

TIMBERLAND BANCORP INC  
Form 10-K  
December 11, 2013

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

FORM 10-K

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

For the Fiscal Year Ended September 30, 2013

OR

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

Commission File Number: 0-23333

TIMBERLAND BANCORP, INC.  
(Exact name of registrant as specified in its charter)  
Washington  
(State or other jurisdiction of incorporation or organization)

91-1863696  
(I.R.S. Employer Identification Number)

624 Simpson Avenue, Hoquiam, Washington  
(Address of principal executive offices)

98550  
(Zip Code)

Registrant's telephone number, including area code: (360) 533-4747

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

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) YES X NO

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company  X

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

As of November 30, 2013, the registrant had 7,047,636 shares of common stock issued and outstanding. The aggregate market value of the common stock held by nonaffiliates of the registrant, based on the closing sales price of the registrant's common stock as quoted on the NASDAQ Global Market on March 31, 2013, was \$57.8 million (7,045,036 shares at \$8.21). For purposes of this calculation, common stock held by officers and directors of the registrant and the Timberland Bank Employee Stock Ownership Plan and Trust are considered nonaffiliates.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of Definitive Proxy Statement for the 2014 Annual Meeting of Stockholders (Part III).
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TIMBERLAND BANCORP, INC.  
 2013 ANNUAL REPORT ON FORM 10-K  
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As used throughout this report, the terms "we," "our," or "us," refer to Timberland Bancorp, Inc. and its consolidated subsidiary, unless the context otherwise requires.

## PART I

### Item 1. Business

#### General

Timberland Bancorp, Inc. (“Timberland Bancorp”, or the “Company”), a Washington corporation, was organized on September 8, 1997 for the purpose of becoming the holding company for Timberland Savings Bank, SSB (“Bank”) upon the Bank’s conversion from a Washington-chartered mutual savings bank to a Washington-chartered stock savings bank (“Conversion”). The Conversion was completed on January 12, 1998 through the sale and issuance of 13,225,000 shares of common stock by the Company. At September 30, 2013, on a consolidated basis, the Company had total assets of \$745.6 million, total deposits of \$608.3 million and total shareholders’ equity of \$89.7 million. The Company’s business activities generally are limited to passive investment activities and oversight of its investment in the Bank. Accordingly, the information set forth in this report, including consolidated financial statements and related data, relates primarily to the Bank and its subsidiary.

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

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

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

#### Corporate Overview

Preferred Stock Received in the Troubled Asset Relief Program (“TARP”) Capital Purchase Program (“CPP”). On December 23, 2008, the Company received \$16.64 million from the U.S. Treasury Department (“Treasury”) as a part of the Treasury’s CPP, which was established as part of the TARP. The Company sold 16,641 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (“Series A Preferred Stock”), with a liquidation value of \$1,000 per share and a related warrant to purchase 370,899 shares of the Company’s common stock at an exercise price of \$6.73 per share (subject to anti-dilution adjustments) at any time through December 23, 2018. The Series A Preferred Stock pays a 5.0% dividend through December 23, 2013, after which the rate increases to 9.0% until the preferred shares are redeemed by the Company.

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

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

During the year ended September 30, 2013, the Company purchased and retired 4,576 shares of its Series A Preferred Stock for \$4.32 million; a \$255,000 discount from the liquidation value. The discount from the liquidation value on the repurchased

shares was recorded as an increase to retained earnings and included in net income to common shareholders in the computation of net income per common share.

On November 19, 2013, the Company's Board of Directors approved the redemption of the remaining 12,065 shares of its Series A Preferred Stock, subject to obtaining regulatory approval. The Company has submitted an application to the Federal Reserve Bank of San Francisco ("FRB" or "Federal Reserve") for approval to redeem the Series A Preferred Stock.

**Agreements with Banking Regulators.** In December 2009, the FDIC and the DFI determined that the Bank required supervisory attention and agreed to terms on a Memorandum of Understanding (the "Bank MOU") with the Bank. The terms of the Bank MOU restricted the Bank from certain activities, and required that the Bank obtain the prior written approval, or non-objection, of the FDIC and/or the DFI to engage in certain activities. On December 12, 2012, the Bank was notified by the FDIC and the DFI that the Bank MOU had been rescinded.

In addition, on February 1, 2010, the FRB determined that the Company required additional supervisory attention and entered into a Memorandum of Understanding with the Company (the "Company MOU"). Under the Company MOU, the Company was required to obtain prior written approval, or non-objection, from the FRB to declare or pay any dividends, or make any other capital distributions; issue any trust preferred securities; or purchase or redeem any of its stock. On January 15, 2013, the Company was notified by the FRB that the Company MOU had been rescinded.

#### Market Area

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

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

For additional information, see "Item 2. Properties."

Hoquiam, with a population of approximately 9,000, is located in Grays Harbor County which is situated along Washington State's central Pacific coast. Hoquiam is located approximately 110 miles southwest of Seattle and 145 miles northwest of Portland, Oregon.

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

Grays Harbor County has a population of 72,000 according to the U.S. Census Bureau 2012 estimates and a median family income of \$55,400 according to 2013 estimates from the Department of Housing and Urban Development

("HUD"). The economic base in Grays Harbor County has been historically dependent on the timber and fishing industries. Other industries that support the economic base are tourism, agriculture, shipping, transportation and technology. According to the Washington State Employment Security Department, the unemployment rate in Grays Harbor County decreased to 11.0% at September 30, 2013 from 12.0% at September 30, 2012. The median price of a resale home in Grays Harbor County for the quarter ended September 30, 2013 increased 1.3% to \$126,900 from \$125,300 for the comparable prior year period. The number of home sales increased 47.0% for the quarter ended September 30, 2013 compared to the same quarter one year earlier. The Bank has six branches



(including its home office) located throughout the county. The downturn in Grays Harbor County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

Pierce County is the second most populous county in the state and has a population of 812,000 according to the U.S. Census Bureau 2012 estimates. The county's median family income is \$70,200 according to 2013 HUD estimates. The economy in Pierce County is diversified with the presence of military related government employment (Joint Base Lewis-McChord), transportation and shipping employment (Port of Tacoma), and aerospace related employment (Boeing). According to the Washington State Employment Security Department, the unemployment rate for the Pierce County area decreased to 7.7% at September 30, 2013 from 8.5% at September 30, 2012. The median price of a resale home in Pierce County for the quarter ended September 30, 2013 increased 11.6% to \$228,300 from \$204,600 for the comparable prior year period. The number of home sales increased 36.1% for the quarter ended September 30, 2013 compared to the same quarter one year earlier. The Bank has five branches in Pierce County and these branches have historically been responsible for a substantial portion of the Bank's construction lending activities. The downturn in Pierce County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

Thurston County has a population of 258,000 according to the U.S. Census Bureau 2012 estimates and a median family income of \$77,300 according to 2013 HUD estimates. Thurston County is home of Washington State's capital (Olympia) and its economic base is largely driven by state government related employment. According to the Washington State Employment Security Department, the unemployment rate for the Thurston County area decreased to 6.7% at September 30, 2013 from 7.4% in 2012. The median price of a resale home in Thurston County for the quarter ended September 30, 2013 increased 4.8% to \$228,300 from \$217,800 for the same quarter one year earlier. The number of home sales increased 19.4% for the quarter ended September 30, 2013 compared to the same quarter one year earlier. The Bank has five branches in Thurston County. This county has historically had a stable economic base primarily attributable to the state government presence; however the downturn in Thurston County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

Kitsap County has a population of 255,000 according to the U.S. Census Bureau 2012 estimates and a median family income of \$73,100 according to 2013 HUD estimates. The Bank has two branches in Kitsap County. The economic base of Kitsap County is largely supported by military related government employment through the United States Navy. According to the Washington State Employment Security Department, the unemployment rate for the Kitsap County area decreased to 6.4% at September 30, 2013 from 7.1% at September 30, 2012. The median price of a resale home in Kitsap County for the quarter ended September 30, 2013 decreased 0.6% to \$248,200 from \$249,800, for the same quarter one year earlier. The number of home sales increased 30.9% for the quarter ended September 30, 2013 compared to the same quarter one year earlier. The downturn in Kitsap County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

King County is the most populous county in the state and has a population of 2.0 million according to the U.S. Census Bureau 2012 estimates. The Bank has one branch in King County. The county's median family income is \$86,700 according to 2013 HUD estimates. King County's economic base is diversified with many industries including shipping, transportation, aerospace (Boeing), computer technology and biotech industries. According to the Washington State Employment Security Department, the unemployment rate for the King County area decreased to 5.6% at September 30, 2013 from 6.9% at September 30, 2012. The median price of a resale home in King County for the quarter ended September 30, 2013 increased 15.3% to \$438,000 from \$379,900, for the same quarter one year earlier. The number of home sales increased 24.9% for the quarter ended September 30, 2013 compared to the same quarter one year earlier.

Lewis County has a population of 76,000 according to the U.S. Census Bureau 2012 estimates and a median family income of \$55,400 according to 2013 HUD estimates. The economic base in Lewis County is supported by

manufacturing, retail trade, local government and industrial services. According to the Washington State Employment Security Department, the unemployment rate in Lewis County decreased to 10.5% at September 30, 2013 from 11.8% at September 30, 2012. The median price of a resale home in Lewis County for the quarter ended September 30, 2013 increased 2.7% to 146,800 from \$142,900, for the same quarter one year earlier. The number of home sales increased 44.1% for the quarter ended September 30, 2013 compared to the same quarter one year earlier. The Bank currently has three branches located in Lewis County. The downturn in Lewis County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

#### Lending Activities

General. Historically, the principal lending activity of the Bank has consisted of the origination of loans secured by first mortgages on owner-occupied, one- to four-family residences, or by commercial real estate and loans for the construction of one-

to four-family residences. During the past several years, the Bank adjusted its lending strategy and began reducing its exposure to speculative construction and land development lending as well as land loans. The Bank's net loans receivable, including loans held for sale, totaled \$548.1 million at September 30, 2013, representing 73.5% of consolidated total assets, and at that date commercial real estate, construction and land development loans (including undisbursed loans in process), and land loans were \$367.6 million, or 63.4%, of total loans. Construction and land development loans, land loans and commercial real estate loans typically have higher rates of return than one- to four-family loans; however, they also present a higher degree of risk. See “-Lending Activities - Commercial Real Estate Lending,” “- Lending Activities - Construction and Land Development Lending” and “- Lending Activities - Land Lending.”

The Bank's internal loan policy limits the maximum amount of loans to one borrower to 25% of its Tier 1 capital. At September 30, 2013, the maximum amount which the Bank could have lent to any one borrower and the borrower's related entities was approximately \$20.6 million under this policy. At September 30, 2013, the largest amount outstanding to any one borrower and the borrower's related entities was \$15.9 million which was secured by commercial buildings located in Pierce and Kitsap counties. These loans were all performing according to their loan repayment terms at September 30, 2013. The next largest amount outstanding to any one borrower and the borrower's related entities was \$8.8 million. These loans were secured by a multi-family building, a commercial building, several one- to four-family properties, and several land parcels. All of the loans were secured by properties located in Grays Harbor County, except for a \$1.7 million multi-family loan secured by property located in Clark County and \$289,000 secured by a single family property and a land parcel located in Clatsop County, Oregon. These loans were performing according to their loan repayment terms at September 30, 2013.

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

	At September 30,		2012		2011		2010		2009	
	2013	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
(Dollars in thousands)										
Mortgage Loans:										
One- to four-family(1)	\$104,298	18.00 %	\$106,979	18.82 %	\$114,680	20.47 %	\$121,014	21.65 %	\$110,556	18.58 %
Multi-family	51,108	8.82	47,521	8.36	30,982	5.53	32,267	5.77	25,638	4.31
Commercial	291,297	50.27	256,254	45.08	246,037	43.92	208,002	37.21	188,205	31.62
Construction and land development	45,136	7.79	56,406	9.92	52,484	9.37	69,271	12.39	139,728	23.48
Land	31,144	5.37	39,655	6.98	49,236	8.79	62,999	11.27	65,642	11.03
Total mortgage loans	522,983	90.25	506,815	89.16	493,419	88.08	493,553	88.29	529,769	89.02
Consumer Loans:										
Home equity and second mortgage	33,014	5.70	32,814	5.77	36,008	6.43	38,418	6.87	41,746	7.01
Other	5,981	1.03	6,183	1.10	8,240	1.47	9,086	1.62	9,827	1.66
Total consumer loans	38,995	6.73	38,997	6.87	44,248	7.90	47,504	8.49	51,573	8.67
Commercial business loans	17,499	3.02	22,588	3.97	22,510	4.02	17,979	3.22	13,775	2.31
Total loans	579,477	100.00 %	568,400	100.00 %	560,177	100.00 %	559,036	100.00 %	595,117	100.00 %
Less:										
Undisbursed portion of construction loans in process	(18,527 )		(16,325 )		(18,265 )		(17,952 )		(31,298 )	
Deferred loan origination fees	(1,710 )		(1,770 )		(1,942 )		(2,229 )		(2,439 )	
Allowance for loan losses	(11,136 )		(11,825 )		(11,946 )		(11,264 )		(14,172 )	
Total loans receivable, net	\$548,104		\$538,480		\$528,024		\$527,591		\$547,208	

(1) Includes loans held-for-sale of \$1.9 million, \$1.4 million, \$4.0 million, \$3.0 million and \$630,000 at September 30, 2013, 2012, 2011, 2010 and 2009, respectively.



Residential One- to Four-Family Lending. At September 30, 2013, \$104.3 million, or 18.0%, of the Bank's loan portfolio consisted of loans secured by one- to four-family residences. The Bank originates both fixed-rate loans and adjustable-rate loans.

Generally, one- to four-family fixed-rate loans and five and seven year balloon reset loans (which are loans that are originated with a fixed interest rate for the initial five or seven years, and thereafter incur one interest rate change in which the new rate remains in effect for the remainder of the loan term) are originated to meet the requirements for sale in the secondary market to the Federal Home Loan Mortgage Corporation ("Freddie Mac"). From time to time, however, a portion of these fixed-rate loans, which include five and seven year balloon reset loans, may be retained in the loan portfolio to meet the Bank's asset/liability management objectives. The Bank uses an automated underwriting program, which preliminarily qualifies a loan as conforming to Freddie Mac underwriting standards when the loan is originated. At September 30, 2013, \$41.4 million, or 39.7%, of the Bank's one- to four-family loan portfolio consisted of fixed-rate mortgage loans.

The Bank also offers adjustable-rate mortgage ("ARM") loans. All of the Bank's ARM loans are retained in its loan portfolio. The Bank offers several ARM products which adjust annually after an initial period ranging from one to five years and are typically subject to a limitation on the annual interest rate increase of 2% and an overall limitation of 6%. These ARM products generally are priced utilizing the weekly average yield on one year U.S. Treasury securities adjusted to a constant maturity of one year plus a margin of 2.88% to 4.00%. The Bank also offers ARM loans tied to the prime rate or to the London Inter-Bank Offered Rate ("LIBOR") indices which typically do not have periodic, or lifetime adjustment limits. Loans tied to these indices normally have margins ranging up to 3.5%. ARM loans held in the Bank's portfolio do not permit negative amortization of principal. Borrower demand for ARM loans versus fixed-rate mortgage loans is a function of the level of interest rates, the expectations of changes in the level of interest rates and the difference between the initial interest rates and fees charged for each type of loan. The relative amount of fixed-rate mortgage loans and ARM loans that can be originated at any time is largely determined by the demand for each in a competitive environment. At September 30, 2013, \$62.9 million, or 60.3%, of the Bank's one- to four- family loan portfolio consisted of ARM loans.

A portion of the Bank's ARM loans are "non-conforming" because they do not satisfy acreage limits, or various other requirements imposed by Freddie Mac. Some of these loans are also originated to meet the needs of