network of 58 ATMs located in Southern California and the San Francisco Metropolitan Area, primarily located at Kaiser Permanente Medical Centers and office buildings.

We began operations as a credit union in 1953 initially serving the employees of the Kaiser Foundation Hospital in Los Angeles, California. As the Kaiser Permanente Medical Care Program evolved so did the credit union, and in 1972, it changed its name to Kaiser Permanente Federal Credit Union. The credit union grew to primarily serve Kaiser Permanente employees and physicians who worked or lived in California. The credit union serviced members with two branches, Pasadena and Santa Clara, and a network of ATMs. However, as a credit union, the credit union was legally restricted to serve only individuals who shared a "common bond" such as a common employer.

After receiving the necessary regulatory and membership approvals, on November 1, 1999, Kaiser Permanente Federal Credit Union converted to a federal mutual savings bank known as Kaiser Federal Bank which serves the general public as well as Kaiser Permanente employees. Kaiser Federal Bank reorganized into the mutual holding company structure in 2003 and became the wholly owned subsidiary of K-Fed Bancorp. On March 30, 2004, K-Fed Bancorp completed a minority stock offering where it sold approximately 39% of its shares to the public. In November 2010, the Company completed the second–step conversion and offering and the Bank became the wholly owned subsidiary of Kaiser Federal Financial Group, Inc.

Kaiser Federal Bank's principal business activity consists of attracting retail deposits from the general public and originating primarily loans secured by first mortgages on owner-occupied one-to-four family residences and multi-family residences located in its market area and, to a lesser extent, commercial real estate, automobile and other consumer loans. Prior to 2007, Kaiser Federal Bank purchased, using our own underwriting standards, a significant number of first mortgages on owner-occupied, one-to-four family residences secured by properties located throughout California. These purchases were primarily funded with Federal Home Loan Bank borrowings. Depending on market conditions and the interest rate environment, we may consider future loan purchases on a case by case basis. Kaiser Federal Bank also originated commercial real estate loans, but made the strategic decision to cease such lending in January 2009 in light of the downturn in economic conditions. As economic conditions improve, we would consider the origination of such loans again. Historically, we have not originated, or purchased, commercial business, commercial construction, or residential construction loans and have no current plans to do so.

Our revenues are derived principally from interest on loans and mortgage-backed and related securities. We also generate revenue from service charges and other income.

We offer a variety of deposit accounts having a wide range of interest rates and terms, which generally include savings accounts, money market accounts, demand deposit accounts and certificate of deposit accounts with varied terms ranging from 90 days to five years. We solicit deposits in our primary market areas of Los Angeles, Orange, San Diego, San Bernardino, Riverside, and Santa Clara counties, in California.

Available Information

Our Internet address is www.kffg.com. We make available free of charge, through our web site, annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (the "SEC"). All SEC filings of the Company are also available at the SEC's website, www.sec.gov.

Market Area

The United States experienced a severe economic recession in 2008 and 2009, which effects have continued into 2011. Recent growth has been slow and unemployment remains at very high levels and is not expected to improve in the near future. Economic conditions remain weak both nationally and in our market area of California. We continue to experience a downward trend on home prices and California, in particular has experienced significant declines in real estate values. In addition, California continues to experience elevated unemployment rates as compared to the national average.

Future growth opportunities will be influenced by the stability of the regional economy and other trends within California, including unemployment rates and housing market conditions. According to the U.S. Census Bureau, unemployment rates in California remain high at 11.8% at June 30, 2011 as compared to 12.3% at June 30, 2010 and 11.6% at June 2009. This compares to the national unemployment rate of 9.2% at June 30, 2011, 9.5% at June 30, 2010 and 9.5% at June 30, 2009. The S&P/Case-Shiller Home Price Index for the Los Angeles Metropolitan Area declined by approximately 37.8% at June 2011 as compared to the high reported in 2006. This compares to the S&P/Case-Shiller U.S. National Home Price Index decline of approximately 32% at June 2011 as compared to the high reported in 2006. The California Association of Realtors reported single-family home sales decreased 4% in June 2011 as compared to June 2010. In addition, the statewide median home price decreased 6% in June 2011 as compared to June 2010.

According to the California Building Industry Association, the housing industry in California is still struggling to keep pace with 2010 which was the second-lowest year for housing production in U.S. history. Builders are competing with a glut of foreclosed and distressed properties while buyers are purchasing fewer homes due to tight lending restrictions and the current climate of economic uncertainty. In response to declining new home sales, builders reduced the pace of new construction over the past several years. According to the U.S. Census Bureau, one-to-four family and multi-family building permits declined significantly in 2008 and 2009 and remained low in 2010, both nationally and in California. On a national level, one-to-four family building permits declined 35% in 2008, 36% in 2009 and increased 3% in 2010. This compares to one-to-four family building permits in California declining 43% in 2008, 44% in 2009 and increasing 2% in 2010. While the recent improvement in construction is encouraging, the California housing market and economy have been adversely impacted by the record low levels of building permits over the past several years.

Competition

We face strong competition in originating real estate and other loans and in attracting deposits. Competition in originating real estate loans comes primarily from other savings institutions, commercial banks, credit unions and mortgage bankers. Other savings institutions, commercial banks, credit unions and finance companies provide vigorous competition in consumer lending.

We attract all of our deposits through our branch and ATM network. Competition for those deposits is principally from other savings institutions, commercial banks and credit unions, as well as mutual funds and other alternative investments. We compete for these deposits by offering superior service and a variety of deposit accounts at competitive rates. We have less than a 1% market share of deposits in each of the markets in which we compete.

Lending Activities

General. Historically, we originated and purchased first lien one-to-four family real estate loans throughout our market area. However, we have not purchased any one-to-four family real estate loans since June 2007 as we have focused our efforts on originating multi-family residential loans. Depending on market conditions and the interest rate environment, we may consider future loan purchases on a case by case basis. We also originate consumer loans, primarily automobile loans. Prior to January 2009, we also originated commercial real estate loans, but have ceased making such loans until economic conditions improve and the real estate market stabilizes.

Our loans carry either a fixed or an adjustable rate of interest. We do not offer adjustable rate loans where the initial rate is below the otherwise applicable index rate (i.e., teaser rates). Mortgage loans generally have a longer term amortization, with maturities up to 30 years, depending upon the type of property with principal and interest due each month. Consumer loans are generally short term and amortize monthly or have interest payable monthly. We also have loans in our portfolio that only require interest payments on a monthly basis. At June 30, 2011, our net loan portfolio totaled $696.6 million, which constituted 81.3% of our total assets. With respect to purchased loans, we underwrote each purchased loan in accordance with our underwriting standards. The majority of the loans that we purchased were acquired with servicing retained by the seller to allow for greater investments in real-estate lending without having to significantly increase our servicing and operations costs. We generally purchased these loans without recourse against the seller.

At June 30, 2011, the maximum amount which we could have loaned to any one borrower and the borrower's related entities under applicable regulations was $18.4 million, or 15% of our unimpaired capital. At June 30, 2011, we had no loans or group of loans to related borrowers with outstanding balances in excess of this amount. Our five largest lending relationships at June 30, 2011 were as follows:

seven loans to an individual for $7.4 million secured by seven multi-family dwellings ranging from 8 to 50 units;

three loans to an individual for $6.7 million secured by a single tenant retail building, a single tenant supermarket building and a 15 tenant mixed use office building;

two loans to an individual totaling $6.4 million, secured by a multi-tenant medical office building and a 54 unit multi-family dwelling;

two loans to an individual for $5.7 million secured by a single tenant industrial building and a single tenant office building; and

two loans to an individual for $5.2 million secured by a single tenant retail building and a 15 tenant office building.

All of the loans noted in the above relationships were performing in accordance with their terms as of June 30, 2011.

The following table presents information concerning the composition of the loan portfolio in dollar amounts and in percentages as of the dates indicated. There were no loans held for sale on any of the dates indicated below.

	At June 30, 2011		2010		2009		2008		2007	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
					(Dollars in thousands)					
Real estate										
One-to-four family	$282,068	39.87 %	$335,631	43.55 %	$377,230	50.22 %	$428,727	57.51 %	$469,459	66.88 %
Multi-family	287,808	40.69	278,397	36.12	196,575	26.17	132,290	17.75	88,112	12.55
Commercial	107,961	15.26	113,458	14.72	121,143	16.13	115,831	15.54	77,821	11.09
Total real estate loans	677,837	95.82	727,486	94.39	694,948	92.52	676,848	90.80	635,392	90.52
Other loans										
Consumer:										
Automobile	18,008	2.55	29,492	3.83	41,798	5.56	52,299	7.01	53,100	7.56
Home equity	940	0.13	1,096	0.14	1,299	0.17	1,405	0.19	1,446	0.21
Other	10,604	1.50	12,672	1.64	13,119	1.75	14,883	2.00	12,024	1.71
Total other loans	29,552	4.18	43,260	5.61	56,216	7.48	68,587	9.20	66,570	9.48
Total loans	707,389	100.00%	770,746	100.00%	751,164	100.00%	745,435	100.00%	701,962	100.00%
Less:										
Net deferred loan origination costs (fees)	659		607		376		33		(134)	
Net (discount) premium on purchased loans	(35)		(59)		(79)		(48)		120	
Allowance for loan losses	(11,367)		(13,309)		(4,586)		(3,229)		(2,805)	
Total loans receivable, net	$696,646		$757,985		$746,875		$742,191		$699,143	

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Loan Maturity. The following schedule illustrates certain information at June 30, 2011 regarding the dollar amount of loans maturing in the portfolio based on their contractual terms-to-maturity, but does not include scheduled payments or potential prepayments. Demand loans, loans having no stated schedule of repayments and no stated maturity are reported as due in one year or less. Loan balances do not include undisbursed loan proceeds, unearned discounts, unearned income and allowance for loan losses.

	Real Estate				Consumer		
	One-to-four family	Multi-family	Commercial	Automobile	Home Equity	Other	Total
				(In thousands)			
At June 30, 2011							
Within 1 year (1)	$17	$ 227	$—	$1,377	$ 940	$2,112	$4,673
After 1 year:							
After 1 year through 3 years	298	5	8,319	8,799	—	1,581	36,254
After 3 year through 5 years	137	233	25,343	7,691	—	1,217	17,369
After 5 year through 10 years	26,482	30,597	73,231	141	—	5,694	136,145
After 10 year through 15 years	8,081	232,744	1,068	—	—	—	241,893
After 15 years	247,053	24,002	—	—	—	—	271,055
Total due after 1 year	282,051	287,581	107,961	16,631	—	8,492	702,716
Total	$282,068	$ 287,808	$ 107,961	$18,008	$ 940	$10,604	$707,389

(1) Includes demand loans and loans that have no stated maturity.

The following table sets forth the dollar amount of all loans at June 30, 2011 that are due after June 30, 2012, which have fixed interest rates and adjustable interest rates.

	Due after June 30, 2012		
	Fixed	Adjustable	Total
		(In thousands)	
Real Estate Loans			
One-to-four family	$229,427	$52,624	$282,051
Multi-family		287,581	287,581
Commercial		107,961	107,961
Real estate loans	229,427	448,166	677,593
Other Loans			
Consumer			
Automobile	16,631		16,631
Home equity			
Other loans	8,492		8,492
Other loans due	25,123		25,123
Total loans	$254,550	$448,166	$702,716

One-to-four Family Residential Lending. At June 30, 2011, our first lien one-to-four family residential mortgage loans totaled $282.1 million, or 39.9%, of our gross loan portfolio. We generally underwrite our one-to-four family loans based on the applicant's employment, credit history and the appraised value of the subject property. With respect to loans we have purchased, we underwrote each loan based upon our underwriting standards prior to making the purchase. Presently, we lend up to 80% of the lesser of the appraised value or purchase price of the subject property for one-to-four family residential loans. We also lend up to 95% of the lesser of the appraised value or purchase price of the subject property with private mortgage insurance ("PMI"). Properties securing our one-to-four family loans are appraised by independent state licensed fee appraisers approved by our Credit Committee. We require our borrowers to obtain title and hazard insurance, and flood insurance, if necessary, in an amount not less than the value of the property improvements.

We currently originate one-to-four family mortgage loans on a fixed rate and adjustable rate basis. Our pricing strategy for mortgage loans includes setting interest rates that are competitive with other local financial institutions and consistent with our internal needs. Adjustable rate loans are tied to indices based on the one year London Inter Bank Offering Rate and U.S. Treasury securities adjusted to a constant maturity of one year. A majority of our adjustable rate loans carry an initial fixed rate of interest for either three or five years which then converts to an interest rate that is adjusted annually based upon the applicable index. Our one-to-four family mortgage loans are structured with a thirty year maturity and with amortizations up to a 30-year period. All of our one-to-four family loans are secured by properties located in California. All of our real estate loans contain a "due on sale" clause allowing us to declare the unpaid principal balance due and payable upon the sale of the property.

Adjustable rate mortgage loans generally pose different credit risks than fixed rate loan mortgages, primarily because as interest rates rise, the borrower's payment rises, increasing the potential for default. At June 30, 2011, our one-to-four family adjustable rate mortgage loan portfolio totaled $52.6 million, or 7.4% of our gross loan portfolio. At that date, the fixed rate one-to-four family mortgage loan portfolio totaled $229.4 million, or 32.5% of our gross loan portfolio. Included in non-accrual loans at June 30, 2011 were $3.3 million in adjustable rate one-to-four family mortgage loans and $15.1 million in fixed rate one-to-four family mortgage loans.

In addition, we previously purchased interest-only one-to-four family mortgage loans. One-to-four family interest-only mortgage loans have decreased by $12.1 million, or 26.6% to $33.2 million at June 30, 2011 from $45.3 million at June 30, 2010. We have also purchased loans underwritten based upon stated income. A stated income loan is a loan where the borrower's income source is not subject to verification through the application process, but the reasonableness of the stated income is verified through review of other sources, such as compensation surveys. One-to-four family stated income mortgage loans have decreased by $12.6 million, or 16.8% to $62.6 million at June 30, 2011 from $75.2 million at June 30, 2010. As of June 30, 2011, $42.4 million of stated income mortgage loans were fixed rate loans and $20.2 million were adjustable rate loans. Included in non-accrual loans at June 30, 2011 were $10.4 million in one-to-four family loans that were interest-only or stated income loans that carried a specific valuation allowance of $2.1 million. There were $4.1 million in interest-only or stated income loans that were modified as of June 30, 2011. The $4.1 million in loans were classified as troubled debt restructurings and are included in non-accrual loans. There are no special or unusual payment arrangements on these loans.

In 2005, we began to purchase interest-only loans assuming a fully amortizing monthly payment and loan qualification was based upon the fully indexed and amortized payment. We have no plans to increase the number of interest-only or stated income loans held in our loan portfolio or originate such loans at this time and have not purchased any such loans since 2007. An interest-only loan typically provides for the payment of interest (rather than both principal and interest) for a fixed period of three, five or seven years, thereafter the loan payments adjust to include both principal and interest for the remaining term. By imposing these additional underwriting standards we believe these loans should not present greater risk than other loans in our one-to-four family loan portfolio.

The following table describes certain risk characteristics of our one-to-four family nonconforming mortgage loans held for investment as of June 30, 2011 and 2010:

Category	Outstanding Balance	Weighted-Average Credit Score(1)	Weighted Average LTV(2)	Weighted-Average Seasoning(3)
		(Dollars in thousands)		
June 30, 2011				
Interest-only(4)	$ 33,235	733	71.91%	5.08years
Stated income(4)(5)	65,554	736	68.18	6.18
Credit score less than or equal to 660	20,933	641	70.88	5.94
June 30, 2010				
Interest-only(4)	$ 45,295	735	71.86%	4.16years
Stated income(4)(5)	75,184	737	66.95	5.18
Credit score less than or equal to 660	25,268	640	70.68	4.90

(1) The credit score is one factor in determining the credit worthiness of a borrower based on the borrower's credit history. The credit score is as of origination.
(2) LTV (loan-to-value) is the ratio calculated by dividing the original loan balance by the original appraised value of the real estate collateral.
(3) Seasoning describes the number of years since the funding date of the loan.
(4) At June 30, 2011 and 2010 there were $8.2 million and $9.9 million in loans that are both stated income and interest-only, respectively.
(5)

Stated income is defined as a borrower provided level of income which is not subject to verification during the loan origination process through the borrower's application, but the reasonableness of the borrower's income is verified through other sources.

Multi-Family Residential Real Estate Lending. We also offer multi-family residential real estate loans through our staff at the Covina headquarters office. These loans are secured by real estate located in our primary market areas, within the state of California. We generally originate multi-family residential loans through our loan officers. We seek to originate multi-family residential loans with initial principal balances of $1.5 million or less. At June 30, 2011, multi-family residential loans totaled $287.8 million, or 40.7%, of our gross loan portfolio, and consisted of 433 loans outstanding with an average loan balance of approximately $665,000 although we originate loans with balances greater than this average.

Our multi-family residential loans are originated with adjustable interest rates. We use a number of indices to set the interest rate, including a rate based on the constant maturity of one year U.S. Treasury securities. Our adjustable rate loans carry an initial fixed rate of interest for one, three, five or seven years which then convert to an interest rate that is adjusted annually based upon the applicable index. Presently, our underwriting guidelines allow us to lend up to 75% of the lesser of the appraised value or purchase price of multi-family residential real estate. These loans require monthly payments, amortize over a period of up to thirty years and have maximum maturity of thirty years and carry prepayment penalties.

Loans secured by multi-family residential real estate are underwritten based on non-discriminatory underwriting standards and loan origination procedures established by Kaiser Federal Bank's Credit Committee. Loan policies are reviewed annually or more frequently if warranted, and approved by both the Credit Committee and Kaiser Federal Bank's board of directors. The loan underwriting process is intended to assess the income producing potential of the property and the financial strength of the borrower. We review the borrower's sources of income, cash flow, assets, and credit history. We evaluate the historical and projected income and expenses of the borrower and property. We also evaluate a guarantor when a guarantee is provided as part of the loan. The net operating income, which is the income derived from the operation of the property less all operating expenses, must be sufficient to cover the payments related to the outstanding debt. Appraisals and secondary review appraisals on properties securing multi-family residential loans are performed by independent state licensed fee appraisers approved by our Credit Committee.

Loans secured by multi-family residential properties are generally larger and involve a greater degree of credit risk than one-to-four family residential mortgage loans. Because payments on loans secured by multi-family residential properties are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. If the cash flow from the project is reduced, or if leases are not obtained or renewed, the borrower's ability to repay the loan may be impaired. In order to monitor the adequacy of cash flows on income-producing properties, the borrowers are required to provide periodic financial information. To ensure adequate resources to request, follow-up, and analyze borrower financial updates, additional staff has been allocated to these functions, and staffing will be added in the future to support the size and complexity of the portfolios. Included in non-accrual loans at June 30, 2011 were four multi-family residential real estate loans totaling $3.1 million, three of which totaling $1.3 million were classified as troubled debt restructurings and are current under the modified terms. See "—Asset Quality - Non-Performing Assets."

Commercial Real Estate Lending. In January 2009, we suspended offering new commercial real estate loans due to the unstable economic outlook for this type of loan. We will reevaluate whether to originate commercial real estate loans in the future as market conditions change. The existing portfolio is secured primarily by small retail establishments, small industrial warehouse buildings and small office buildings located in our primary market area, within the state of California, and are both owner and non-owner occupied. These loans were originated through our staff at our Covina headquarters office. Generally, we have not purchased commercial real estate loans. At June 30, 2011, commercial real estate loans totaled $108.0 million, or 15.3% of our gross loan portfolio, of which $22.6 million or 20.9% of this portfolio was to borrowers who occupy the property.

The table below shows the number and outstanding balance by collateral type of our commercial real estate loans at June 30, 2011.

Type of Loan	Number of Loans	Outstanding Balance (In thousands)	
Office	33	$	37,793
Owner occupied	31		22,610
Manufacturing facilities	13		16,602
Retail	10		15,863
Medical office	4		5,263
Other	12		9,830
Total	103	$	107,961

We originated only adjustable rate commercial real estate loans. The interest rate on these loans is tied to a rate based on the constant maturity of one year U.S. Treasury securities. A majority of our adjustable rate loans carry an initial fixed rate of interest for either three, five or seven years which then converts to an interest rate that is adjusted annually based upon the index. Presently, our underwriting guidelines allow us to lend up to 65% of the lesser of the appraised value or purchase price for the commercial real estate. These loans require monthly payments, amortize up to thirty years, have maturities of up to fifteen years and carry prepayment penalties.

Loans secured by commercial real estate were underwritten based on the income producing potential of the property, the financial strength of the borrower and any guarantors. The net operating income, which is the income derived from the operation of the property less all operating expenses, must be sufficient to cover the payments related to the outstanding debt. We may require an assignment of rents or leases in order to be assured that the cash flow from the project will be used to repay the debt. All loans required an appraisal and secondary review from two different independent state licensed fee appraisers on our approved appraiser list, which is approved by the Credit Committee.

Loans secured by commercial real estate properties are generally larger and involve a greater degree of credit risk than one-to-four family residential mortgage loans. Because payments on loans secured by commercial real estate properties are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. If the cash flow from the project is reduced, or if leases are not obtained or renewed, the borrower's ability to repay the loan may be impaired. In order to monitor the adequacy of cash flows on income-producing properties, the borrowers are required to provide periodic financial information. Included in non-accrual loans totaling as of June 30, 2011 were two contractually current commercial real estate loans with balances of $4.3 million. See "—Asset Quality - Non-Performing Assets."

Consumer Loans. We offer a variety of secured consumer loans, including home equity lines of credit, new and used automobile loans, and loans secured by savings deposits. We also offer a limited amount of unsecured loans. Consumer loans generally have shorter terms to maturity, which reduces our exposure to changes in interest rates, and carry higher rates of interest than do one-to-four family residential mortgage loans. At June 30, 2011, our consumer loan portfolio, exclusive of automobile loans, totaled $11.5 million, or 1.6%, of our gross loan portfolio.

The most significant component of our consumer lending is automobile loans. We originate automobile loans only on a direct basis with the borrower. Many of our automobile loans are made to employees of the Kaiser Permanente Health Care System. Loans secured by automobiles totaled $18.0 million, or 2.6%, of our gross loan portfolio at June 30, 2011. Automobile loans may be written for up to seven years for new automobiles and a maximum of five years for used automobiles and have fixed rates of interest. Loan-to-value ratios for automobile loans are up to 120% of the manufacturer's suggested retail price for new automobiles and up to 120% of retail value on used cars, based on valuation from official used car guides including tax, license, mechanical breakdown insurance and guaranteed automobile protection.

Each automobile loan requires the borrower to keep the financed vehicle fully insured against loss for damage by fire, theft and collision. Nevertheless, there can be no assurance that each financed vehicle will continue to be covered by physical damage insurance provided by the borrower during the entire term which the related loan is outstanding. In addition, we have the right to force place insurance coverage in the event the required physical damage insurance on an automobile is not maintained by the borrower.

Our primary focus when originating automobile loans is on the ability of the borrower to repay the loan rather than the value of the underlying collateral. The amount financed by us is generally up to the manufacturer's suggested retail price of the financed vehicle plus sales tax, dealer preparation fees, license fees and title fees, plus the cost of service and warranty contracts obtained through us in connection with the vehicle.

Consumer loans may entail greater risk than do one-to-four family residential mortgage loans, particularly in the case of consumer loans which are secured by rapidly depreciable assets, such as automobiles. In these cases, any repossessed collateral for a defaulted loan may not provide an adequate source of repayment of the outstanding loan balance. As a result, consumer loan collections are dependent on the borrower's continuing financial stability and, thus, are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy.

Loan Approval Procedures and Authority. All multi-family residential and commercial real estate loans require an appraisal and secondary review appraisal as part of the underwriting process. One-to-four family residential loans require an appraisal and may be subject to a secondary review appraisal. Secured consumer loans require evaluation of collateral. Additionally, any multi-family residential and commercial real estate loan request that results in a total credit exposure to one borrower of over $500,000 and up to $1.5 million requires the additional approval of a second underwriter and/or the Chief Credit Officer. Any one-to-four family residential loan that results in a total credit exposure to one borrower of over $500,000 and up to $1 million requires an additional approval by a real estate lending manager; over $1 million and up to $1.5 million requires approval by a credit committee member. Any loan request that results in a total credit exposure to one borrower over $1.5 million and up to $5 million requires the approval of the Credit Committee, which is currently comprised of the Chairman of the Board, President/CEO, Chief Credit Officer, and other senior lending staff. Loan requests that result in a credit exposure to one borrower over $5.0 million require the board of directors' approval. All loan approvals granted by the Credit Committee are documented in the meeting minutes and reported to the board of directors. Although our regulatory loans-to-one borrower limit is substantially higher than the $5 million internal limit, our intention is to keep our internal lending limits at their current levels.

Loan Originations, Purchases, Sales and Repayments. We originate loans through employees located at our headquarters office. Walk-in customers and referrals from our current customer base, advertisements, real estate brokers and mortgage loan brokers are also important sources of loan originations.

While we originate adjustable rate and fixed rate loans, our ability to originate loans is dependent upon customer demand for loans in our market area. Demand is affected by local competition and the interest rate environment. Prior to June 2007, we have also purchased real estate whole loans as well as participation interests in real estate loans. Depending on market conditions and the interest rate environment, we may consider future loan purchases on a case by case basis. At June 30, 2011, our real estate loan portfolio totaled $677.8 million or 95.8% of the gross loan portfolio. Purchased real estate loans serviced by others at June 30, 2011 totaled $173.9 million, or 24.6% of the gross loan portfolio. At June 30, 2010, our real estate loan portfolio totaled $727.5 million or 94.4% of the gross loan portfolio. Purchased real estate loans serviced by others at June 30, 2010 totaled $215.3 million, or 27.9% of the gross loan portfolio.

The following table shows the loan originations, purchases, sales and repayment activities for the years indicated.

	Year ended June 30,		
	2011	2010	2009
		(In thousands)	
Originations by type:			
Adjustable rate:			
Real estate one-to-four family	$	$	$
-multi-family	40,675	91,104	76,495
-commercial			13,664
Non-real estate -other consumer			
Total adjustable rate	40,675	91,104	90,159
Fixed rate:			
Real estate one-to-four family	10,771	29,045	7,777
Non-real estate –consumer automobile	4,881	8,285	12,395
-other consumer	6,545	9,397	11,264
Total fixed rate	22,197	46,727	31,436
Total loans originated	62,872	137,831	121,595
Purchases:			
Adjustable rate:			
Real estate one-to-four family			
-multi-family			
-commercial			
Total adjustable rate			
Fixed rate:			
Real estate- one-to-four family			
Total fixed rate			
Total loans purchased			
Sales and repayments:			
Sales and loan participations sold		2,485	
Principal repayments	124,318	115,764	115,866
Total reductions	124,318	118,249	115,866
Increase (decrease) in other items, net	107	(8,472)	(1,045)
Net (decrease) increase	$ (61,339)	$ 11,110	$ 4,684

Asset Quality

General. We continue our disciplined lending practices including our strict adherence to a long standing regimented credit culture that emphasizes the consistent application of underwriting standards to all loans. In this regard, we fully underwrite all loans based on an applicant's employment history, credit history and an appraised value of the subject property. With respect to loans we purchased, we underwrote each loan based upon our own underwriting standards prior to making the purchase.
The following underwriting guidelines, among other things, have been used by us as underwriting tools to further limit our potential loss exposure:

All variable rate one-to-four family residential loans are underwritten using the fully indexed rate.
We only lend up to 80% of the lesser of the appraised value or purchase price for one-to-four family residential loans without PMI, up to 95% with PMI.
We only lend up to 75% of the appraised value or purchase price for multi-family residential loans.
We only lend up to 65% of the appraised value or purchase price for commercial real estate loans.

Additionally, our portfolio has remained strongly anchored in traditional mortgage products. We do not originate or purchase construction and development loans, teaser option-adjustable rate mortgage loans, negatively amortizing loans or high loan-to-value loans.

At June 30, 2011, one-to-four family residential mortgage loans totaled $282.0 million, or 39.9%, of our gross loan portfolio of which $229.4 million were fixed rate and $52.6 million were adjustable rate loans. Adjustable rate mortgages generally pose different credit risks than fixed rate mortgages, primarily because as interest rates rise, the borrower's payment rises, increasing the potential for default. Included in non-accrual loans at June 30, 2011 were $3.3 million in adjustable rate one-to-four family loans and $15.1 million in fixed rate one-to-four family loans. Overall this represents 6.5% of the one-to-four family residential mortgage loan portfolio.

All of our real estate loans are secured by properties located in California. The following tables set forth our real estate loans and non-accrual real estate loans by county:

Real Estate Loans by County as of June 30, 2011

County	One-to-four family	Multi-family residential	Commercial	Total	Percent
	(Dollars in thousands)				
Los Angeles	$104,919	$ 220,967	$ 61,100	$386,986	57.09 %
Orange	49,321	20,753	27,815	97,889	14.44
San Diego	25,062	16,586	2,664	44,312	6.54
San Bernardino	13,271	15,788	4,112	33,171	4.90
Riverside	12,247	5,430	9,178	26,855	3.96
Santa Clara	20,747	560	—	21,307	3.14
Alameda	10,838	51	459	11,348	1.67
Other	45,663	7,673	2,633	55,969	8.26
Total	$282,068	$ 287,808	$ 107,961	$677,837	100.00 %

Non-accrual Real Estate Loans by County as of June 30, 2011

County	One-to-four family	Multi-family residential	Commercial	Total	Percent of Non-accrual to Loans in Each Category
			(Dollars in thousands)		
Los Angeles	$5,312	$ —	$ 1,614	$6,926	1.79 %
Orange	2,548	—	—	2,548	2.60
San Diego	2,178	648	2,665	5,491	12.39
San Bernardino	2,538	2,214	637	5,389	16.25
Riverside	1,206	228	—	1,434	5.34
Santa Clara	1,149	—	—	1,149	5.39
Alameda	1,295	—	—	1,295	11.41
Other	2,159	—	—	2,159	3.86
Total	$18,385	$ 3,090	$4,916	$26,391	3.89 %

Problem Assets. For one-to-four family residential, multi-family residential and commercial real estate loans serviced by us, a notice is sent to the borrower when the loan is between seven and ten days past due. When the loan is between ten and fifteen days past due, we mail a subsequent delinquency notice to the borrower. Typically, before the loan becomes thirty days past due, contact with the borrower is made requesting payment of the delinquent amount in full, or the establishment of an acceptable repayment plan to bring the loan current. If an acceptable repayment plan has not been agreed upon, loan personnel will generally prepare a notice of intent to foreclose. The notice of intent to foreclose allows the borrower up to ten days to bring the account current. Once the loan becomes sixty days delinquent, and an acceptable repayment plan has not been agreed upon, the servicing officer will turn over the account to the deed of trust trustee with instructions to initiate foreclosure. Real estate loans serviced by a third party are subject to the servicing institution's collection policies. However, we track each purchased loan individually to attempt to receive full payments as scheduled. Each month, third party servicers are required to provide delinquent loan status reports to our servicing officer, which are included in the month-end delinquent real estate report to management.

When a borrower fails to make a timely payment on a consumer loan, a delinquency notice is sent when the loan is seven days past due. When the loan is fourteen days past due, we mail a subsequent delinquency notice to the borrower. Once a loan is thirty days past due, our staff contacts the borrower by telephone to determine the reason for delinquency and to request payment of the delinquent amount in full or to establish an acceptable repayment plan to bring the loan current. If the borrower is unable to make or keep payment arrangements, additional collection action is taken in the form of repossession of collateral for secured loans and legal action for unsecured loans.

At June 30, 2011, $167.6 million, or 59.4% of our one-to-four family residential mortgage portfolio was serviced by others. As a result of a higher level of delinquent loans nationwide, third party servicers have been unable to service and in certain circumstances foreclose on properties in a timely manner. Currently, we track the servicing of these loans on our core mortgage servicing system. We have hired additional experienced mortgage loan workout staff and reallocated existing staff to monitor the collection activity of the servicers and perform direct customer outreach when a loan falls 30 days past due. In many instances, our role has been to provide direction to the third party servicers regarding loan modification requests and to develop collection plans for individual loans, while maintaining contact with the borrower. Due to a number of factors, including the high rate of loan delinquencies, we believe our servicers have not vigorously pursued collection efforts on our behalf. We have filed legal suit against two servicers seeking to obtain the transfer of servicing rights on $165.2 million of loans serviced by them to us. In anticipation of this effort, we have hired additional staff in the real estate loan servicing area.

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The following table presents information concerning the composition of the one-to-four family residential loan portfolio by servicer at June 30, 2011:

	Amount	Percent	Non-performing	Percent of Non-accrual to Loans in Each Category
		(Dollars in thousands)		
Purchased and serviced by others	$ 167,605	59.42%	$ 13,065	7.80%
Purchased and servicing transferred to us	24,343	8.63	3,232	13.28
Originated and serviced by us	90,120	31.95	2,088	2.32
Total	$ 282,068	100.00%	$ 18,385	6.52%

Delinquent Loans. The following table sets forth certain information with respect to our loan portfolio delinquencies at the dates indicated:

	Loans Delinquent :					
	60-89 Days		90 Days or More		Total Delinquent Loans	
	Number of Loans	Amount	Number of Loans	Amount	Number of Loans	Amount
			(Dollars in thousands)			
At June 30, 2011						
Real estate loans:						
One-to-four family	2	$ 1,043	17	$ 6,583	19	$ 7,626
Multi-family	1	457	1	1,757	2	2,214
Commercial	—	—	1	637	1	637
Other loans:						
Automobile	1	6	—	—	1	6
Home equity	—	—	—	—	—	—
Other	1	3	3	5	4	8
Total loans	5	$ 1,509	22	$ 8,982	27	$ 10,491
At June 30, 2010						
Real estate loans:						
One-to-four family	3	$ 1,297	33	$ 13,373	36	$ 14,670
Multi-family	—	—	2	2,786	2	2,786
Commercial	—	—	—	—	—	—
Other loans:						
Automobile	4	35	—	—	4	35
Home equity	—	—	1	63	1	63
Other	—	—	2	4	2	4
Total loans	7	$ 1,332	38	$ 16,226	45	$ 17,558
At June 30, 2009						
Real estate loans:						
One-to-four family	6	$ 2,212	14	$ 6,220	20	$ 8,432
Multi-family	—	—	—	—	—	—
Commercial	—	—	—	—	—	—
Other loans:						
Automobile	3	16	—	—	3	16
Home equity	—	—	—	—	—	—
Other	11	16	6	11	17	27
Total loans	20	$ 2,244	20	$ 6,231	40	$ 8,475
At June 30, 2008						
Real estate loans:						
One-to-four family	—	$ —	4	$ 1,583	4	$ 1,583
Multi-family	—	—	—	—	—	—
Commercial	—	—	—	—	—	—
Other loans:						
Automobile	10	159	8	132	18	291

Home equity	—		—	—		—	—		—
Other	22		34	9		15	31		49
Total loans	32	$	193	21	$	1,730	53	$	1,923
At June 30, 2007									
Real estate loans:									
One-to-four family	—	$	—	2	$	1,115	2	$	1,115
Multi-family	—		—	—		—	—		—
Commercial	—		—	—		—	—		—
Other loans:									
Automobile	7		111	2		19	9		130
Home equity	—		—	—		—	—		—
Other	5		8	4		7	9		15
Total loans	12	$	119	8	$	1,141	20	$	1,260

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Delinquent loans 60 days or more past due decreased to $10.5 million or 1.48% of total loans at June 30, 2011 from $17.6 million or 2.28% of total loans at June 30, 2010. Delinquent one-to-four family loans decreased from $14.7 million at June 30, 2010 to $7.6 million at June 30, 2011. In addition, there was one multi-family residential loan totaling $1.8 million and one commercial real estate loan totaling $637,000 that were over 90 days delinquent at June 30, 2011 and are in the process of foreclosure.

Non-Performing Assets. Non-performing assets consist of non-accrual loans and foreclosed assets. Loans to a customer whose financial condition has deteriorated are considered for non-accrual status whether or not the loan is 90 days and over past due. All loans past due 90 days and over are classified as non-accrual. On non-accrual loans, interest income is not recognized until actually collected. At the time the loan is placed on non-accrual status, interest previously accrued but not collected is reversed and charged against current income. Non-accrual loans also include certain troubled debt restructurings.

At June 30, 2011, we had $12.9 million in troubled debt restructurings. Of the $12.9 million in troubled debt restructurings, all are included in non-accrual loans in the following table. Troubled debt restructured loans are included in non-accrual loans until there is a sustained period of payment performance (determined on a case by case basis) and there is a reasonable assurance that the payment will continue. There were no further commitments to customers whose loans are troubled debt restructurings at June 30, 2011.

Any changes or modifications made to loans are carefully reviewed to determine whether they are troubled debt restructurings. Any loan modifications made due to financial difficulties of the borrower where a concession is made are reported as troubled debt restructurings. Any other changes or modifications made for borrowers who are not experiencing financial difficulties are done on an infrequent basis. There were seventeen loans that were modified in fiscal 2011 and not accounted for as troubled debt restructurings in the amount of $7.8 million. The modifications were made to refinance the credits to maintain the borrowing relationships and generally consisted of term or rate modifications. The borrowers were not experiencing financial difficulty and the modifications were made at market terms.

Real Estate Owned. Real estate owned and repossessed assets consist of real estate and other assets which have been acquired through foreclosure on loans. At the time of foreclosure, assets are recorded at fair value less estimated selling costs, with any write-down charged against the allowance for loan losses. The fair value of real estate owned is determined by a third party appraisal of the property.

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

	At June 30, 2011	2010	2009	2008	2007
	(Dollars in thousands)				
Non-accrual loans:					
Real estate loans:					
One-to-four family	$9,513	$15,561	$6,766	$1,583	$1,115
Multi-family	1,757	2,786	—	—	—
Commercial	2,252	—	—	—	—
Other loans:					
Automobile	—	—	—	132	19
Home Equity	—	63	—	—	—
Other	5	4	11	15	7
Troubled debt restructuring:					
One-to-four family	8,872	9,193	1,859	—	—
Multi-family	1,332	1,179	235	—	—
Commercial	2,665	2,665	—	—	—
Total non-accrual loans	26,396	31,451	8,871	1,730	1,141
Other real estate owned and repossessed assets:					
Real estate:					
One-to-four family	828	1,373	496	1,045	238
Multi-family	—	—	—	—	—
Commercial	—	—	—	—	—
Other:					
Automobile	10	—	3	161	74
Home equity	—	—	—	—	—
Other	—	—	—	—	—
Total other real estate owned and repossessed assets	838	1,373	499	1,206	312
Total non-performing assets	$27,234	$32,824	$9,370	$2,936	$1,453
Ratios:					
Non-performing loans to total loans (1)	3.73 %	4.08 %	1.18 %	0.23 %	0.16 %
Non-performing assets to total assets	3.18 %	3.79 %	1.05 %	0.35 %	0.18 %
Non-accrued interest (2)	$364	$408	$170	$49	$17

(1) Total loans are net of deferred fees and costs

(2) If interest on the loans classified as non-accrual had been accrued, interest income in these amounts would have been recor

While non-accrual loans decreased as compared to the prior year they remain at historically elevated levels. The elevated level of non-accrual loans was a result of the decline in the housing market as well as the prolonged levels of high unemployment in our market area. The decrease from the prior year was a result of homes sold by borrowers through negotiated short sales and loans foreclosed on by the Bank. We continue to work with responsible borrowers to keep their properties and as a result we have restructured $12.9 million in mortgage loans of which $10.9 million were performing in accordance with their revised contractual terms at June 30, 2011. This compares to $16.0 million in restructured loans at June 30, 2010. Of the $12.9 million in restructured loans all were reported as non-accrual at June 30, 2011. Troubled debt restructured loans are reported as non-accrual until there is a sustained period of payment performance (usually six months or longer) and there is a reasonable assurance that the payment will continue. At June 30, 2011, there were $8.0 million of multi-family residential and commercial real estate loans on non-accrual for which specific valuation allowances of $1.8 million have been applied. Included in the $8.0 million of income property loans on non-accrual at June 30, 2011 were four multi-family residential loans totaling $3.1 million and three commercial real estate loans totaling $4.9 million.

At June 30, 2011, there were four multi-family residential loans on non-accrual. The first multi-family residential loan was made to a borrower with a principal balance of $1.8 million located in Adelanto, California at June 30, 2011. The loan was over 90 days delinquent and had a court appointed receiver in place to manage the property and collect the rents during the judicial foreclosure process. The remaining three multi-family residential loans on non-accrual were in the amount of $1.3 million in the aggregate and were troubled debt restructurings at June 30, 2011. At June 30, 2011, there were three commercial real estate loans on non-accrual. The first commercial real estate loan had a principal balance of $637,000 secured by an office warehouse in San Bernardino County, California, which was not current at June 30, 2011 and has experienced cash flow problems. The second commercial real estate loan had a principal balance of $1.6 million secured by an office building in Los Angeles County, California, which was current at June 30, 2011, but had previously experienced cash flow problems. The third commercial real estate loan had a principal balance of $2.7 million secured by a strip mall in San Diego, California, which was current at June 30, 2011, but had previously experienced cash flow problems. The level of non-accrual loans has impacted our determination of the allowance for loan losses at June 30, 2011. Non-accrual loans are assessed to determine impairment. Loans that are found to be impaired are individually evaluated and a specific valuation allowance is applied.

Classified Assets. Regulations provide for the classification of loans and other assets, such as debt and equity securities considered by regulators to be of lesser quality, as “substandard,” “doubtful” or “loss.” An asset is considered “substandard” if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. “Substandard” assets include those characterized by the “distinct possibility” that the insured institution will sustain “some loss” if the deficiencies are not corrected. Assets classified as “doubtful” have all of the weaknesses inherent in those classified “substandard,” with the added characteristic that the weaknesses present make “collection or liquidation in full,” on the basis of currently existing facts, conditions, and values, “highly questionable and improbable.” Assets classified as “loss” are those considered “uncollectible” and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Loans are classified as special mention when it is determined a loan relationship should be monitored more closely. Loans are classified as special mention for a variety of reasons including changes in recent borrower financial condition, changes in borrower operations, changes in value of available collateral, concerns regarding changes in economic conditions in a borrower’s industry, and other matters. A loan classified as special mention in many instances may be performing in accordance with the loan terms.

When an insured institution classifies problem assets as either substandard or doubtful, it may establish general allowances for loan losses in an amount deemed prudent by management and approved by the board of directors. General allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies problem assets as "loss," it is required either to establish a specific allowance for losses equal to 100% of that portion of the asset so classified or to charge off such amount. An institution's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC"), which may order the establishment of additional general or specific loss allowances.

In connection with the filing of our periodic reports in the past with the Office of Thrift Supervision ("OTS") and in accordance with our classification of assets policy, we regularly review the problem assets in our portfolio to determine whether any assets require classification in accordance with applicable regulations. The total amount of classified and special mention assets represented 28.66% of our equity capital and 5.27% of our total assets at June 30, 2011, as compared to 53.48% of our equity capital and 5.84% of our total assets at June 30, 2010. At June 30, 2011 and 2010, there were $26.4 million and $31.5 million in non-accrual loans included in classified assets, respectively.

The aggregate amount of our classified and special mention assets at the dates indicated were as follows:

	At June 30,		
	2011	2010	2009
		(In thousands)	
Classified and Special Mention Assets:			
Loss	$5	$9	$20
Doubtful	29	43	126
Substandard	34,043	40,513	13,964
Special Mention	11,026	10,043	7,316
Total	$45,103	$50,608	$21,426

Allowance for Loan Losses. We maintain an allowance for loan losses to absorb probable incurred losses inherent in the loan portfolio. The allowance is based on ongoing, quarterly assessments of the probable losses inherent in the loan portfolio. In accordance with generally accepted accounting principles ("GAAP"), the allowance is comprised of both specific and general valuation allowances.

The specific component relates to loans that are classified as impaired. We consider a loan impaired when it is probable that we will be unable to collect all amounts due according to the terms of the loan agreement and determine impairment by computing a fair value either based on discounted cash flows using the loan's initial interest rate or the fair value of the collateral, less estimated selling costs, if the loan is collateral dependent. The general component covers non-impaired loans and is based both on our historical loss experience as well as significant factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date.

The general valuation allowance is calculated by applying loss factors to outstanding loans based on the internal risk evaluation of the loans or pools of loans. Changes in risk evaluations of both performing and non-performing loans affect the amount of the allowance. The appropriateness of the allowance is reviewed and established by management based upon its evaluation of then-existing economic and business conditions affecting key lending areas and other conditions, such as credit quality trends (including trends in non-performing loans expected to result from existing conditions), collateral values, loan volumes and concentrations, specific industry conditions and peer data within portfolio segments, and recent loss experience in particular segments of the portfolio that existed as of the balance sheet date and the impact that such conditions were believed to have had on the collectability of the loan. Significant factors reviewed in determining the allowance for loan losses included loss ratio trends by loan product; levels of and trends in delinquencies and impaired loans; levels of and trends in classified assets; levels of and trends in charge-offs and recoveries; trends in volume of loans by loan product; effects of changes in lending policies and practices; industry conditions and effects of concentrations in geographic regions and by third party servicers. Specific valuation allowances on real estate loans are charged-off at foreclosure; however, we include specific valuation allowances in our historical loss experience ratios. Holding period restrictions imposed by the State of California on lenders foreclosing on owner occupied real estate securing one-to-four family residential loans and difficulty pursuing collection efforts through third party servicers on our behalf has delayed our ability to foreclose.

Our multi-family and commercial real estate loans (“income property”) are less seasoned, and therefore, to-date we have not incurred material charge-offs and our delinquent history on income property loans has been less than our single-family real estate loans. In addition, the multi-family portfolio has been a significant growth area in our loan portfolio beginning in fiscal 2009. For income property loans we review the debt service coverage ratios, seasoning and peer group data. In fiscal 2010, we expanded our migration analysis to include the credit loss migration from published sources, including both the OTS and FDIC, in order to determine the allowance for loan losses on income property loans, given the characteristics of the peer group as compared to our portfolio. Due to the decline in loss experience of our peer group over the past year, our analysis of debt service coverage ratios, and the limited growth of our income property loans compared to the prior year, the general valuation portion of our income property loan portfolio decreased by $765,000 at June 30, 2011 as compared to June 30, 2010.

Senior management reviews these conditions quarterly in discussions with our senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management’s estimate of the effect of such conditions may be reflected as a specific allowance applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management’s evaluation of the loss related to this condition is reflected in the general allowance. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments.

Given that management evaluates the adequacy of the allowance for loan losses based on a review of individual loans, historical loan loss experience, the value and adequacy of collateral and economic conditions in our market area, this evaluation is inherently subjective as it requires material estimates, including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Large groups of smaller balance homogeneous loans that are collectively evaluated for impairment and are excluded from specific impairment evaluation; their allowance for loan losses is calculated in accordance with the allowance for loan losses policy described above.

Because the allowance for loan losses is based on estimates of losses inherent in the loan portfolio, actual losses can vary significantly from the estimated amounts. Our methodology as described above permits adjustments to any loss factor used in the computation of the formula allowance in the event that, in management's judgment, significant factors which affect the collectability of the portfolio as of the evaluation date are not reflected in the loss factors. By assessing the estimated losses inherent in the loan portfolio on a quarterly basis, we are able to adjust specific and inherent loss estimates based upon any more recent information that has become available. In addition, management's determination as to the amount of our allowance for loan losses is subject to review by the OCC and the FDIC, which may require the establishment of additional general or specific allowances based upon their judgment of the information available to them at the time of their examination of our Bank.

Our provision for loan losses decreased to $950,000 for the year ended June 30, 2011 compared to $9.9 million for the year ended June 30, 2010. The decline in the overall provision was a result of the continued improvement in our delinquent loans and non-performing assets and a reduction in the Bank's gross loans receivable. Delinquent loans 60 days or more to total loans improved from 2.28% at June 30, 2010 to 1.48% at June 30, 2011. Non-performing assets to total assets improved from 3.79% at June 30, 2010 to 3.18% at June 30, 2011. In addition, our net loans decreased by $61.3 million during the same period. The provision reflects management's continuing assessment of the credit quality of the Company's loan portfolio, which is affected by various trends, including current economic conditions. The following sets forth an analysis of our allowance for loans losses.

	Year Ended June 30,				
	2011	2010	2009	2008	2007
	(Dollars in thousands)				
Balance at beginning of year	$13,309	$4,586	$3,229	$2,805	$2,722
Charge-offs:					
One-to-four family real estate	2,189	966	860	70	—
Multi-family real estate	772	—	—	—	—
Commercial real estate	—	—	—	110	—
Consumer – automobile	79	184	487	646	676
Consumer – other	97	82	141	80	92
Total Charge-offs	3,137	1,232	1,488	906	768
Recoveries:					
One-to-four family real estate	91	—	—	—	—
Multi-family real estate	—	—	—	27	—
Commercial real estate	—	—	—	—	—
Consumer – automobile	127	65	227	304	312
Consumer – other	27	23	32	37	10
Total Recoveries	245	88	259	368	322
Net charge-offs	2,892	1,144	1,229	538	446
Provision for losses	950	9,867	2,586	962	529
Balance at end of year	$11,367	$13,309	$4,586	$3,229	$2,805
Ratios:					
Net charge-offs to average loans during the year (1)	0.39 %	0.15 %	0.16 %	0.07 %	0.07 %
Net charge-offs to average non-performing loans during the year	10.15 %	5.24 %	23.91 %	35.35 %	47.90 %
Allowance for loan losses to non-performing loans (end of year)	43.06 %	42.32 %	51.69 %	186.66 %	245.84 %
Allowance for loan losses to total loans (end of year) (1)	1.61 %	1.73 %	0.61 %	0.43 %	0.40 %

(1) Loans are net of deferred fees and costs.

Allocation of Allowance for Loan Losses. The distribution of the allowance for losses on loans at the dates indicated is summarized as follows.

	At June 30,									
	2011		2010		2009		2008		2007	
	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans
	(Dollars in thousands)									
Real estate loans:										
One-to-four family	$6,378	39.87 %	$7,821	43.55 %	$3,326	50.22 %	$1,744	57.51 %	$1,626	66.88 %
Multi-family	2,654	40.69	3,643	36.12	515	26.17	407	17.75	114	12.55
Commercial	2,254	15.26	1,599	14.72	286	16.13	245	15.54	73	11.09
Other loans:										
Automobile	59	2.55	185	3.83	342	5.56	716	7.01	922	7.56
Home equity	17	0.13	7	0.14	6	0.17	1	0.19	1	0.21
Other	5	1.50	54	1.64	111	1.75	116	2.00	69	1.71
Total allowance for loan losses	$11,367	100.00 %	$13,309	100.00 %	$4,586	100.00 %	$3,229	100.00 %	$2,805	100.00 %

Investment Activities

General. We are required by federal regulations to maintain an amount of liquid assets in order to meet our liquidity needs. These assets consist of certain specified securities. Cash flow projections are regularly reviewed and updated to assure that adequate liquidity is provided.

We are authorized to invest in various types of liquid assets, including U.S. Treasury obligations, securities of various federal agencies, certain certificates of deposit of insured banks and savings institutions, certain bankers' acceptances, repurchase agreements and federal funds. Subject to various restrictions, federal savings banks may also invest their assets in investment grade commercial paper and corporate debt securities and mutual funds whose assets conform to the investments that a federally chartered savings bank is otherwise authorized to make directly. See "How We Are Regulated - Kaiser Federal Bank" for a discussion of additional restrictions on our investment activities.

Under the direction and guidance of the Asset and Liability Management Committee and board policy, our chief financial officer has the responsibility for the management of our investment portfolio. Various factors are considered when making decisions, including the marketability, maturity and tax consequences of the proposed investment. The maturity structure of investments will be affected by various market conditions, including the current and anticipated short and long term interest rates, the level of interest rates, the trend of new deposit inflows, and the anticipated demand for funds via deposit withdrawals and loan originations and purchases.

The current structure of our investment portfolio provides liquidity when loan demand is high, assists in maintaining earnings when loan demand is low and maximizes earnings while satisfactorily managing risk, including credit risk, reinvestment risk, liquidity risk and interest rate risk. See "Quantitative and Qualitative Disclosures about Market Risk – Asset and Liability Management and Market Risk."

At June 30, 2011, our investment portfolio totaled $18.2 million and consisted principally of investment grade collateralized mortgage obligations and mortgage-backed securities. From time to time, investment levels may increase or decrease depending upon yields available on investment alternatives and management's projected demand for funds for loan originations, deposits, and other activities. At June 30, 2011 we held no trust preferred securities and have never invested in trust preferred securities.

The following table sets forth the composition of our investment portfolio at the dates indicated.

	At June 30,					
	2011		2010		2009	
	Carrying Value	Percent of Total	Carrying Value	Percent of Total	Carrying Value	Percent of Total
	(Dollars in thousands)					
Securities available-for-sale:						
FHLB bond	$4,999	27.41 %	$—	— %	$—	— %
Mortgage-backed securities:						
Freddie Mac	184	1.01	341	5.65	524	5.37
Collateralized mortgage obligations:						
Fannie Mae	5,115	28.04	—	—	—	—
Freddie Mac	5,740	31.47	1,949	32.25	3,712	38.01
Total securities available-for-sale	$16,038	87.93 %	$2,290	37.90 %	$4,236	43.38 %
Securities held-to-maturity:						
Mortgage-backed securities:						
Fannie Mae	144	0.79	162	2.68	191	1.96
Freddie Mac	109	0.60	131	2.17	156	1.60
Ginnie Mae	52	0.28	60	1.00	111	1.14
Collateralized mortgage obligations:						
Fannie Mae	908	4.98	1,352	22.38	1,819	18.63
Freddie Mac	989	5.42	2,046	33.87	3,251	33.29
Total securities held-to-maturity	$2,202	12.07 %	$3,751	61.10 %	$5,528	56.62 %
Total securities	$18,240	100.00 %	$6,041	100.00 %	$9,764	100.00 %
Other earning assets:						
Interest earning time deposits in other financial institutions	$11,669	11.39 %	$19,267	30.48 %	$25,508	32.22 %
Federal funds sold	80,440	78.52	31,775	50.26	41,020	51.81
FHLB stock	10,334	10.09	12,179	19.26	12,649	15.97
Total other earning assets	$102,443	100.00 %	$63,221	100.00 %	$79,177	100.00 %
Total securities and other earning assets	$120,683		$69,262		$88,941	

Portfolio Maturities and Yields. The composition and maturities of the investment securities portfolio at June 30, 2011 are summarized in the following table. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur.

	One year or less		More than One Year through Five Years		More than Five Years through Ten Years		More than Ten Years		Total Securities		
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Fair Value	Weighted Average Yield
	(Dollars in thousands)										
Securities available-for-sale:											
FHLB bond	$ —	—%	$ 4,998	1.63 %	$ —	— %	$ —	— %	$ 4,998	$ 4,999	1.63 %
Mortgage-backed securities:											
Freddie Mac	—	—	179	4.50	—	—	—	—	179	184	4.50
Collateralized mortgage obligations:											
Fannie Mae	—	—	—	—	—	—	5,210	1.75	5,210	5,115	1.75
Freddie Mac	—	—	—	—	—	—	5,686	3.45	5,686	5,740	3.45
Total securities available-for-sale	$ —	—%	$ 5,177	1.73 %	$ —	— %	$ 10,896	2.64 %	$ 16,073	$ 16,038	2.34 %
Securities held-to-maturity:											
Mortgage-backed securities:											
Fannie Mae	$ —	—%	$ —	— %	$ —	— %	$ 144	2.08 %	$ 144	$ 147	2.08 %
Freddie Mac	—	—	—	—	—	—	109	4.41	109	116	4.41
Ginnie Mae	—	—	—	—	22	4.13	30	3.03	52	53	2.95
Collateralized mortgage obligations:											
Fannie Mae	—	—	—	—	—	—	908	3.52	908	940	3.52
Freddie Mac	—	—	—	—	517	5.30	472	5.05	989	1,043	5.18
Total securities held-to-maturity	—	—	—	—	539	5.21	1,663	3.88	2,202	2,299	4.20
Total securities	$ —	—%	$ 5,177	1.73 %	$ 539	5.21 %	$ 12,559	2.80 %	$ 18,275	$ 18,337	2.57 %

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Mortgage-Backed Securities. We invest in mortgage-backed securities insured or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. We invest in mortgage-backed securities to achieve positive interest rate spreads with minimal administrative expense, and to lower our credit risk as a result of the guarantees provided by Freddie Mac, Fannie Mae or Ginnie Mae.

Mortgage-backed securities are created by pooling mortgages and issuing a security with an interest rate that is less than the interest rate on the underlying mortgages. Mortgage-backed securities typically represent a participation interest in a pool of single-family or multi-family residential mortgages, although we invest primarily in mortgage-backed securities backed by one- to four-family mortgages. The issuers of such securities pool and resell the participation interests in the form of securities to investors such as us. Some securities pools are guaranteed as to payment of principal and interest to investors. Mortgage-backed securities generally yield less than the loans that underlie such securities because of the cost of payment guarantees and credit enhancements. However, mortgage-backed securities are more liquid than individual mortgage loans since there is an active trading market for such securities. In addition, mortgage-backed securities may be used to collateralize our specific liabilities and obligations. Finally, mortgage-backed securities are assigned lower risk weightings for purposes of calculating our risk-based capital level.

Investments in mortgage-backed securities involve a risk that actual payments will be greater or less than the prepayment rate estimated at the time of purchase, which may require adjustments to the amortization of any premium or acceleration of any discount relating to such interests, thereby affecting the net yield on our securities. We periodically review current prepayment speeds to determine whether prepayment estimates require modification that could cause amortization or accretion adjustments.

Collateralized mortgage obligations are debt securities issued by a special-purpose entity that aggregates pools of mortgages and mortgage-backed securities and creates different classes of securities with varying maturities and amortization schedules, as well as a residual interest, with each class possessing different risk characteristics. The cash flows from the underlying collateral are generally divided into “tranches” or classes that have descending priorities with respect to the distribution of principal and interest cash flows, while cash flows on pass-through mortgage-backed securities are distributed pro rata to all security holders.

Interest Earning Deposits in Other Financial Institutions. Interest earning time deposits in other financial institutions consists of certificates of deposit placed with federally insured financial institutions in amounts that do not exceed the insurable limit of $250,000. These deposits are used to invest our excess liquidity as part of our overall asset/liability management. These deposits had a weighted-average yield of 0.69% and a weighted average maturity of 5.01 months at June 30, 2011.

Federal Home Loan Bank Stock. As a member of the Federal Home Loan Bank of San Francisco, we are required to own capital stock in the Federal Home Loan Bank. The amount of stock we hold is based on percentages specified by the Federal Home Loan Bank of San Francisco on our outstanding advances and the requirements of their Mortgage Purchase Program. The redemption of any excess stock we hold is at the discretion of the Federal Home Loan Bank of San Francisco. The carrying value of Federal Home Loan Bank of San Francisco stock totaled $10.3 million and had a weighted-average-yield of 0.37% for the year ended June 30, 2011. The yield on the Federal Home Loan Bank of San Francisco stock is produced by stock dividends that are subject to the discretion of the board of directors of the Federal Home Loan Bank of San Francisco.

Equity Investment. At June 30, 2011, we also had an investment in an affordable housing fund totaling $1.1 million for the purposes of obtaining tax credits and for Community Reinvestment Act purposes. The investment is being accounted for using the equity method of accounting. The investment is evaluated regularly for impairment based on the remaining allocable tax credits and tax benefits.

Bank-Owned Life Insurance. In April 2005, we purchased $10.0 million in bank-owned life insurance, which covers certain key employees, to provide tax-exempt income to assist in offsetting costs associated with employee benefit plans offered by the Bank. The bank-owned life insurance is recorded at its cash surrender value, or the amount that can be realized. At June 30, 2011, the cash surrender value was $12.9 million.

Sources of Funds

General. Our sources of funds are deposits, payment of principal and interest on loans, interest earned on or maturity of investment securities, borrowings, and funds provided from operations.

Deposits. We offer a variety of deposit accounts to consumers with a wide range of interest rates and terms. Our deposits consist of time deposit accounts, savings, money market and demand deposit accounts. We have historically paid competitive rates on our deposit accounts. We primarily rely on competitive pricing policies, marketing and customer service to attract and retain these deposits. At June 30, 2011, approximately 31% of the dollar amount of our deposits were from customers who are employed by the Kaiser Permanente Medical Care Program, one of the largest employers in Southern California. Our ATMs are located in our branches and near Kaiser Permanente Medical Centers and office buildings. We currently do not accept brokered deposits and had none at June 30, 2011.

The flow of deposits is influenced significantly by general economic conditions, changes in money market and prevailing interest rates and bi-weekly direct deposits from Kaiser Permanente Medical Care Program payrolls. The variety of deposit accounts we offer has allowed us to be competitive in obtaining funds and to respond with flexibility to changes in consumer demand. We have become more susceptible to short-term fluctuations in deposit flows, as customers have become more interest rate conscious. We try to manage the pricing of our deposits in keeping with our asset/liability management, liquidity and profitability objectives, subject to competitive factors. Based on our experience, we believe that our deposits are a relatively stable source of funds. Despite this stability, our ability to attract and maintain these deposits and the rates paid on them has been and will continue to be significantly affected by market conditions.

The following table sets forth our deposit flows during the years indicated.

	Year Ended June 30,		
	2011	2010	2009
	(Dollars in thousands)		
Opening balance	$630,694	$566,193	$495,058
Deposits, net of withdrawals	(4,489)	53,572	58,013
Interest credited	8,504	10,929	13,122
Ending balance	$634,709	$630,694	$566,193
Net increase in deposits	$4,015	$64,501	$71,135
Percent increase in deposits	0.64%	11.39%	14.37%

The following table shows the distribution of, and certain other information relating to, deposits by type of deposit, as of the dates indicated.

	At June 30,					
	2011		2010		2009	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
			(Dollars in thousands)			
Noninterest-bearing demand	$ 57,512	9.06 %	$ 53,022	8.41 %	$ 50,161	8.86 %
Savings	133,891	21.09	131,693	20.88	129,390	22.85
Money Market	131,958	20.79	120,719	19.14	108,858	19.23
Certificates of deposit:						
0.10% - 1.99%	123,770	19.50	89,657	14.21	16,603	2.93
2.00% - 2.99%	140,671	22.16	117,489	18.63	99,222	17.52
3.00% - 3.99%	19,881	3.13	78,642	12.47	102,933	18.18
4.00% - 4.99%	20,366	3.21	32,682	5.18	52,035	9.19
5.00% - 5.99%	6,660	1.05	6,790	1.08	6,991	1.24
Total Certificates of deposit	311,348	49.05	325,260	51.57 %	277,784	49.06
Total	$ 634,709	100.00 %	$ 630,694	100.00 %	$ 566,193	100.00 %

The following table indicates the amount of certificates of deposit by time remaining until maturity as of June 30, 2011.

	Less than or equal to one year	More than one to two years	More than two to three years	More than three to four years	More than four years	Total
			(Dollars in thousands)			
0.10% - 1.99%	$91,905	$ 21,306	$ 10,140	$ 162	$ 257	$123,770
2.00% - 2.99%	12,635	16,232	12,772	32,376	66,656	140,671
3.00% - 3.99%	376	1,003	15,806	2,681	15	19,881
4.00% - 4.99%	3,096	3,420	13,838	—	12	20,366
5.00% - 5.99%	6,637	23	—	—	—	6,660
	$114,649	$ 41,984	$ 52,556	$ 35,219	$ 66,940	$311,348

As of June 30, 2011, the aggregate amount of outstanding certificates of deposit in amounts greater than or equal to $100,000 was $158.3 million as compared to $155.7 million at June 30, 2010. The following table sets forth the maturity of those certificates as of June 30, 2011.

Maturity Period	Certificates of Deposit (In thousands)
Three months or less	$ 13,772
Over three through six months	10,865
Over six through twelve months	19,958
Over twelve months	113,712
Total	$ 158,307

Borrowings. Although deposits are our primary source of funds, we may utilize borrowings when they are a less costly source of funds, and can be invested at a positive interest rate spread, when we desire additional capacity to fund loan demand or when they meet our asset/liability management goals. Our borrowings historically have consisted of advances from the Federal Home Loan Bank of San Francisco. See Note 9 of the Notes to our Consolidated Financial Statements.

We may obtain advances from the Federal Home Loan Bank of San Francisco upon the security of our mortgage loans and mortgage-backed securities. These advances may be made pursuant to several different credit programs, each of which has its own interest rate, range of maturities and call features. At June 30, 2011, we had $60.0 million in Federal Home Loan Bank advances outstanding. At June 30, 2011, we had available credit for advances from the FHLB of San Francisco in the amount of $300.3 million. We interchange the use of deposits and borrowings to fund assets, such as the origination of loans, depending on various factors including liquidity and asset/liability management strategies. We have an established line of credit with the Federal Reserve Bank of San Francisco. As of June 30, 2011, we pledged $98.1 million commercial real estate loans, $18.2 million automobile loans and $89,000 in investment securities to secure any future borrowings under this line. At June 30, 2011, the available line of credit was $74.3 million. We have never drawn on this line of credit.

The following table sets forth information as to our Federal Home Loan Bank advances for the years indicated.

	Year Ended June 30,		
	2011	2010	2009
	(Dollars in thousands)		
Balance at end of year	$60,000	$137,000	$207,004
Average balance outstanding	100,615	157,770	214,088
Maximum month-end balance	137,000	207,002	235,018
Weighted average interest rate during the year	4.72 %	4.60 %	4.50 %
Weighted average interest rate at end of year	4.86 %	4.59 %	4.51 %

Employees

At June 30, 2011, we had a total of 110 full-time employees and 7 part-time employees. Our employees are not represented by any collective bargaining group. Management believes that we have good relations with our employees.

How We Are Regulated

Set forth below is a brief description of certain laws and regulations which are applicable to Kaiser Federal Financial Group, Inc. and Kaiser Federal Bank. The description of these laws and regulations, as well as descriptions of laws and regulations contained elsewhere herein, does not purport to be complete and is qualified in its entirety by reference to the applicable laws and regulations.

Legislation is introduced from time to time in the United States Congress that may affect the operations of Kaiser Federal Financial Group, Inc. and Kaiser Federal Bank. In addition, the regulations governing Kaiser Federal Financial Group, Inc. and Kaiser Federal Bank may be amended from time to time by the OCC and/or the Board of Governors of the Federal Reserve System ("Federal Reserve Board"). Any such legislation or regulatory changes in the future could adversely affect Kaiser Federal Financial Group, Inc. or Kaiser Federal Bank. No assurance can be given as to whether or in what form any such changes may occur.

New Federal Legislation

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") has significantly changed the former bank regulatory structure and affected the lending, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act eliminated our former primary federal regulator, the OTS, and required Kaiser Federal Bank to be regulated by the Office of the Comptroller of the Currency (the primary federal regulator for national banks) as of July 21, 2011. The Dodd-Frank Act also authorizes the Board of Governors of the Federal Reserve System to supervise and regulate all savings and loan holding companies like the Company, in addition to bank holding companies which it previously regulated. As a result, the Federal Reserve Board's current regulations applicable to bank holding companies, including holding company capital requirements, will apply to savings and loan holding companies following a five year phase in period for holding company capital requirements. These capital requirements will be substantially similar to the capital requirements currently applicable to Kaiser Federal Bank, as described in "—Federal Banking Regulation—Capital Requirements." The Dodd-Frank Act also requires the Federal Reserve Board to set minimum capital levels for bank and savings and loan holding companies that are as stringent as those required for the insured depository subsidiaries, and the components of Tier 1 capital would be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions. Bank and savings and loan holding companies with assets of less than $500 million are exempt from these capital requirements. Under the Dodd-Frank Act, the proceeds of trust preferred securities are excluded from

Tier 1 capital unless such securities were issued prior to May 19, 2010 by bank or savings and loan holding companies with less than $15 billion of assets. The legislation also establishes a floor for capital of insured depository institutions that cannot be lower than the standards in effect when the law was enacted, and directs the federal banking regulators to implement new leverage and capital requirements within 18 months that take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives.

The Dodd-Frank Act also created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions such as Kaiser Federal Bank, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets will continue to be examined for compliance by their applicable bank regulators (in Kaiser Federal Bank's case, the Office of the Comptroller of the Currency). The new legislation also weakened the federal preemption available for national banks and federal savings associations, and gave state attorneys general the ability to enforce applicable federal consumer protection laws.

The legislation also broadened the base for FDIC insurance assessments. Assessments are now based on an institution's average consolidated total assets less tangible equity capital. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor, retroactive to January 1, 2009, and non-interest bearing transaction accounts have unlimited deposit insurance through December 31, 2013. The Dodd-Frank Act increased stockholder influence over boards of directors by requiring companies to give stockholders a non-binding vote on executive compensation and so-called "golden parachute" payments, and authorizing the Securities and Exchange Commission to promulgate rules that would allow stockholders to nominate their own candidates using a company's proxy materials. The legislation also directed the Federal Reserve Board to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded or not. The Dodd-Frank Act provided for originators of certain securitized loans to retain a percentage of the risk for transferred loans, directed the Federal Reserve Board to regulate pricing of certain debit card interchange fees and contained a number of reforms related to mortgage origination.

Kaiser Federal Financial Group, Inc.

General. Kaiser Federal Financial Group, Inc is a non-diversified savings and loan holding company within the meaning of Section 10(o) of the Home Owners' Loan Act. It is required to file reports with and is subject to regulation and examination by the Federal Reserve Board. In addition, the Federal Reserve Board has enforcement authority over the Company and any non-savings institution subsidiaries. This permits the Federal Reserve Board to restrict or prohibit activities that it determines to be a serious risk to the Bank. This regulation is intended primarily for the protection of the depositors and not for the benefit of stockholders of the Company. Any change in these laws or regulations, whether by the FDIC, the Federal Reserve Board, or Congress, could have a material adverse impact on Kaiser Federal Financial Group, Inc. and Kaiser Federal Bank and their operations. Under the Dodd-Frank Act, the functions of the OTS relating to savings and loan holding companies and their subsidiaries, as well as rulemaking and supervision authority over thrift holding companies was transferred to the Federal Reserve Board on July 21, 2011.

Permissible Activities. Under present law, the business activities of Kaiser Federal Financial Group, Inc. are generally limited to those activities permissible for financial holding companies under Section 4(k) of the Bank Holding Company Act of 1956, as amended, or for multiple savings and loan holding companies. A financial holding company may engage in activities that are financial in nature, including underwriting equity securities and insurance as well as activities that are incidental to financial activities or complementary to a financial activity. A multiple savings and loan holding company is generally limited to activities permissible for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act, subject to prior regulatory approval, and certain additional activities authorized by federal regulations.

Federal law prohibits a savings and loan holding company, including Kaiser Federal Financial Group, Inc., directly or indirectly, or through one or more subsidiaries, from acquiring more than 5% of another savings institution or holding company thereof, without prior written approval of the Federal Reserve Board. It also prohibits the acquisition or retention of, with certain exceptions, more than 5% of a nonsubsidiary company engaged in activities that are not closely related to banking or financial in nature, or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings institutions, the Federal Reserve Board must consider the financial and managerial resources, future prospects of the company and institution involved, the effect of the acquisition on the risk to the federal deposit insurance fund, the convenience and needs of the community and competitive factors.

The Federal Reserve Board is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, subject to two exceptions:

(i) the approval of interstate supervisory acquisitions by savings and loan holding companies; and

(ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisition.

The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

Capital. Savings and loan holding companies are not currently subject to specific regulatory capital requirements. The Dodd-Frank Act, however, requires the Federal Reserve Board to promulgate consolidated capital requirements for depository institution holding companies that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to institutions themselves. Instruments such as cumulative preferred stock and trust preferred securities will no longer be includable as Tier 1 capital as is currently the case with bank holding companies. Instruments issued by May 19, 2010 will be grandfathered for companies with consolidated assets of $15 billion or less. There is a five-year transition period (from the July 21, 2010 effective date of the Dodd-Frank Act) before the capital requirements will apply to savings and loan holding companies.

Source of Strength. The Dodd-Frank Act also extends the “source of strength” doctrine to savings and loan holding companies. The regulatory agencies must issue regulations requiring that all bank and savings and loan holding companies serve as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial stress.

Dividends. The Bank must notify the Federal Reserve Board thirty (30) days before declaring any dividend to the Company. The dividend notice may be denied under certain circumstances, such as where the dividend raises safety or soundness concerns, the dividend would cause the savings bank to be undercapitalized or the dividend would violate a law, regulation, regulatory condition or enforcement order.

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Acquisition. Under the Federal Change in Control Act, a notice must be submitted to the Federal Reserve Board if any person (including a company), or group acting in concert, seeks to acquire direct or indirect “control” of a savings and loan holding company. Under certain circumstances, such as where the company involved has securities registered with the SEC under the Securities Exchange Act of 1934, a change of control may occur, and prior notice is required, upon the acquisition of 10% or more of the company’s outstanding voting stock, unless the Federal Reserve Board has found that the acquisition will not result in control of the company. That rebuttable presumption applies to the Company. A change in control definitively occurs upon the acquisition of 25% or more of the company’s outstanding voting stock. Under the Change in Control Act, the Federal Reserve Board generally has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the competitive effects of the acquisition.

Kaiser Federal Bank

General. Kaiser Federal Bank is examined and supervised by the OCC and is subject to examination by the FDIC. This regulation and supervision establishes a comprehensive framework of activities in which an institution may engage and is intended primarily for the protection of the FDIC’s deposit insurance fund and depositors. Under this system of federal regulation, financial institutions are periodically examined to ensure that they satisfy applicable standards with respect to their capital adequacy, assets, management, earnings, liquidity and sensitivity to market interest rates. Following completion of its examination, the federal agency critiques the institution’s operations and assigns its rating (known as an institution’s CAMELS rating). Under federal law, an institution may not disclose its CAMELS rating to the public. Kaiser Federal Bank also is a member of and owns stock in the Federal Home Loan Bank of San Francisco, which is one of the twelve regional banks in the Federal Home Loan Bank System. Kaiser Federal Bank is also regulated to a lesser extent by the Board of Governors of the Federal Reserve System, governing reserves to be maintained against deposits and other matters. The OCC examines Kaiser Federal Bank and prepares reports for the consideration of its board of directors on any operating deficiencies. Kaiser Federal Bank’s relationship with its depositors and borrowers is also regulated to a great extent by federal law and, to a much lesser extent, state law, especially in matters concerning the ownership of deposit accounts and the form and content of Kaiser Federal Bank’s mortgage documents.

On July 21, 2011, under the Dodd-Frank Act, the OTS’s functions relating to federal savings associations, including rulemaking authority, were transferred to the Office of the Comptroller of the Currency. The thrift charter has been preserved and a new Deputy Comptroller of the Currency will supervise and examine federal savings associations and savings banks.

Set forth below is a brief description of certain regulatory requirements that are or will be applicable to Kaiser Federal Bank. The description below is limited to certain material aspects of the statutes and regulations addressed, and is not intended to be a complete description of such statutes and regulations and their effects on Kaiser Federal Bank.

Federal Banking Regulation

Business Activities. A federal savings bank derives its lending and investment powers from the Home Owners’ Loan Act, as amended, and the regulations of the OCC. Under these laws and regulations, the Bank may invest in mortgage loans secured by residential and nonresidential real estate, commercial business loans and consumer loans, certain types of debt securities and certain other assets, subject to applicable limits. The Bank also may establish subsidiaries that may engage in activities not otherwise permissible for the Bank, including real estate investment and securities and insurance brokerage.

Capital Requirements. Federal regulations require federal savings banks to meet three minimum capital standards: a 1.5% tangible capital ratio, a 4% leverage ratio (3% for federal savings banks receiving the highest rating on the CAMELS rating system) and an 8% risk-based capital ratio.

The risk-based capital standard for federal savings banks requires the maintenance of Tier 1 (core) and total capital (which is defined as core capital and supplementary capital) to risk-weighted assets of at least 4% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100%, assigned by the regulations, based on the risks believed inherent in the type of asset. Core capital is defined as common stockholders' equity (including retained earnings), certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries, less intangibles other than certain mortgage servicing rights and credit card relationships. The components of supplementary capital currently include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock, the general valuation allowance for loan losses limited to a maximum of 1.25% of risk-weighted assets and up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital. Additionally, a savings bank that retains credit risk in connection with an asset sale may be required to maintain additional regulatory capital because of the purchaser's recourse to the savings bank. The Bank does not typically engage in asset sales.

At June 30, 2011, the Bank's capital exceeded all applicable requirements.

Loans-to-One Borrower. Generally, a federal savings bank may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of unimpaired capital and surplus. An additional amount may be loaned, equal to 10% of unimpaired capital and surplus, if the loan is secured by readily marketable collateral, which generally does not include real estate. As of June 30, 2011, the Bank was in compliance with the loans-to-one borrower limitations.

Qualified Thrift Lender Test. As a federal savings bank, the Bank must satisfy the qualified thrift lender, or "QTL," test. Under the QTL test, the Bank must maintain at least 65% of its "portfolio assets" in "qualified thrift investments" in at least nine months of the most recent 12 months. "Portfolio assets" generally means total assets of a savings institution, less the sum of specified liquid assets up to 20% of total assets, goodwill and other intangible assets, and the value of property used in the conduct of the savings bank's business.

"Qualified thrift investments" include various types of loans made for residential and housing purposes, investments related to such purposes, including certain mortgage-backed and related securities, and loans for personal, family, household and certain other purposes up to a limit of 20% of portfolio assets. "Qualified thrift investments" also include 100% of an institution's credit card loans, education loans and small business loans. The Bank also may satisfy the QTL test by qualifying as a "domestic building and loan association" as defined in the Internal Revenue Code.

A savings bank that fails the qualified thrift lender test is subject to certain operating restrictions. In addition, the Dodd-Frank Act made noncompliance with the QTL test potentially subject to agency enforcement action for violation of laws. At June 30, 2011, the Bank held 84.04% of its "portfolio assets" in "qualified thrift investments," and satisfied this test.

Capital Distributions. Federal regulations govern capital distributions by a federal savings bank, which include cash dividends, stock repurchases and other transactions charged to the capital account. A savings bank must file an application for approval of a capital distribution if:

the total capital distributions for the applicable calendar year exceed the sum of the savings bank's net income for that year to date plus the savings bank's retained net income for the preceding two years,

the savings bank would not be at least adequately capitalized following the distribution;

the distribution would violate any applicable statute, regulation, agreement or OCC-imposed condition; or

the savings bank is not eligible for expedited treatment of its filings.

Even if an application is not otherwise required, every savings bank that is a subsidiary of a holding company must still file a notice with the OCC at least 30 days before the board of directors declares a dividend or approves a capital distribution.

The OCC may disapprove a notice or application if:

the savings bank would be undercapitalized following the distribution;

the proposed capital distribution raises safety and soundness concerns; or

the capital distribution would violate a prohibition contained in any statute, regulation or agreement.

In addition, the Federal Deposit Insurance Act provides that an insured depository institution may not make any capital distribution, if after making such distribution the institution would be undercapitalized.

Liquidity. A federal savings bank is required to maintain a sufficient amount of liquid assets to ensure its safe and sound operation.

Community Reinvestment Act and Fair Lending Laws. All federal savings banks have a responsibility under the Community Reinvestment Act and related federal regulations to help meet the credit needs of their communities, including low- and moderate-income neighborhoods. In connection with its examination of a federal savings bank, the OCC is required to assess the bank's record of compliance with the Community Reinvestment Act. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. A bank's failure to comply with the provisions of the Community Reinvestment Act could, at a minimum, result in denial of certain corporate applications such as branches or mergers. The failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions by the OCC, as well as other federal regulatory agencies and the Department of Justice. The Bank received a "satisfactory" Community Reinvestment Act rating in its most recent federal examination.

Transactions with Related Parties. A federal savings bank's authority to engage in transactions with its affiliates is limited by OTS regulations and by Sections 23A and 23B of the Federal Reserve Act and its implementing Regulation W. An affiliate is a company that controls, is controlled by, or is under common control with an insured depository institution such as Kaiser Federal Bank. In general, loan transactions between an insured depository institution and its affiliate are subject to certain quantitative and collateral requirements. In this regard, transactions between an insured depository institution and its affiliate are limited to 10% of the institution's unimpaired capital and unimpaired surplus for transactions with any one affiliate and 20% of unimpaired capital and unimpaired surplus for transactions in the aggregate with all affiliates. Collateral in specified amounts ranging from 100% to 130% of the amount of the transaction must usually be provided by affiliates in order to receive loans from the bank. In addition, OCC regulations prohibit a savings bank from lending to any of its affiliates that are engaged in activities that are not permissible for bank holding companies and from purchasing the securities of any affiliate, other than a subsidiary. Finally, transactions with affiliates must be consistent with safe and sound banking practices, not involve low-quality assets and be on terms that are as favorable to the institution as comparable transactions with non-affiliates. Federal regulations require federal savings banks to maintain detailed records of all transactions with affiliates.

The Bank's authority to extend credit to its directors, executive officers and 10% stockholders, as well as to entities controlled by such persons, is currently governed by the requirements of Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O of the Federal Reserve Board. Among other things, these provisions require that extensions of credit to insiders (i) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features, and (ii) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the Bank's capital. In addition, extensions of credit in excess of certain limits must be approved by the Bank's board of directors.

Enforcement. The OCC has primary enforcement responsibility over federal savings institutions and has the authority to bring enforcement action against all "institution-affiliated parties," including stockholders, and attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal enforcement action by the OCC may range from the issuance of a capital directive or cease and desist order, to removal of officers and/or directors of the institution and the appointment of a receiver or conservator. Civil penalties cover a wide range of violations and actions, and range up to $25,000 per day, unless a finding of reckless disregard is made, in which case penalties may be as high as $1 million per day. The FDIC also has the authority to terminate deposit insurance or to recommend to the OCC that enforcement action be taken with respect to a particular savings institution. If action is not taken by the OCC, the FDIC has authority to take action under specified circumstances.

Standards for Safety and Soundness. Federal law requires each federal banking agency to prescribe certain standards for all insured depository institutions. These standards relate to, among other things, internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, compensation, and other operational and managerial standards as the agency deems appropriate. The federal banking agencies adopted Interagency Guidelines Prescribing Standards for Safety and Soundness to implement the safety and soundness standards required under federal law. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The guidelines address internal controls and information systems, internal audit systems, credit underwriting, loan documentation, interest rate risk exposure, asset growth, compensation, fees and benefits. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to submit a compliance plan.

Prompt Corrective Action Regulations. Under the prompt corrective action regulations, the OCC is required and authorized to take supervisory actions against undercapitalized federal savings banks. For this purpose, a savings bank is placed in one of the following five categories based on the savings bank's capital:

well-capitalized (at least 5% leverage capital, 6% Tier 1 risk-based capital and 10% total risk-based capital);

adequately capitalized (at least 4% leverage capital (3% for federal savings banks with a composite examination rating of 1), 4% Tier 1 risk-based capital and 8% total risk-based capital);

undercapitalized (less than 4% leverage capital (3% for federal savings banks with a composite examination rating of 1), 4% Tier 1 risk-based capital or 3% leverage capital);

significantly undercapitalized (less than 6% total risk-based capital, 3% Tier 1 risk-based capital or 3% leverage capital); or

critically undercapitalized (less than 2% tangible capital).

Generally, the OCC is required to appoint a receiver or conservator for a savings bank that is "critically undercapitalized" within specific time frames. The regulations also provide that a capital restoration plan must be filed with the OCC within 45 days of the date a savings bank receives notice that it is "undercapitalized," "significantly undercapitalized" or "critically undercapitalized." The criteria for an acceptable capital restoration plan include, among other things, the establishment of the methodology and assumptions for attaining adequately capitalized status on an annual basis, procedures for ensuring compliance with restrictions imposed by applicable federal regulations, the identification of the types and levels of activities the savings bank will engage in while the capital restoration plan is in effect, and assurances that the capital restoration plan will not appreciably increase the current risk profile of the savings bank. Any holding company for the savings bank required to submit a capital restoration plan must guarantee the lesser of: an amount equal to 5% of a savings bank's assets at the time it was notified or deemed to be undercapitalized by the OCC, or the amount necessary to restore the savings bank to adequately capitalized status. This guarantee remains in place until the OCC notifies the savings bank that it has maintained adequately capitalized status for each of four consecutive calendar quarters. Failure by a holding company to provide the required guarantee will result in certain operating restrictions on the savings bank, such as restrictions on the ability to declare and pay dividends, pay executive compensation and management fees, and increase assets or expand operations. The OCC may also take any one of a number of discretionary supervisory actions against undercapitalized federal savings banks, including the issuance of a capital directive and the replacement of senior executive officers and directors.

At June 30, 2011, the Bank met the criteria for being considered "well-capitalized."

Insurance of Deposit Accounts. The Deposit Insurance Fund of the FDIC, insures deposits at FDIC-insured depository institutions such as Kaiser Federal Bank. Deposit accounts in Kaiser Federal Bank are insured by the FDIC generally up to a maximum of $250,000 per separately insured depositor and up to a maximum of $250,000 for self-directed retirement accounts. The Dodd-Frank Act also extended the unlimited deposit insurance on noninterest bearing transaction accounts through December 31, 2012.

The FDIC charges insured depository institutions premiums to maintain the Deposit Insurance Fund. Under the FDIC's risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other risk factors. Rates are based on each institution's risk category and certain specified risk adjustments. Stronger institutions pay lower rates while riskier institutions pay higher rates. Previously, the rates for insured institutions varied between seven and 77.5 basis points of assessable deposits.

In February 2011, as required by the Dodd-Frank Act, the FDIC published a rule revising the risk-based deposit insurance assessment system. The rule redefined the assessment base used for calculating deposit insurance assessments effective April 1, 2011. Under the new rule, assessments are based on an institution's average consolidated total assets minus average tangible equity, instead of total deposits. The proposed rule also revised the assessment rate schedule to provide for assessments ranging from 2.5 to 45 basis points.

As part of a plan to restore the deposit insurance fund or view of numerous failures, the FDIC imposed a special assessment on all insured institutions equal to five basis points of assets less Tier 1 capital as of June 30, 2009, which was payable on September 30, 2009. On November 12, 2009, the FDIC approved a final rule requiring insured depository institutions to prepay on December 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012. Estimated assessments for the fourth quarter of 2009 and for all of 2010 were based upon the assessment rate in effect on September 30, 2009, with three basis points added for the 2011 and 2012 assessment rates. In addition, a 5% annual growth in the assessment base was assumed. Prepaid assessments were to be applied against the actual quarterly assessments until exhausted, and may not be applied to any special assessments that may occur in the future. Any unused prepayments will be returned to the institution on June 30, 2013. On December 30, 2009, the Kaiser Federal Bank prepaid $3.6 million in estimated assessment fees for the fourth quarter of 2009 through 2012. Because the prepaid assessments represent the prepayment of future expense, they do not affect regulatory capital (the prepaid asset will have a risk-weighting of 0%) or tax obligations.

Insurance of deposits may be terminated by the Federal Deposit Insurance Corporation upon a finding that an institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the Federal Deposit Insurance Corporation. Kaiser Federal Bank does not believe it is taking or is subject to any action, condition or violation that could lead to termination of its deposit insurance.

In addition to the Federal Deposit Insurance Corporation assessments, the Financing Corporation ("FICO") is authorized to impose and collect, with the approval of the Federal Deposit Insurance Corporation, assessments for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the former Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO are due to mature in 2017 through 2019. For the quarter ended June 30, 2011, the annualized FICO assessment was equal to 1.00 basis points for each $100 in domestic deposits maintained at an institution.

Prohibitions Against Tying Arrangements. Federal savings banks are prohibited, subject to some exceptions, from extending credit to or offering any other service, or fixing or varying the consideration for such extension of credit or service, on the condition that the customer obtain some additional service from the institution or its affiliates or not obtain services of a competitor of the institution.

Federal Home Loan Bank System. Kaiser Federal Bank is a member of the Federal Home Loan Bank System, which consists of 12 regional Federal Home Loan Banks. The Federal Home Loan Bank System provides a central credit facility primarily for member institutions as well as other entities involved in home mortgage lending. As a member of the Federal Home Loan Bank of San Francisco, Kaiser Federal Bank is required to acquire and hold shares of capital stock in the Federal Home Loan Bank. As of June 30, 2011, Kaiser Federal Bank was in compliance with this requirement.

Federal Reserve System

Federal Reserve Board regulations require federal savings banks to maintain noninterest-earning reserves against their transaction accounts, such as negotiable order of withdrawal and regular checking accounts. At June 30, 2011, Kaiser Federal Bank was in compliance with these reserve requirements.

Other Regulations

Interest and other charges collected or contracted for by Kaiser Federal Bank are subject to state usury laws and federal laws concerning interest rates. Kaiser Federal Bank's operations are also subject to federal laws applicable to credit transactions, such as the:

Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies;

Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;

Truth in Savings Act; and

Rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. As directed by the Sarbanes-Oxley Act, our Chief Executive Officer and Chief Financial Officer are required to certify that our quarterly and annual reports do not contain any untrue statement of a material fact. The rules adopted by the Securities and Exchange Commission under the Sarbanes-Oxley Act have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our internal control over financial reporting; they have made certain disclosures to our auditors and the audit committee of the board of directors about our internal control over financial reporting; and they have included information in our quarterly and annual reports about their evaluation and whether there have been changes in our internal control over financial reporting or in other factors that could materially affect internal control over financial reporting. We have existing policies, procedures and systems designed to comply with these regulations, and we are further enhancing and documenting such policies, procedures and systems to ensure continued compliance with these regulations.

Federal Securities Laws

The stock of Kaiser Federal Financial Group, Inc. is registered with the SEC under the Securities Exchange Act of 1934, as amended. Kaiser Federal Financial Group, Inc. is subject to the information, proxy solicitation, insider trading restrictions and other requirements of the SEC under the Securities Exchange Act of 1934.

Kaiser Federal Financial Group, Inc. stock held by persons who are affiliates of Kaiser Federal Financial Group, Inc. may not be resold without registration unless sold in accordance with certain resale restrictions. Affiliates are generally considered to be officers, directors and principal stockholders. If Kaiser Federal Financial Group, Inc. meets specified current public information requirements, each affiliate of Kaiser Federal Financial Group, Inc. will be able to sell in the public market, without registration, a limited number of shares in any three-month period.

Federal Taxation

General. Kaiser Federal Financial Group, Inc. and Kaiser Federal Bank are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to Kaiser Federal Financial Group, Inc. or Kaiser Federal Bank.

Kaiser Federal Financial Group, Inc. and Kaiser Federal Bank are not currently under audit with respect to their federal income tax returns and their federal income tax returns have not been audited for the past five years.

Method of Accounting. For federal income tax purposes, Kaiser Federal Financial Group, Inc. currently reports its income and expenses on the accrual method of accounting and uses a tax year ending June 30 for filing its federal and state income tax returns.

Alternative Minimum Tax. The Internal Revenue Code of 1986, as amended, imposes an alternative minimum tax (“AMT”) at a rate of 20% on a base of regular taxable income plus certain tax preferences (“alternative minimum taxable income” or “AMTI”). The AMT is payable to the extent such AMTI is in excess of an exemption amount and the AMT exceeds the regular income tax. Net operating losses can offset no more than 90% of AMTI. Certain payments of AMT may be used as credits against regular tax liabilities in future years. Kaiser Federal Financial Group, Inc. and Kaiser Federal Bank have been subject to the AMT but currently have no such amounts available as credits for carryover.

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Net Operating Loss Carryovers. Generally, a financial institution may carry back net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years. However, as a result of recent legislation, subject to certain limitations, the carryback period for net operating losses incurred in 2009 or 2010 (but not both years) has been expanded to five years. At June 30, 2011, Kaiser Federal Bank had no net operating loss carryovers for federal income tax purposes.

Corporate Dividends-Received Deduction. Kaiser Federal Financial Group, Inc. may exclude from its federal taxable income 100% of dividends received from Kaiser Federal Bank as a wholly owned subsidiary.

Capital Loss Carryovers. Generally, a financial institution may carry back capital losses to the preceding three taxable years and forward to the succeeding five taxable years. At June 30, 2011, Kaiser Federal Financial Group, Inc. and its subsidiary have no capital loss carryovers.

State Taxation

Kaiser Federal Financial Group, Inc. and Kaiser Federal Bank are subject to the California Corporate (Franchise) tax which is assessed at the rate of 10.84%. For this purpose, taxable income generally means federal taxable income subject to certain modifications provided for in California law.

As a Maryland business corporation, Kaiser Federal Financial Group, Inc. is required to file annual returns and pay annual fees to the State of Maryland.

Item 1A. Risk Factors

The following are the most significant risk factors that could impact our business, financial results and results of operations. Investing in our common stock involves risks, including those described below. In addition to the risks and uncertainties described below, other risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition and results of operations. The value or market price of our common stock could decline due to any of these identified or other risks, and you could lose all or part of your investment.

Further deterioration of economic conditions in our primary market of California, could seriously impair the value of our loan portfolio and adversely affect our results of operations.

All our real estate loans are secured by properties located in California. Decreases in California real estate values beginning in 2008 and continuing through the current period have adversely affected the value of properties collateralizing our loans. As of June 30, 2011, 95.8% or $677.8 million of our loan portfolio consisted of loans secured by real estate. As a result of the weak economy in California, our levels of non-performing and delinquent loans are elevated as compared to historical levels. At June 30, 2011, loans delinquent 90 days or more totaled $9.0 million, or 1.3% of total loans compared to $6.2 million or 0.8% of total loans at June 30, 2009. At June 30, 2011, non-performing loans totaled $26.4 million, or 3.7% of total loans compared to $8.9 million, or 1.2% of total loans at June 30, 2009. In the event that we are required to foreclose on a property securing a mortgage loan or pursue other remedies in order to protect our investment, there can be no assurance that we will recover funds in an amount equal to any remaining loan balance as a result of prevailing general economic or local conditions, real estate values and other factors associated with the ownership of real property. As a result, the market value of the real estate or other collateral underlying the loans may not, at any given time, be sufficient to satisfy the outstanding principal amount of the loans. Consequently, we would sustain significant loan losses and potentially incur a higher provision for loan loss expense. Adverse changes in the economy may also have a negative effect on the ability of borrowers to make timely repayments of their loans, which could have an adverse impact on earnings. See "Item 1-Business- Market Area- Asset Quality."

Our loan portfolio possesses increased risk due to our level of multi-family residential real estate and commercial real estate loans which could increase our level of provision for loan losses.

Our outstanding multi-family residential real estate and commercial real estate loans accounted for 55.95% of our total loan portfolio as of June 30, 2011. Generally, management considers these types of loans to involve a higher degree of risk compared to permanent first mortgage loans on one-to-four family, owner occupied residential properties. These loans have higher risks than permanent loans secured by residential real estate for the following reasons:

Multi-Family Residential Real Estate Loans. These loans are underwritten on the income producing potential of the property, financial strength of the borrower and any guarantors. Repayment is dependent on income being generated in amounts sufficient to cover operating expenses and debt service. At June 30, 2011, 40.7% of our total loan portfolio consisted of multi-family loans, and we intend, subject to market conditions, to increase our origination of multi-family residential loans. A significant portion of our multi-family residential loans are relatively new or "unseasoned," and have not been outstanding for a sufficient period of time to demonstrate performance and indicate the potential risks in the loan portfolio.

Commercial Real Estate Loans. These loans are underwritten on the income producing potential of the property or the successful operation of the borrowers' or tenants' businesses, financial strength of the borrower and any guarantors. Repayment is dependent on income being generated in amounts sufficient to cover operating expenses and debt service.

Management plans to continue its increased emphasis on higher yielding products such as multi-family residential and as market conditions permit commercial real estate loans, while returning to a moderate growth of one-to-four family residential real estate loans. Many of our commercial and multi-family residential real estate loans are not fully amortizing and contain large balloon payments upon maturity. These balloon payments may require the borrower to either sell or refinance the underlying property in order to make the balloon payment. Further, commercial and multi-family residential real estate loans generally have relatively large balances to single borrowers or related groups of borrowers. Accordingly, if we make any errors in judgment in the collectability of our commercial and multi-family residential real estate loans or the valuation of underlying collateral, any resulting charge-offs may be larger on a per loan basis than those incurred with our residential or consumer loan portfolios. As a result of the above factors, management may determine it necessary to increase the level of provision for loan losses. Increased provisions for loan losses could negatively affect our results of operations.

Our loan portfolio possesses increased risk due to its amount of nonconforming loans.

A significant portion of our one-to-four family residential loans are nonconforming to secondary market requirements, and are therefore, not saleable to Freddie Mac or Fannie Mae. At June 30, 2011, about 18.4% of our one-to-four family residential loan portfolio consisted of loans that were considered nonconforming due to loan size. Included in non-accrual loans at June 30, 2011 were two loans totaling $1.3 million that were nonconforming due to each loan's principal amount.

As of June 30, 2011, we held in portfolio one-to-four family interest-only mortgage loans totaling $33.2 million or 4.7% of gross loans as compared to $45.3 million or 5.9% of gross loans at June 30, 2010. The interest rates on these loans are generally initially fixed for three, five, seven or ten year terms and then adjust in accordance with the terms of the loan to require payment of both principal and interest in order to amortize the loan for the remainder of the term. At June 30, 2011, $16.0 million of these loans convert to fully-amortizing status within the next five years. From February 2004 until February 2007, we originated or purchased interest-only loans ensuring the loans were underwritten at the fully indexed and fully amortized rate. During this period, we also purchased loans made to borrowers who provide limited or no documentation of income, known as stated income loans. A stated income loan is a loan where the borrower's income source is not subject to verification through the application process, but the reasonableness of the stated income is verified through review of other sources, such as compensation surveys. At June 30, 2011, we had $62.6 million in stated income loans, or 9.3% of gross loans, as compared to $75.2 million, or 9.8% of gross loans at June 30, 2010. Included in our stated income loans at June 30, 2011 were $8.2 million in interest-only loans. We have not purchased any one- to-four family loans since 2007.

Nonconforming one-to-four family residential loans are generally considered to have an increased risk of delinquency and foreclosure than conforming loans and may result in higher levels of provision for loan losses. For example, if the interest rate adjustment results in the borrower being unable to make higher payments of both interest and principal or to refinance the loan, we would be required to initiate collection efforts including foreclosure in order to protect our investment. The percentage of nonconforming loans that are either performing or less than 60 days delinquent at June 30, 2011 was 83.6% as compared to 88.7% at June 30, 2010. There can be no assurance that our nonconforming loan portfolio would not be adversely affected should regional and national economic conditions deteriorate further. In addition, there can be no assurance, that we will recover funds in an amount equal to any remaining loan balance. Consequently, we could sustain loan losses and potentially incur a higher provision for loan losses.

High loan-to-value ratios on a portion of our residential mortgage loan portfolio expose us to greater risk of loss.

Many of our residential mortgage loans are secured by liens on mortgage properties in which the borrowers have little or no equity because of the decline in home values in our market areas. Residential loans with high loan-to-value ratios will be more sensitive to declining property values than those with lower combined loan-to-value ratios and, therefore, may experience a higher incidence of default and severity of losses. In addition, if the borrowers sell their homes, such borrowers may be unable to repay their loans in full from the sale. As a result, these loans may experience higher rates of delinquencies, defaults and losses.

If the allowance for loan losses is not sufficient to cover actual losses, our results of operations may be negatively affected.

In the event that loan customers do not repay their loans according to their terms and the collateral security for the payments of these loans is insufficient to pay any remaining loan balance, we may experience significant loan losses. Such credit risk is inherent in the lending business, and failure to adequately assess such credit risk could have a material adverse affect on our financial condition and results of operations. Management makes various assumptions and judgments about the collectability of the loan portfolio, including the creditworthiness of the borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of the loans. In determining the amount of the allowance for loan losses, management reviews the loan portfolio and historical loss and delinquency experience, as well as overall economic conditions and peer data. If management's assumptions are incorrect, the allowance for loan losses may be insufficient to cover probable incurred losses in the loan portfolio, resulting in additions to the allowance. The allowance for loan losses is also periodically reviewed by our regulators, who may disagree with the allowance and require us to increase such amount. Additions to the allowance for loans losses would be made through increased provisions for loan losses and could negatively affect our results of operations. At June 30, 2011, our allowance for loan losses was $11.4 million, or 1.6% of total loans and 43.1% of non-performing loans as compared to $13.3 million, or 1.7% of total loans and 42.3% of non-performing loans at June 30, 2010.

If our non-performing assets continue to increase, our earnings will suffer.

At June 30, 2011, our non-performing assets totaled $27.2 million, which was an increase of $17.9 million or 190.7% over non-performing assets at June 30, 2009. Our non-performing assets adversely affect our net income in various ways. We do not record interest income on non-accrual loans or real estate owned. We must establish an allowance for loan losses that reserves for losses inherent in the loan portfolio that are both probable and reasonably estimable through current period provisions for loan losses. From time to time, we also write down the value of properties in our real estate owned portfolio to reflect changing market values. Additionally, there are legal fees associated with the resolution of problem assets as well as carrying costs such as taxes, insurance and maintenance related to our real estate owned. Further, the resolution of non-performing assets requires the active involvement of management, which can distract them from our overall supervision of operations and other income-producing activities. Finally, if our estimate of the allowance for loan losses is inadequate, we will have to increase the allowance for loan losses accordingly.

A major portion of our one-to-four family residential loan portfolio is serviced by third parties which limits our ability to foreclose on such loans and foreclosure is further limited by California law.

At June 30, 2011, $167.6 million or 59.4% of our one-to-four family residential loans were serviced by third parties. Of this amount, $13.1 million or 7.8% percent were non-performing. Our policy is to timely pursue our foreclosure rights to maximize our ability to obtain control of the property, however, our ability to implement this policy requires the timely cooperation of our third party servicers.

When a loan goes into default, it is the responsibility of the third party servicer to enforce the borrower's obligation to repay the outstanding indebtedness. In the event the borrower is unable to bring the loan current or a loan modification is not agreed to, the servicer is obligated to foreclose on the property on behalf of Kaiser Federal Bank. Due to a number of factors, including the high rate of loan delinquencies, we believe that our servicers have not vigorously pursued collection efforts on our behalf. We have attempted to exercise our rights under servicing agreements to have the loan servicing returned to us so that we can aggressively resolve the delinquency status of these loans. We have been unsuccessful in negotiating the transfer of these servicing rights to us and are currently pursuing legal action to obtain the transfer of these servicing rights.

The State of California has previously enacted laws that placed severe restrictions on the ability of a lender to foreclose on owner occupied real estate securing one-to-four family residential loans. This added 90 days to the standard timeline for foreclosures of most owner occupied single family mortgages. Other similar bills placing additional temporary moratoriums on foreclose sales otherwise modifying the foreclosure procedures to the benefit of borrowers and the detriment of lenders may be enacted by the United State Congress or the State of California in the future.

Delays in our ability to foreclose on property, whether caused by restrictions under state or federal law or the failure of a third party servicer to timely pursue foreclosure action, can increase our potential loss on such property, due to other factors such as lack of maintenance, unpaid property taxes and adverse changes in market conditions. These delays may adversely affect our ability to limit our credit losses.

If property taken into real estate owned is not properly valued or sufficiently reserved to cover actual losses, or if we are required to increase our valuation reserves, our earnings could be reduced.

We obtain updated valuations in the form of appraisals and broker price opinions when a loan has been foreclosed and the property is transferred to real estate owned, and at certain other times during the asset's holding period. Our net book value in the loan at the time of foreclosure and thereafter is compared to the lower of adjusted cost basis or updated market value of the foreclosed property less estimated selling costs (fair value). A charge-off is recorded for any excess in the asset's net book value over its fair value when the loan is transferred to real estate owned. If our valuation determination is inaccurate, the fair value of our investments in real estate may not be sufficient to recover our net book value in such assets, resulting in the need for additional charge-offs. Additional charge-offs to our investments in real estate could have an adverse effect on our financial condition and results of operations.

In addition, bank regulators periodically review our real estate owned and may require us to recognize further charge-offs. Any increase in our charge-offs, as required by such regulators, may have an adverse effect on our financial condition and results of operations.

Our litigation related costs might continue to increase.

We are subject to a variety of legal proceedings that have arisen in the ordinary course of business. In the current economic environment, our involvement in litigation has increased significantly, primarily as a result of the increase in our non-performing assets. In addition, we may incur additional litigation costs related to our seeking to terminate certain third-party loan servicers. There can be no assurance that our loan workout and other activities will not result in increased litigation expense that may have a material adverse effect on our profitability.

We depend on our management team to implement our business strategy and execute successful operations and we could be harmed by the loss of their services.

We are dependent upon the services of our senior management team. Our strategy and operations are directed by the senior management team. Any loss of the services of the President and Chief Executive Officer or other members of the management team could impact our ability to implement our business strategy, and have a material adverse effect on our results of operations and our ability to compete in our markets.

Strong competition in our primary market area may reduce our ability to attract and retain deposits and also may increase our cost of funds.

We operate in a very competitive market for the attraction of deposits, the primary source of our funding. Historically, our most direct competition for deposits has come from credit unions, community banks, large commercial banks and thrift institutions within our primary market areas. In recent years competition has also come from institutions that largely deliver their services over the internet. Such competitors have the competitive advantage of lower infrastructure costs. Particularly in times of extremely low or extremely high interest rates, we have faced significant competition for investors' funds from short-term money market securities and other corporate and government securities. During periods of regularly increasing interest rates, competition for interest bearing deposits increases as customers, particularly certificate of deposit customers, tend to move their accounts between competing businesses to obtain the highest rates in the market. As a result, Kaiser Federal Bank incurs a higher cost of funds in an effort to attract and retain customer deposits. We strive to grow our lower cost deposits, such as non-interest bearing checking accounts, in order to reduce our cost of funds.

Strong competition in our primary market area may reduce our ability to originate loans and also decrease our yield on loans.

We are located in a competitive market that affects our ability to obtain loans through origination as well as originating them at rates that provide an attractive yield. Competition for loans comes principally from mortgage bankers, commercial banks, other thrift institutions and credit unions. Internet based lenders have also become a greater competitive factor in recent years. Such competition for the origination of loans may limit future growth and earnings prospects.

Changes in interest rates could adversely affect our results of operations and financial condition.

Our results of operations and financial condition are significantly affected by changes in interest rates. Our results of operations depend substantially on our net interest income, which is the difference between the interest income we earn on our interest-earning assets, such as loans and securities, and the interest expense we pay on our interest-bearing liabilities, such as deposits and borrowings. Because our interest-bearing liabilities generally reprice or mature more quickly than our interest-earning assets, an increase in interest rates generally would result in a decrease in net interest income.

Changes in interest rates may also affect the average life of loans and mortgage-related securities. Decreases in interest rates can result in increased prepayments of loans and mortgage-related securities, as borrowers refinance to reduce their borrowing costs. Under these circumstances, we are subject to reinvestment risk to the extent that we are unable to reinvest the cash received from such prepayments at rates that are comparable to the rates on existing loans and securities. Additionally, increases in interest rates may decrease loan demand and make it more difficult for borrowers to repay adjustable rate loans. Also, increases in interest rates may extend the life of fixed-rate assets, which would restrict our ability to reinvest in higher yielding alternatives, and may result in customers withdrawing certificates of deposit early so long as the early withdrawal penalty is less than the additional interest they could receive on an alternative investment.

If our investment in the Federal Home Loan Bank of San Francisco becomes impaired, our earnings and stockholders' equity could decrease.

We are required to own common stock of the Federal Home Loan Bank of San Francisco to qualify for membership in the Federal Home Loan Bank System and to be eligible to borrow funds under the Federal Home Loan Bank's advance program. Our investment in Federal Home Loan Bank common stock as of June 30, 2011 was $10.3 million. Federal Home Loan Bank common stock is not a marketable security and can only be redeemed by the Federal Home Loan Bank.

Federal Home Loan Banks may be subject to accounting rules and asset quality risks that could materially lower their regulatory capital. In an extreme situation, it is possible that the capitalization of a Federal Home Loan Bank, including the Federal Home Loan Bank of San Francisco, could be substantially diminished or reduced to zero. Furthermore, Standard and Poor's recently downgraded the credit rating of ten of the twelve Federal Home Loan Banks, including the Federal Home Loan Bank of San Francisco. Consequently, there is a risk that our investment in Federal Home Loan Bank of San Francisco common stock could be deemed impaired at some time in the future, and if this occurs, it would cause our earnings and stockholders' equity to decrease by the amount of the impairment charge.

The United States economy remains weak and unemployment levels are high. A prolonged recession, especially one affecting our geographic market area, will adversely affect our business and financial results.

The United States experienced a severe economic recession in the past few years, which effects have continued into 2011. Recent growth has been slow and unemployment remains at very high levels and is not expected to improve in the near future. Loan portfolio quality has deteriorated at many financial institutions reflecting, in part, the weak United States economy and high unemployment rates. In addition, the value of real estate collateral supporting many commercial loans and home mortgages has declined and may continue to decline, increasing the risk that we would incur losses if borrowers default on their loans. Bank and bank holding company stock prices have declined substantially, and it is significantly more difficult for banks and bank holding companies to raise capital or borrow funds.

The FDIC Quarterly Banking Profile has reported that non-performing assets as a percentage of assets for FDIC-insured financial institutions rose to 2.95% as of March 31, 2011, compared to 0.95% as of December 31, 2007. The NASDAQ Bank Index declined 34.0% between December 31, 2007 and June 30, 2011. At June 30, 2011, our non-performing assets as a percentage of total assets was 3.18%.

Continued negative developments in the financial services industry and the domestic and international credit markets may significantly affect the markets in which we do business, the market for and value of our loans and investments, and our ongoing operations, costs and profitability. Continued declines in both the volume of real estate sales and the sale price couple with the current recession and the associated increase in unemployment may result in higher than expected loan delinquencies or problem assets, a decline in demand for our products and services, or lack of growth or a decrease in deposits. These potential negative events may cause us to incur losses, adversely affect our capital, liquidity, financial condition and business operations. These declines may have a greater affect on our earnings and capital than on the earnings and capital of financial institutions whose loan portfolios are more diversified. Moreover, continued declines in the stock market in general, or stock values of financial institutions and their holding companies specifically, could adversely affect our stock performance.

The Standard & Poor’s downgrade in the U.S. Government’s sovereign credit rating, and in the credit ratings of instruments issued, insured or guaranteed by certain related institutions, agencies and instrumentalities, could result in risks to us and general economic conditions that we are not able to predict.

On August 5, 2011, Standard & Poor’s downgraded the United States’ long-term debt rating from its AAA rating to AA+. On August 8, 2011, Standard & Poor’s downgraded the credit ratings of certain long-term debt instruments issued by Fannie Mae and Freddie Mac and other U.S. government agencies linked to long-term U.S. debt. Instruments of this nature are key assets on the balance sheets of financial institutions, including Kaiser Federal Bank. These downgrades could adversely affect the market value of such instruments, and could adversely impact our ability to obtain funding that is collateralized by affected instruments, as well as affecting the pricing of that funding when it is available. We cannot predict if, when or how these changes to the credit ratings will affect economic conditions. However, these ratings downgrades could result in a significant adverse impact to us, and could exacerbate the other risks to which we subject, including those described herein.

We operate in a highly regulated environment and may be adversely affected by changes in laws and regulations.

We are currently subject to extensive regulation, supervision and examination by the OCC, the Federal Reserve Board and the FDIC. Such regulators govern the activities in which we may engage, primarily for the protection of depositors and the Deposit Insurance Fund. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the ability to impose restrictions on a bank’s operations, reclassify assets, determine the adequacy of a bank’s allowance for loan losses and determine the level of deposit insurance premiums assessed. New financial reform legislation, entitled the Dodd-Frank Wall Street Reform and Consumer Protection Act has been enacted by Congress and took effect on July 21, 2011 changing the bank regulatory framework, creating an independent consumer protection bureau that assumed the consumer protection responsibilities of the various federal banking agencies, and will establish more stringent capital standards for banks and bank holding companies. The legislation will also result in new regulations affecting the lending, funding, trading and investment activities of banks and bank holding companies. Any further changes in such regulation and oversight, whether in the form of regulatory policy, new regulations or legislation or additional deposit insurance premiums could have a material impact on our operations. Because our business is highly regulated, the laws and applicable regulations are subject to frequent change. Any new laws, rules and regulations could make compliance more difficult or expensive or otherwise adversely affect our business, financial condition or prospects.

Financial reform legislation which took effect on July 21, 2011 has, among other things, eliminated the OTS, will tighten capital standards, created a new Consumer Financial Protection Bureau and will result in new laws and regulations that are expected to increase our costs of operations.

The Dodd-Frank Act has significantly changed the former bank regulatory structure and affected the lending, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act eliminated our former primary federal regulator, the OTS, and required Kaiser Federal Bank to be regulated by the Office of the Comptroller of the Currency (the primary federal regulator for national banks) as of July 21, 2011. The Dodd-Frank Act also authorizes the Board of Governors of the Federal Reserve System to supervise and regulate all savings and loan holding companies like the Company, in addition to bank holding companies which it previously regulated. As a result, the Federal Reserve Board's current regulations applicable to bank holding companies, including holding company capital requirements, will apply to savings and loan holding companies following a five year phase in period for holding company capital requirements. These capital requirements will be substantially similar to the capital requirements currently applicable to Kaiser Federal Bank, as described in "How We Are Regulated—Federal Banking Regulation—Capital Requirements." The Dodd-Frank Act also requires the Federal Reserve Board to set minimum capital levels for bank holding companies that are as stringent as those required for the insured depository subsidiaries, and the components of Tier 1 capital would be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions. Bank and savings and loan holding companies with assets of less than $500 million are exempt from these capital requirements. Under the Dodd-Frank Act, the proceeds of trust preferred securities are excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by bank or savings and loan holding companies with less than $15 billion of assets. The legislation also establishes a floor for capital of insured depository institutions that cannot be lower than the standards in effect when the law was enacted, and directs the federal banking regulators to implement new leverage and capital requirements within 18 months that take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives.

The Dodd-Frank Act also created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions such as Kaiser Federal Bank, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets will continue to be examined by their applicable bank regulators, in the Bank's case, the Office of the Comptroller of the Currency. The new legislation also weakened the federal preemption available for national banks and federal savings associations, and gave state attorneys general the ability to enforce applicable federal consumer protection laws.

The legislation also broadened the base for FDIC insurance assessments. Assessments are now based on an institution's average consolidated total assets less tangible equity capital. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor, retroactive to January 1, 2009, and non-interest bearing transaction accounts have unlimited deposit insurance through December 31, 2013. The Dodd-Frank Act increased stockholder influence over boards of directors by requiring companies to give stockholders a non-binding vote on executive compensation and so-called "golden parachute" payments, and by authorizing the SEC to promulgate rules that would allow stockholders to nominate their own candidates using a company's proxy materials. The legislation also directed the Federal Reserve Board to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded or not. The Dodd-Frank Act provided for originators of certain securitized loans to retain a percentage of the risk for transferred loans, directed the Federal Reserve Board to regulate pricing of certain debit card interchange fees and contained a number of reforms related to mortgage origination.

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It is difficult to predict at this time what effect the new legislation and implementing regulations will have on community banks, including the lending and credit practices of such banks. Moreover, the legislation requires various federal agencies to promulgate numerous and extensive implementing regulations over the next several years. Although the substance and scope of these regulations cannot be determined at this time, it is expected that the legislation and implementing regulations, particularly those relating to the new Consumer Financial Protection Bureau, may curtail our revenue opportunities and increase our operating and compliance costs, and could require us to hold higher levels of regulatory capital and/or liquidity or otherwise adversely affect our business or financial results in the future.

Changes in laws and regulations and the cost of regulatory compliance with new laws and regulations may adversely affect our operations and our income.

In response to the financial crisis over the past few years, Congress has taken actions that are intended to strengthen confidence and encourage liquidity in financial institutions, and the FDIC has taken actions to increase insurance coverage on deposit accounts. The Dodd-Frank Act and implementing regulations are likely to have a significant effect on the financial services industry, which are likely to increase operating costs and reduce profitability. In addition, there have been proposals made by members of Congress and others that would reduce the amount delinquent borrowers are otherwise contractually obligated to pay on their mortgage loans and limit an institution's ability to foreclose on mortgage collateral.

The potential exists for additional federal or state laws and regulations, or changes in policy, affecting lending and funding practices and liquidity standards. Moreover, bank regulatory agencies have been active in responding to concerns and trends identified in examinations, and have issued many formal enforcement orders requiring capital ratios in excess of regulatory requirements. Bank regulatory agencies, such as the OCC, the Federal Reserve Board and the FDIC, govern the activities in which we may engage, primarily for the protection of depositors, and not for the protection or benefit of potential investors. In addition, new laws and regulations may increase our costs of regulatory compliance and of doing business, and otherwise affect our operations. New laws and regulations may significantly affect the markets in which we do business, the markets for and value of our loans and investments, the fees we can charge, and our ongoing operations, costs and profitability. Legislative proposals limiting our rights as a creditor could result in credit losses or increased expense in pursuing our remedies as a creditor.

System failure or breaches of our network security could subject us to increased operating costs as well as litigation and other liabilities.

The computer systems and network infrastructure we use could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from physical theft, fire, power loss, telecommunications failure or a similar catastrophic event, as well as from security breaches, denial of service attacks, viruses, worms and other disruptive problems caused by hackers. Any damage or failure that causes an interruption in our operations could have a material adverse effect on our financial condition and results of operations. Computer break-ins, phishing and other disruptions could also jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us and may cause existing and potential customers to refrain from doing business with us. Although we, with the help of third-party service providers, intend to continue to implement security technology and establish operational procedures to prevent such damage, there can be no assurance that these security measures will be successful. In addition, advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms we and our third-party service providers use to encrypt and protect customer transaction data. A failure of such security measures could have a material adverse effect on our financial condition and results of operations.

Changes in our accounting policies or in accounting standards could materially affect how we report our financial condition and operating results.

Our accounting policies are essential to understanding our financial results and condition. Some of these policies require the use of estimates and assumptions that may affect the value of our assets or liabilities and financial results. Some of our accounting policies are critical because they require management to make difficult, subjective, and complex judgments about matters that are inherently uncertain and because it is likely that materially different amounts would be reported under different conditions or using different assumptions. If such estimates or assumptions underlying our financial statements are incorrect, we may experience material losses.

From time to time, the Financial Accounting Standards Board and the Securities Exchange Commission change the financial accounting and reporting standards or the interpretation of those standards that govern the preparation of our external financial statements. These changes are beyond our control, can be hard to predict and could materially impact how we report our results of operations and financial condition. We could be required to apply a new or revised standard retroactively, resulting in our restating prior period financial statements in material amounts.

The need to account for certain assets and liabilities at estimated fair value may adversely affect our results of operations.

We report certain assets, including securities, at fair value. Generally, for assets that are reported at fair value, we use quoted market prices or valuation models that utilize observable market inputs to estimate fair value. Because we carry these assets on our books at their estimated fair value, we may incur losses even if the asset in question presents minimal credit risk. Elevated delinquencies, defaults, and estimated losses from the disposition of collateral in our private-label mortgage-backed securities portfolio may require us to recognize additional other-than-temporary impairments in future periods with respect to our securities portfolio. The amount and timing of any impairment recognized will depend on the severity and duration of the decline in the estimated fair value of the securities and our estimation of the anticipated recovery period.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

At June 30, 2011, we had three full service offices and six financial service centers. Our financial service centers provide all the same services as a full service office except they do not dispense cash; however, cash is available from an ATM located on site. The net book value of our investment in premises, equipment and fixtures, excluding computer equipment, was $1.6 million at June 30, 2011.

The following table provides a list of our offices.

Location	Owned or Leased	Lease Expiration Date	Deposits at June 30, 2011 (In thousands)
HOME AND EXECUTIVE OFFICE 1359 North Grand Avenue (1) Covina, CA 91724	Leased	April 2020	$ 90,653
LOCATIONS: 252 South Lake Avenue (1) Pasadena, CA 91101	Leased	May 2015	65,709
3375 Scott Boulevard, Suite 312 (2) Santa Clara, CA 95054	Leased	May 2014	68,895
9714 Sierra Avenue, Suite 101 (2) Fontana, CA 92335	Leased	December 2014	48,870
8501 Van Nuys Boulevard (1) Panorama City, CA 91402	Leased	February 2016	133,524
251 Stonewood Street (2) Downey, CA 90241	Leased	March 2016	64,473
26640 Western Avenue, Suite N (2) Harbor City, CA 90710	Leased	March 2016	38,712
1118 N. Vermont Avenue (2) Los Angeles, CA 90029	Leased	November 2015	82,518