TIMBERLAND BANCORP INC
Form 10-K
December 11, 2013

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

FORM 10-K

[X]	ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the Fiscal Year Ended September 30, 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	91-1863696
(State or other jurisdiction of incorporation or organization)	(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 of Section 15(d) of the Act. YES NO X

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

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

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

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

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

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

As of November 30, 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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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. 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.

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,									
	2013		2012		2011		2010		2009	
	Amount	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.

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

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

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

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

The Bank's lending policies generally limit the maximum loan-to-value ratio on mortgage loans secured by owner-occupied properties to 95% of the lesser of the appraised value or the purchase price. However, the Bank usually obtains private mortgage insurance ("PMI") on the portion of the principal amount that exceeds 80% of the appraised value of the security property. The maximum loan-to-value ratio on mortgage loans secured by non-owner-occupied properties is generally 80% (90% for loans originated for sale in the secondary market to Freddie Mac). At September 30, 2013, 31 single family loans totaling $7.0 million were on non-accrual status. See "- Lending Activities - Non-performing Loans and Delinquencies."

Construction and Land Development Lending. Prompted by unfavorable economic conditions in its primary market area in the 1980s, the Bank sought to establish a market niche and, as a result, began originating construction loans outside of Grays Harbor County. In recent periods, construction lending activities have been primarily in the Pierce, King, Thurston, Grays Harbor, and Kitsap County markets although, as a result of the current economic environment, the Bank has sharply curtailed speculative construction and land development lending.

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

At September 30, 2013 and 2012, the composition of the Bank's construction and land development loan portfolio was as follows:

	At September 30,					
	2013			2012		
	Outstanding Balance	Percent of Total		Outstanding Balance	Percent of Total	
	(Dollars in thousands)					
Custom and owner/builder	$40,811	90.42	%	$33,345	59.12	%
Speculative one-to four-family	1,428	3.16		1,880	3.33	
Multi-family (including condominium)	143	0.32		345	0.61	
Commercial real estate	2,239	4.96		20,247	35.90	
Land development	515	1.14		589	1.04	
Total	$45,136	100.00	%	$56,406	100.00	%

Custom construction loans are made to home builders who, at the time of construction, have a signed contract with a home buyer who has a commitment to purchase the finished home. Custom construction loans are generally originated for a term of six to 12 months, with fixed interest rates currently ranging from 5.75% to 7.88% and with loan-to-value ratios of 80% of the appraised estimated value of the completed property or sales price, whichever is less.

Owner/builder construction loans are originated to home owners rather than home builders and are typically converted to or refinanced into permanent loans at the completion of construction. The construction phase of an owner/builder construction loan generally lasts up to 12 months with fixed interest rates currently ranging from 5.75% to 7.88%, and with loan-to-value ratios of 80% (or up to 95% with PMI) of the appraised estimated value of the completed property. At the completion of construction, the loan is converted to or refinanced into either a fixed-rate mortgage loan, which conforms to secondary market standards, or an ARM loan for retention in the Bank's portfolio. At September 30, 2013, custom and owner/builder construction loans totaled $40.8 million, or 90.4%, of the total construction and land development loan portfolio. At September 30, 2013, the largest outstanding custom and owner/builder construction loan had an outstanding balance of $1.5 million (including $658,000 of undisbursed loans in process) and was performing according to its repayment terms.

Speculative one-to four-family construction loans are made to home builders and are termed “speculative” because the home builder does not have, at the time of loan origination, a signed contract with a home buyer who has a commitment for permanent financing with either the Bank or another lender for the finished home. The home buyer may be identified either during or after the construction period, with the risk that the builder will have to debt service the speculative construction loan and finance real estate taxes and other carrying costs of the completed home for a significant time after the completion of construction until the home buyer is identified and a sale is consummated. Historically, the Bank has originated loans to approximately 50 builders located in the Bank's primary market areas, each of which generally would have one to eight speculative loans outstanding from the Bank during a 12 month period. Rather than originating lines of credit to home builders to construct several homes at once, the Bank generally originates and underwrites a separate loan for each home. Speculative construction loans are generally originated for a term of 12 months, with current rates averaging 6.50%, and with a loan-to-value ratio of no more than 80% of the appraised estimated value of the completed property. The Bank is currently originating speculative construction loans on a limited basis. At September 30, 2013, speculative construction loans totaled $1.4 million, or 3.2%, of the total construction and land development loan portfolio. At September 30, 2013, the Bank had two borrowers with an aggregate outstanding speculative loan balance of more than $500,000. The largest aggregate outstanding balance to one borrower for speculative construction loans, totaled $687,000 and was comprised of a single loan that was performing according to its restructured terms.

The Bank historically originated loans to real estate developers with whom it had established relationships for the purpose of developing residential subdivisions (i.e., installing roads, sewers, water and other utilities; generally with ten to 50 lots). The Bank is not currently originating any new land development loans. At September 30, 2013, the Bank had three land development loans totaling $515,000, or 1.1% of construction and land development loans receivable, which were not performing according to their terms and were on non-accrual status. Land development loans are secured by a lien on the property and typically were made for a period of two to five years with fixed or variable interest rates, and were made with loan-to-value ratios generally not exceeding 75%. Land development loans are generally structured so that the Bank is repaid in full upon the sale by the borrower of approximately 80% of the subdivision lots. A majority of the Bank's land development loans are secured by property located in its primary market areas. In addition, in the case of a corporate borrower, the Bank also generally obtains personal guarantees from corporate principals and reviews their personal financial statements.

Land development loans secured by land under development involve greater risks than one- to four-family residential mortgage loans because these loans are advanced upon the predicted future value of the developed property upon completion. If the estimate of the future value proves to be inaccurate, in the event of default and foreclosure the Bank may be confronted with a property the value of which is insufficient to assure full repayment. The Bank has historically attempted to minimize this risk by generally limiting the maximum loan-to-value ratio on land loans to 75% of the estimated developed value of the secured property. The Bank is not currently originating any new land development loans.

The Bank also provides construction financing for multi-family and commercial properties. At September 30, 2013, these loans amounted to $2.4 million, or 5.3% of construction and land development loans. These loans are secured by condominiums, apartment buildings, mini-storage facilities, office buildings, hotels and retail rental space predominantly located in the Bank's primary market area. At September 30, 2013, the largest outstanding multi-family construction loan was secured by an apartment building project in Pierce County and had a balance of $143,000 and was not performing according to its repayment terms. At September 30, 2013, the largest outstanding commercial real estate construction loan had a balance of $719,000. This loan was secured by a mixed use building being constructed in Thurston County and was performing according to its repayment terms.

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

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

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

Construction lending affords the Bank the opportunity to achieve higher interest rates and fees with shorter terms to maturity than does its single-family permanent mortgage lending. Construction lending, however, is generally considered to involve a higher degree of risk than single-family permanent mortgage lending because of the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost of the project. The nature of these loans is such that they are generally more difficult to evaluate and monitor. If the estimate of construction cost proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the project. If the estimate of value upon completion proves to be inaccurate, the borrower may be confronted with a project whose value is insufficient to assure full repayment and the Bank may incur a loss. Projects may also be jeopardized by disagreements between borrowers and builders and by the failure of builders to pay subcontractors. Loans to builders to construct homes for which no purchaser has been identified carry more risk because the payoff for the loan depends on the builder's ability to sell the property prior to the time that the construction loan is due. The Bank has sought to address these risks by adhering to strict underwriting policies, disbursement procedures, and monitoring practices. The Bank's construction loans are primarily secured by properties in its primary market area, and changes in the local and state economies and real estate markets have adversely affected the Bank's construction loan portfolio.

Multi-Family Lending. At September 30, 2013, the Bank had $51.1 million, or 8.8% of the Bank's total loan portfolio, secured by multi-family dwelling units (more than four units) located primarily in the Bank's primary market area. Multi-family loans are generally originated with variable rates of interest ranging from 2.00% to 3.50% over the one-year constant maturity U.S. Treasury Bill Index or a matched term FHLB advance, with principal and interest payments fully amortizing over terms of up to 30 years. At September 30, 2013 the Bank's largest multi-family loan had an outstanding principal balance of $7.3 million and was secured by an apartment building located in Thurston County. At September 30, 2013, this loan was performing according to its repayment terms.

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

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

Commercial Real Estate Lending. Commercial real estate loans totaled $291.3 million, or 50.3% of the total loan portfolio at September 30, 2013. The Bank originates commercial real estate loans generally at variable interest rates with principal and interest payments fully amortizing over terms of up to 30 years. These loans are secured by properties, such as restaurants, motels, mini-storage facilities, office buildings and retail/wholesale facilities, located in the Bank's primary market area. At September 30, 2013, the largest commercial real estate loan was secured by an office building in Grays Harbor County and had a balance of $6.4 million and was performing according to its terms. At September 30, 2013, eight commercial real estate loans totaling $3.4 million were on non-accrual status. See "- Lending Activities - Non-performing Loans and Delinquencies."

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

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

Land Lending. The Bank has historically originated loans for the acquisition of land upon which the purchaser can then build or make improvements necessary to build or to sell as improved lots. Currently the Bank is originating land loans on a limited basis and is attempting to decrease its land loan portfolio. At September 30, 2013, land loans totaled $31.1 million, or 5.4% of the Bank's total loan portfolio as compared to $39.7 million, or 7.0% of the Bank's total loan portfolio at September 30, 2012. Land loans originated by the Bank generally have maturities of five to ten years. The largest land loan had an outstanding balance of $3.7 million at September 30, 2013 and was performing according to its repayment terms. At September 30, 2013, 17 land loans totaling $2.4 million were not performing according to their repayment terms. See "- Lending Activities - Non-performing Loans and Delinquencies."

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

Consumer Lending. Consumer loans generally have shorter terms to maturity and higher interest rates than mortgage loans. Consumer loans include home equity lines of credit, second mortgage loans, savings account loans, automobile loans, boat loans, motorcycle loans, recreational vehicle loans and unsecured loans. Consumer loans are made with both fixed and variable interest rates and with varying terms. At September 30, 2013, consumer loans amounted to $39.0 million, or 6.7%, of the total loan portfolio.

At September 30, 2013, the largest component of the consumer loan portfolio consisted of second mortgage loans and home equity lines of credit, which totaled $33.0 million, or 5.7% of the total loan portfolio. Home equity lines of credit and second mortgage loans are made for purposes such as the improvement of residential properties, debt consolidation and education expenses, among others. The majority of these loans are made to existing customers and are secured by a first or second mortgage on residential property. The loan-to-value ratio is typically 80% or less, when taking into account both the first and second mortgage loans. Second mortgage loans typically carry fixed interest rates with a fixed payment over a term between five and 15 years. Home equity lines of credit are generally made at interest rates tied to the prime rate or the 26 week Treasury Bill. Second mortgage loans and home equity lines of credit have greater credit risk than one- to four-family residential mortgage loans because they are generally secured by mortgages subordinated to the existing first mortgage on the property, which may or may not be held by the Bank.

Consumer loans entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans. The Bank believes that these risks are not as prevalent in the case of the Bank's consumer loan portfolio because a large percentage of the portfolio consists of second mortgage loans and home equity lines of credit that are underwritten in a manner such that they result in credit risk that is substantially similar to one- to four-family residential mortgage loans. At September 30, 2013, five consumer loans totaling $536,000 were delinquent in excess of 90 days. See "- Lending Activities - Non-performing Loans and Delinquencies."

Commercial Business Lending. Commercial business loans totaled $17.5 million, or 3.0% of the loan portfolio at September 30, 2013. Commercial business loans are generally secured by business equipment, accounts receivable, inventory or other property and are made at variable rates of interest equal to a negotiated margin above the prime rate. The Bank also generally obtains personal guarantees from the principals based on a review of personal financial statements. The largest commercial business loan had an outstanding balance of $1.9 million at September 30, 2013 and was performing according to its repayment terms. At September 30, 2013, all commercial business loans were performing according to their repayment terms. See "- Lending Activities - Non-performing Loans and Delinquencies."

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

Loan Maturity. The following table sets forth certain information at September 30, 2013 regarding the dollar amount of loans maturing in the Bank's portfolio based on their contractual terms to maturity, but does not include scheduled payments or potential prepayments. Loans having no stated maturity and overdrafts are reported as due in one year or less.

	Within 1 Year	After 1 Year Through 3 Years	After 3 Years Through 5 Years	After 5 Years Through 10 Years	After 10 Years	Total
		(In thousands)				
Mortgage loans:						
One- to four-family (1)	$4,099	$3,075	$3,913	$10,679	$82,532	$104,298
Multi-family	391	5,465	4,718	39,751	783	51,108
Commercial	14,600	20,262	60,952	182,000	13,483	291,297
Construction and land development (2)	45,136	—	—	—	—	45,136
Land	7,239	11,701	9,363	1,582	1,259	31,144
Consumer loans:						
Home equity and second mortgage	4,059	4,255	4,349	9,909	10,442	33,014
Other	1,702	418	384	813	2,664	5,981
Commercial business loans	4,967	1,531	5,153	4,078	1,770	17,499
Total	$82,193	$46,707	$88,832	$248,812	$112,933	579,477
Less:						
Undisbursed portion of construction loans in process						(18,527)
Deferred loan origination fees						(1,710)
Allowance for loan losses						(11,136)
Loans receivable, net						$548,104

(1) Includes $1.9 million of loans held-for-sale.
(2) Includes construction/permanent loans that convert to permanent mortgage loans once construction is completed.

The following table sets forth the dollar amount of all loans due after one year from September 30, 2013, which have fixed interest rates and have floating or adjustable interest rates.

	Fixed Rates	Floating or Adjustable Rates	Total
	(In thousands)		
Mortgage loans:			
One- to four-family (1)	$38,005	$62,194	$100,199
Multi-family	9,115	41,602	50,717
Commercial	55,313	221,384	276,697
Construction and land development	—	—	—
Land	14,016	9,889	23,905
Consumer loans:			
Home equity and second mortgage	14,261	14,694	28,955
Other	3,595	684	4,279
Commercial business loans	4,917	7,615	12,532
Total	$139,222	$358,062	$497,284

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(1) Includes loans held-for-sale.

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

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

Loan applications are initiated by loan officers and are required to be approved by an authorized loan underwriter, one of the Bank's Loan Committees or the Bank's Board of Directors. The Bank's Consumer Loan Committee consists of three underwriters, each of whom can approve one- to four-family mortgage loans and other consumer loans up to and including the current Freddie Mac single-family limit. Certain consumer loans up to and including $25,000 may be approved by individual loan officers and the Bank's Consumer Lending Department Manager may approve consumer loans up to and including $75,000. The Bank's Regional Manager of Commercial Lending has individual lending authority for loans up to and including $250,000, excluding speculative construction loans and unsecured loans. The Bank's Commercial Loan Committee, which consists of the Bank's President, Chief Credit Administrator, Executive Vice President of Lending, Regional Manager of Community Lending, and Regional Manager of Commercial Lending, may approve commercial real estate loans and commercial business loans up to and including $1.5 million. The Bank's President, Chief Credit Administrator and Executive Vice President of Lending also have individual lending authority for loans up to and including $750,000. The Bank's Board Loan Committee, which consists of two rotating non-employee Directors and the Bank's President, may approve loans up to and including $3.0 million. Loans in excess of $3.0 million, as well as loans of any amount granted to a single borrower whose aggregate loans exceed $3.0 million, must be approved by the Bank's Board of Directors.

Loan Originations, Purchases and Sales. During the years ended September 30, 2013, 2012 and 2011, the Bank's total gross loan originations were $217.8 million, $228.3 million and $160.2 million, respectively. Periodically, the Bank purchases participation interests in construction and land development loans, commercial real estate loans, and multi-family loans, secured by properties generally located in Washington State, from other lenders. These purchases are underwritten to the Bank's underwriting guidelines and are without recourse to the seller other than for fraud. During the years ended September 30, 2013, 2012 and 2011, the Bank purchased loan participation interests of $43,000, $2.0 million and $187,000, respectively. See "- Lending Activities - Construction and Land Development Lending" and "- Lending Activities - Multi-Family Lending."

Consistent with its asset/liability management strategy, the Bank's policy generally is to retain in its portfolio all ARM loans originated and to sell fixed rate one- to four-family mortgage loans in the secondary market to Freddie Mac; however, from time to time, a portion of fixed-rate loans may be retained in the Bank's portfolio to meet its asset-liability objectives. Loans sold in the secondary market are generally sold on a servicing retained basis. At September 30, 2013, the Bank's loan servicing portfolio, which is not included in the Company's consolidated financial statements, totaled $325.7 million.

The Bank also periodically sells participation interests in construction and land development loans, commercial real estate loans, and land loans to other lenders. These sales are usually made to avoid concentrations in a particular loan type or concentrations to a particular borrower. During the years ended September 30, 2013 and 2012, the Bank sold loan participation interests to other lenders of $4.3 million and $3.6 million, respectively. The Bank did not sell any loan participation interests to other lenders during the year ended September 30, 2011.

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

	Year Ended September 30,		
	2013	2012	2011
Loans originated:	(In thousands)		
Mortgage loans:			
One- to four-family	$104,879	$103,887	$57,620
Multi-family	7,530	20,882	2,009
Commercial	50,314	48,450	38,262
Construction and land development	38,491	39,907	40,724
Land	1,853	1,858	3,793
Consumer	11,237	8,856	7,424
Commercial business loans	3,499	4,415	10,325
Total loans originated	217,803	228,255	160,157
Loans purchased:			
Mortgage loans:			
One- to four-family	—	—	187
Multi-family	43	56	—
Commercial business	—	1,955	—
Total loans purchased	43	2,011	187
Total loans originated and purchased	217,846	230,266	160,344
Loans sold:			
Partial loans sold	(4,263)	(3,600)	—
Whole loans sold	(89,352)	(97,357)	(62,480)
Total loans sold	(93,615)	(100,957)	(62,480)
Loan principal repayments	(113,154)	(121,086)	(96,723)
Other items, net	(1,453)	2,233	(708)
Net increase in loans receivable	$9,624	$10,456	$433

Loan Origination Fees. The Bank receives loan origination fees on many of its mortgage loans and commercial business loans. Loan fees are a percentage of the loan which are charged to the borrower for funding the loan. The amount of fees charged by the Bank is generally up to 2.0% of the loan amount. Current accounting principles generally accepted in the United States of America require fees received and certain loan origination costs for originating loans to be deferred and amortized into interest income over the contractual life of the loan. Net deferred fees or costs associated with loans that are prepaid are recognized as income at the time of prepayment. Unamortized deferred loan origination fees totaled $1.7 million at September 30, 2013.

Non-performing Loans and Delinquencies. The Bank assesses late fees or penalty charges on delinquent loans of approximately 5% of the monthly loan payment amount. A majority of loan payments are due on the first day of the month; however, the borrower is given a 15 day grace period to make the loan payment. When a mortgage loan borrower fails to make a required payment when due, the Bank institutes collection procedures. A notice is mailed to the borrower 16 days after the date the payment is due. Attempts to contact the borrower by telephone generally begin on or before the 30th day of delinquency. If

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a satisfactory response is not obtained, continuous follow-up contacts are attempted until the loan has been brought current. Before the 90th day of delinquency, attempts are made to establish (i) the cause of the delinquency, (ii) whether the cause is temporary, (iii) the attitude of the borrower toward repaying the debt, and (iv) a mutually satisfactory arrangement for curing the default.

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

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

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

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

	At September 30, 2013	2012	2011	2010	2009
Loans accounted for on a non-accrual basis:	(Dollars in thousands)				
Mortgage loans:					
One- to four-family	$6,985	$3,382	$2,150	$3,691	$1,343
Multi-Family	—	1,449	—	—	—
Commercial	3,435	6,049	6,571	7,252	5,004
Construction and land development	659	1,570	3,522	7,609	17,594
Land	2,146	8,613	8,935	5,460	5,023
Consumer loans	385	268	367	806	258
Commercial business loans	—	—	44	46	65
Total	13,610	21,331	21,589	24,864	29,287
Accruing loans which are contractually past due 90 days or more	436	1,198	1,754	1,325	796
Total of non-accrual and 90 days past due loans	14,046	22,529	23,343	26,189	30,083
Non-accrual investment securities	2,187	2,442	2,796	3,390	477
Other real estate owned and other repossessed assets	11,720	13,302	10,811	11,519	8,185
Total non-performing assets (1)	$27,953	$38,273	$36,950	$41,098	$38,745
Troubled debt restructured loans on accrual status (2)	$18,573	$13,410	$18,166	$8,995	$—
Non-accrual and 90 days or more past due loans as a percentage of loans receivable, net	2.51 %	4.09 %	4.32 %	4.86 %	5.36 %
Non-accrual and 90 days or more past due loans as a percentage of total assets	1.88 %	3.06 %	3.16 %	3.53 %	4.28 %
Non-performing assets as a percentage of total assets	3.75 %	5.19 %	5.01 %	5.53 %	5.52 %
Loans receivable, net (3)	$559,240	$550,305	$539,970	$538,855	$561,380
Total assets	$745,648	$736,954	$738,224	$742,687	$701,676

(1) Does not include troubled debt restructured loans on accrual status.

(2) Does not include troubled debt restructured loans totaling $4.0 million, $10.1 million, $7.4 million, $7.4 million and $9.5 million reported as non-accrual loans at September 30, 2013, 2012, 2011, 2010 and 2009, respectively.

(3) Includes loans held-for-sale and is before the allowance for loan losses.

The Bank’s non-accrual loans decreased by $7.7 million to $13.6 million at September 30, 2013 from $21.3 million at September 30, 2012, primarily as a result of a $6.5 million decrease in land loans, a $2.6 million decrease in commercial real estate loans, a $1.4 million decrease in multi-family loans and a $911,000 decrease in construction and land development loans on non-accrual status. These decreases were partially offset by a $3.6 million increase in one- to four-family loans and a $117,000 increase in consumer loans on non-accrual status. The largest non-performing loan was secured by a restaurant and motel located in Grays Harbor County which had a balance of $1.6 million at September 30, 2013. A discussion of our largest non-performing loans is set forth below under "Asset Classification."

Additional interest income which would have been recorded for the year ended September 30, 2013 had non-accruing loans been current in accordance with their original terms totaled $4.0 million.

Other Real Estate Owned and Other Repossessed Assets. Real estate acquired by the Bank as a result of foreclosure or by deed-in-lieu of foreclosure is classified as other real estate owned ("OREO") until sold. When property is acquired, it is recorded at the estimated fair market value less estimated costs to sell. At September 30, 2013, the Bank had $11.7 million of OREO and other repossessed assets consisting of 47 individual properties, a decrease of $1.6 million from $13.3 million at September 30, 2012. The OREO properties consisted of 26 land parcels totaling $4.6 million, six commercial real estate properties totaling $3.2 million, three multi-family properties totaling $2.1 million and 12 single family homes totaling $1.8 million. The largest OREO property was a multi-family property with a balance of $1.3 million located in Pierce County.

Restructured Loans. Under accounting principles generally accepted in the United States of America, the Bank is required to account for certain loan modifications or restructurings as "troubled debt restructurings" or "troubled debt restructured loans." In general, the modification or restructuring of a debt constitutes a troubled debt restructuring if the Bank for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrower that the Bank would not otherwise consider. Debt restructuring or loan modifications for a borrower does not necessarily always constitute troubled debt restructuring, however, and troubled debt restructurings do not necessarily result in non-accrual loans. Troubled debt restructured loans are classified as non-performing loans unless they have been performing in accordance with modified terms for a period of least six months. The Bank had troubled debt restructured loans at September 30, 2013 and 2012, totaling $22.6 million and $23.5 million, of which $4.0 million and $10.1 million respectively, were on non-accrual status, respectively. The allowance for loan losses allocated to troubled debt restructured loans at September 30, 2013 and 2012 was $2.4 million and $1.9 million, respectively.

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

The categories of non-accrual loans and impaired loans overlap, although they are not coextensive. The Bank considers all circumstances regarding the loan and borrower on an individual basis when determining whether an impaired loan should be placed on non-accrual status, such as the financial strength of the borrower, the collateral value, reasons for delay, payment record, the amount past due and the number of days past due. At September 30, 2013, the Bank had $38.1 million in impaired loans. For additional information on impaired loans, see Note 4 of the Notes to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Other Loans of Concern. Loans not reflected in the table above as non-performing, but where known information about possible credit problems of borrowers causes management to have doubts as to the ability of the borrower to comply with present repayment terms and that may result in disclosure of such loans as non-performing assets in the future are commonly referred to as "other loans of concern" or "potential problem loans." The amount included in potential problem loans results from an evaluation, on a loan-by-loan basis, of loans classified as "substandard" and "special mention," as those terms are defined under "Asset Classification" below. The amount of potential problem loans was $37.1 million at September 30, 2013. The vast majority of these loans are collateralized by real estate. See "-Asset Classification" below for additional information regarding our problem loans.

Asset Classification. Applicable regulations require that each insured institution review and classify its assets on a regular basis. In addition, in connection with examinations of insured institutions, regulatory examiners have authority to identify problem assets and, if appropriate, require them to be classified. There are three classifications for problem assets: substandard, doubtful and loss. Substandard loans are classified as those loans that are inadequately protected by the current net worth, and paying capacity of the obligor, or of the collateral pledged. Assets classified as substandard have a well-defined weakness, or weaknesses that jeopardize the repayment of the debt. If the weakness, or weaknesses are not corrected there is the distinct possibility that some loss will be sustained. Doubtful assets have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. An asset classified as loss is considered uncollectible and of such little value that continuance as an asset of the Bank is not warranted. When the Bank classifies problem assets as either substandard or doubtful, it is required to establish allowances for loan losses in an amount deemed prudent by management. These allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities and the risks associated with particular problem assets. When the Bank classifies problem assets as loss, it charges off the balance of the asset against the allowance for loan losses. Assets which do not currently expose the Bank to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are designated by the Bank as special mention. The Bank’s determination of the classification of its assets and the amount of its valuation allowances is subject to review by the FDIC and the Division which can require the establishment of additional loss allowances.

Special mention loans are defined as those credits deemed by management to have some potential weakness that deserve management's close attention. If left uncorrected these potential weaknesses may result in the deterioration of the payment prospects of the loan. Assets in this category are not adversely classified and currently do not expose the Bank to sufficient risk to warrant a substandard classification. Nine individual loans comprised $20.5 million, or 89.5%, of the $22.9 million in loans classified as special mention. They include four commercial real estate loans totaling $12.2 million and five multi-family loans totaling $8.3 million. All of these loans were current and paying in accordance with their required loan repayment terms at September 30, 2013, except one commercial real estate loan with a balance of $2.5 million that was 60 days past due.

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

	At September 30,		
	2013	2012	2011
	(In thousands)		
Loss	$—	$—	$—
Doubtful	—	—	—
Substandard (1)(2)	27,978	33,082	56,980
Special mention (1)	22,916	32,944	27,419
Total classified and special mention loans	$50,894	$66,026	$84,399
Allowance for loan losses	$11,136	$11,825	$11,946

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

Loans classified as substandard decreased $5.1 million to $28.0 million at September 30, 2013 from $33.1 million at September 30, 2012. At September 30, 2013, 84 loans were classified as substandard compared to 89 loans at September 30, 2012. Of the $28.0 million in loans classified as substandard at September 30, 2013, $13.6 million were on non-accrual status and $151,000 were past due 90 days or more and still accruing. Troubled debt restructured loans totaling $11.0 million were classified as substandard at September 30, 2013, with $4.0 million in troubled debt restructured loans on non-accrual status and $7.0 million in troubled debt restructured loans on accrual status. The largest loan classified as substandard at September 30, 2013 had a balance of $2.6 million and was secured by a mini-storage facility in King County. This loan was performing according to its restructured loan repayment terms at September 30, 2013. The next largest loan classified as substandard at September 30, 2013 had a balance of $2.4 million and was secured by a commercial building with retail office space in Thurston County and was performing according to its loan repayment terms at September 30, 2013.

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

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

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

At September 30, 2013, the Bank’s allowance for loan losses totaled $11.1 million. The Bank’s allowance for loan losses as a percentage of total loans receivable and non-performing loans was 1.99% and 79.28%, respectively, at September 30, 2013 and 2.15% and 52.48%, respectively, at September 30, 2012.

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

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

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

	Year Ended September 30,				
	2013	2012	2011	2010	2009
	(Dollars in thousands)				
Allowance at beginning of year	$11,825	$11,946	$11,264	$14,172	$8,050
Provision for loan losses	2,925	3,500	6,758	10,550	10,734
Allocated to loan commitments	—	—	—	—	(169)
Recoveries:					
Mortgage loans:					
One- to four-family	95	74	151	—	—
Multi-family	—	14	41	—	—
Commercial	55	—	—	13	—
Construction	172	505	109	104	—
Land	54	97	46	153	83
Consumer loans:					
Home equity and second mortgage	5	14	42	86	—
Other	—	—	2	6	5
Commercial business loans	105	2	1	—	—
Total recoveries	486	706	392	362	88
Charge-offs:					
Mortgage loans:					
One- to four-family	769	276	543	200	46
Multi-family	—	14	—	—	—
Construction	159	885	3,972	8,012	3,108
Commercial	667	1,215	47	1,888	235
Land	2,307	1,251	1,704	3,285	705
Consumer loans:					
Home equity and second mortgage	184	232	150	399	162
Other	14	24	30	36	25
Commercial business loans	—	430	22	—	250
Total charge-offs	4,100	4,327	6,468	13,820	4,531
Net charge-offs	3,614	3,621	6,076	13,458	4,443
Allowance at end of year	$11,136	$11,825	$11,946	$11,264	$14,172
Allowance for loan losses as a percentage of total loans receivable (net) outstanding at the end of the year (1)	1.99 %	2.15 %	2.21 %	2.09 %	2.52 %
Net charge-offs as a percentage of average loans outstanding during the year	0.65 %	0.66 %	1.13 %	2.45 %	0.79 %
Allowance for loan losses as a percentage of non-performing loans at end of year	79.28 %	52.48 %	51.18 %	43.01 %	47.11 %

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

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

	At September 30, 2013		2012		2011		2010		2009	
	Amount	Percent of Loans in Category to Total Loans	Amount	Percent of Loans in Category to Total Loans	Amount	Percent of Loans in Category to Total Loans	Amount	Percent of Loans in Category to Total Loans	Amount	Percent of Loans in Category to Total Loans
	(Dollars in thousands)									
Mortgage loans:										
One- to four-family	$1,449	18.00 %	$1,558	18.82 %	$760	20.47 %	$530	21.65 %	$616	18.58 %
Multi-family	749	8.82	1,156	8.36	1,076	5.53	392	5.77	431	4.31
Commercial	5,275	50.27	4,247	45.08	4,035	43.92	3,173	37.21	2,719	31.63
Construction and land development	414	7.79	943	9.92	1,618	9.37	1,626	12.39	5,132	23.48
Land	1,940	5.37	2,392	6.98	2,795	8.79	3,709	11.27	3,348	11.03
Non-mortgage loans:										
Consumer loans	982	6.73	1,013	6.87	875	7.90	461	8.49	1,216	8.66
Commercial business loans	327	3.02	516	3.97	787	4.02	1,373	3.22	710	2.31
Total allowance for loan losses	$11,136	100.00 %	$11,825	100.00 %	$11,946	100.00 %	$11,264	100.00 %	$14,172	100.00 %

Investment Activities

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

At September 30, 2013, the Bank's investment portfolio totaled $6.8 million, primarily consisting of $3.1 million of mortgage-backed securities available-for-sale, $958,000 of mutual funds available-for-sale, and $2.7 million of mortgage-backed securities held-to-maturity. The Bank does not maintain a trading account for any investments. This compares with a total investment portfolio of $8.3 million at September 30, 2012, primarily consisting of $3.9 million of mortgage-backed securities available-for-sale, $1.0 million of mutual funds available-for-sale, and $3.3 million of mortgage-backed securities held-to-maturity. The composition of the portfolios by type of security, at each respective date is presented in the following table.

	At September 30,								
	2013			2012			2011		
	Recorded Value	Percent of Total		Recorded Value	Percent of Total		Recorded Value	Percent of Total	
	(Dollars in thousands)								
Held-to-Maturity:									
U.S. agency securities	$14	0.20	%	$27	0.33	%	$27	0.25	%
Mortgage-backed securities	2,723	39.82		3,312	39.98		4,118	37.91	
Available-for-Sale (at fair value):									
Mortgage-backed securities	3,143	45.97		3,932	47.46		5,717	52.63	
Mutual funds	958	14.01		1,013	12.23		1,000	9.21	
Total portfolio	$6,838	100.00	%	$8,284	100.00	%	$10,862	100.00	%

The following table sets forth the maturities and weighted average yields of the investment and mortgage-backed securities in the Bank's investment securities portfolio at September 30, 2013. Mutual funds, which by their nature do not have maturities, are classified in the one year or less category.

	One Year or Less			After One to Five Years			After Five to Ten Years			After Ten Years		
	Amount	Yield		Amount	Yield		Amount	Yield		Amount	Yield	
	(Dollars in thousands)											
Held-to-Maturity:												
U.S. agency securities	$—	—	%	$14	3.98	%	$—	—	%	$—	—	%
Mortgage-backed securities	—	—		8	4.65		22	1.71		2,693	4.69	

Available-for-Sale:								
Mortgage-backed securities	—	—	28	5.84	29	1.50	3,086	3.94
Mutual funds	958	2.52	—	—	—	—	—	—
Total portfolio	$958	2.52 %	$50	5.13 %	$51	1.59 %	$5,779	4.29 %

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There were no securities which had an aggregate book value in excess of 10% of the Bank's total equity at September 30, 2013. At September 30, 2013, the Bank had $2.4 million of private label mortgage-backed securities of which $2.2 million were on non-accrual status. For additional information regarding investment securities, see "Item 1A, Risk Factors – Other-than-temporary impairment charges in our investment securities portfolio could result in additional losses" and Note 3 of the Notes to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Deposit Activities and Other Sources of Funds

General. Deposits and loan repayments are the major sources of the Bank's funds for lending and other investment purposes. Scheduled loan repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are influenced significantly by general interest rates and money market conditions. Borrowings through the FHLB-Seattle and the FRB may be used to compensate for reductions in the availability of funds from other sources.

Deposit Accounts. Substantially all of the Bank's depositors are residents of Washington. Deposits are attracted from within the Bank's market area through the offering of a broad selection of deposit instruments, including money market deposit accounts, checking accounts, regular savings accounts and certificates of deposit. Deposit account terms vary, according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors. In determining the terms of its deposit accounts, the Bank considers current market interest rates, profitability to the Bank, matching deposit and loan products and its customer preferences and concerns. The Bank actively seeks consumer and commercial checking accounts through checking account acquisition marketing programs. At September 30, 2013, the Bank had 40.07% of total deposits in non-interest bearing accounts and NOW checking accounts.

At September 30, 2013 the Bank had $64.0 million of jumbo certificates of deposit of $100,000 or more. The Bank also had brokered certificates of deposit totaling $1.2 million at September 30, 2013. The Bank believes that its jumbo certificates of deposit, which represented 10.5% of total deposits at September 30, 2013, present similar interest rate risks as compared to its other deposits.

The following table sets forth information concerning the Bank's deposits at September 30, 2013.

Category	Weighted Average Interest Rate		Amount	Percentage of Total Deposits	
	(In thousands)				
Non-interest bearing	—	%	$87,657	14.41	%
Negotiable order of withdrawal ("NOW") checking	0.30		156,100	25.66	
Savings	0.06		91,349	15.02	
Money market	0.28		99,006	16.28	
Subtotal	0.23		434,112	71.37	
Certificates of Deposit(1)					
Maturing within 1 year	0.59		111,480	18.33	
Maturing after 1 year but within 2 years	1.12		29,950	4.92	
Maturing after 2 years but within 5 years	1.57		31,353	5.15	
Maturing after 5 years	1.31		1,367	0.23	
Total certificates of deposit	0.86		174,150	28.63	

Total deposits	0.44	%	$608,262	100.00	%

(1) Based on remaining maturity of certificates.

The following table indicates the amount of the Bank's jumbo certificates of deposit by time remaining until maturity as of September 30, 2013. Jumbo certificates of deposit have principal balances of $100,000 or more and the rates paid on these accounts are generally negotiable.

Maturity Period	Amount (In thousands)
Three months or less	$12,873
Over three through six months	8,211
Over six through twelve months	18,425
Over twelve months	24,449
Total	$63,958

Deposit Flow. The following table sets forth the balances of deposits in the various types of accounts offered by the Bank at the dates indicated.

	At September 30, 2013			2012			2011	
	Amount	Percent of Total	Increase (Decrease)	Amount	Percent of Total	Increase (Decrease)	Amount	Percent of Total
	(Dollars in thousands)							
Non-interest-bearing	$87,657	14.41 %	$12,361	$75,296	12.60 %	$10,802	$64,494	10.88 %
NOW checking	156,100	25.66	5,961	150,139	25.11	(5,160)	155,299	26.20
Savings	91,349	15.02	3,856	87,493	14.63	3,857	83,636	14.11
Money market	99,006	16.28	19,457	79,549	13.30	18,521	61,028	10.30
Certificates of deposit which mature:								
Within 1 year	111,480	18.33	(20,175)	131,655	22.02	(25,506)	157,161	26.52
After 1 year, but within 2 years	29,950	4.92	(8,647)	38,597	6.46	(1,196)	39,793	6.71
After 2 years, but within 5 years	31,353	5.15	(3,704)	35,057	5.86	4,416	30,641	5.17
Certificates maturing thereafter	1,367	0.23	1,227	140	0.02	(486)	626	0.11
Total	$608,262	100.0 %	$10,336	$597,926	100.0 %	$5,248	$592,678	100.00 %

Certificates of Deposit by Rates. The following table sets forth the certificates of deposit in the Bank classified by rates as of the dates indicated.

	At September 30, 2013	2012	2011
	(In thousands)		
0.00 - 1.99%	$149,120	$174,456	$193,790
2.00 - 3.99%	24,759	30,552	33,345
4.00 - 5.99%	271	441	1,086
Total	$174,150	$205,449	$228,221

Certificates of Deposit by Maturities. The following table sets forth the amount and maturities of certificates of deposit at September 30, 2013.

	Amount Due				
	Less Than One Year	One to Two Years	After Two to Five Years	After Five Years	Total
	(In thousands)				
0.00 - 1.99%	$104,751	$21,228	$21,774	$1,367	$149,120
2.00 - 3.99%	6,560	8,722	9,477	—	24,759
4.00 - 5.99%	169	—	102	—	271
Total	$111,480	$29,950	$31,353	$1,367	$174,150

Deposit Activities. The following table sets forth the deposit activities of the Bank for the periods indicated.

	Year Ended September 30,		
	2013	2012	2011
	(In thousands)		
Beginning balance	$597,926	$592,678	$578,869
Net deposits before interest credited	7,768	1,297	7,673
Interest credited	2,568	3,951	6,136
Net increase in deposits	10,336	5,248	13,809
Ending balance	$608,262	$597,926	$592,678

Borrowings. Deposits and loan repayments are generally the primary source of funds for the Bank's lending and investment activities and for general business purposes. The Bank has the ability to use advances from the FHLB-Seattle to supplement its supply of lendable funds and to meet deposit withdrawal requirements. The FHLB-Seattle functions as a central reserve bank providing credit for member financial institutions. As a member of the FHLB-Seattle, the Bank is required to own capital stock in the FHLB-Seattle and is authorized to apply for advances on the security of such stock and certain mortgage loans and other assets (principally securities which are obligations of, or guaranteed by, the United States government) provided certain creditworthiness standards have been met. Advances are made pursuant to several different credit programs. Each credit program has its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based on the financial condition of the member institution and the adequacy of collateral pledged to secure the credit. At September 30, 2013, the Bank maintained an uncommitted credit facility with the FHLB-Seattle that provided for immediately available advances up to an aggregate amount of 25% of the Bank’s total assets, limited by available collateral, under which $45.0 million was outstanding. The Bank also maintains a short-term borrowing line with the FRB with total credit based on eligible collateral. At September 30, 2013, the Bank had no outstanding balance and $52.7 million in unused borrowing capacity on this borrowing line. A short-term borrowing line of $10.0 million is also maintained at Pacific Coast Bankers' Bank ("PCBB"); the Bank had no outstanding balance on this borrowing line at September 30, 2013.

The following table sets forth certain information regarding borrowings including repurchase agreements by the Bank at the end of and during the periods indicated:

	At or For the Year Ended September 30,		
	2013	2012	2011
	(Dollars in thousands)		
Average total borrowings	$45,352	$48,302	$55,511
Weighted average rate paid on total borrowings	4.13 %	4.13 %	4.32 %
Total borrowings outstanding at end of period	$45,000	$45,855	$55,729

The following table sets forth certain information regarding short-term borrowings including repurchase agreements with customers, by the Bank at the end of and during the periods indicated. Borrowings are considered short-term when the original maturity is less than one year.

	At or For the Year Ended September 30,		
	2013	2012	2011
	(Dollars In thousands)		
Maximum amount outstanding at any month end:			
FHLB advances	$—	$—	$—
Repurchase agreements	787	948	729
FRB borrowings	—	—	—
Average outstanding during period:			
FHLB advances	$—	$—	$—
Repurchase agreements	352	699	511
FRB borrowings	—	—	—
Total average outstanding during period	$352	$699	$511
Weighted average rate paid during period:			
FHLB advances	— %	— %	— %
Repurchase agreements	0.05	0.05	0.05
Total weighted average rate paid during period	—	0.05	0.05
Outstanding at end of period:			
FHLB advances	$—	$—	$—
Repurchase agreements	—	855	729
FRB borrowings	—	—	—
Total outstanding at end of period	$—	$855	$729
Weighted average rate at end of period:			
FHLB advances	— %	— %	— %
Repurchase agreements	—	0.05	0.05
Total weighted average rate at end of period	—	0.05	0.05

Bank Owned Life Insurance

The Bank has purchased life insurance policies covering certain officers. These policies are recorded at their cash surrender value, net of any cash surrender charges. Increases in cash surrender value, net of policy premiums, and proceeds from death benefits are recorded in non-interest income. At September 30, 2013, the cash surrender value of bank owned life insurance (“BOLI”) was $17.1 million.

How We Are Regulated

General. As a bank holding company, Timberland Bancorp is subject to examination and supervision by, and is required to file certain reports with, the Federal Reserve. Timberland Bancorp is also subject to the rules and regulations of the SEC under the federal securities laws. As a state-chartered savings bank, the Bank is subject to regulation and oversight by the Division and the applicable provisions of Washington law and regulations of the Division adopted thereunder. The Bank also is subject to regulation and examination by the FDIC, which insures the deposits of the Bank to the maximum extent permitted by law, and requirements established by the Federal Reserve. State law and regulations govern the Bank's ability to take deposits and pay interest thereon, to make loans on or invest in residential and other real estate, to make consumer loans, to invest in securities, to offer various banking services to its customers, and to establish branch offices. Under state law, savings banks in Washington also generally have all of the powers that federal savings banks have under federal laws and regulations. The Bank is subject to periodic examination and reporting requirements by and of the Division and the FDIC.

The following is a brief description of certain laws and regulations applicable to Timberland Bancorp and the Bank. Descriptions of laws and regulations here and elsewhere in this report do not purport to be complete and are qualified in their entirety by reference to the actual laws and regulations. Legislation is introduced from time to time in the United States Congress or the Washington State Legislature that may affect the operations of Timberland Bancorp and Bank. In addition, the regulations governing the Company and the Bank may be amended from time to time by the FDIC, DFI, Federal Reserve and the Consumer Financial Protection Bureau ("CFPB"). Any such legislation or regulatory changes in the future could adversely affect the Company's and the Bank's operations and financial condition.

Financial Regulatory Reform. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which was enacted in July 2010, imposed new restrictions and an expanded framework of regulatory oversight for financial institutions, including depository institutions and their holding companies. The following summarizes significant aspects of the Dodd-Frank Act that may materially affect the operations of the Bank and Timberland Bancorp:

- Dodd-Frank Act established the CFPB and empowered it to exercise broad regulatory, supervisory and enforcement authority with respect to both new and existing consumer financial protection laws. The Bank is subject to consumer protection regulations issued by the CFPB, but as a smaller financial institution, it is generally subject to supervision and enforcement by the FDIC and the Division with respect to its compliance with consumer financial protection laws and CFPB regulations;
- Bank holding companies, like Timberland Bancorp, are required to serve as a source of strength for their depository institution subsidiaries;
- Require new capital rules and apply the same leverage and risk-based capital requirements that apply to insured depository institutions;
- Provide for new disclosure and other requirements relating to executive compensation and corporate governance;
- The prohibition on payment of interest on demand deposits was repealed;
- Deposit insurance is permanently increased to $250,000;
- The deposit insurance assessment base for FDIC insurance became the depository institution's average consolidated total assets less the average tangible equity during the assessment period; and
- The minimum reserve ratio of the FDIC's Deposit Insurance Fund ("DIF") increased to 1.35% of estimated annual insured deposits or the comparable percentage of the assessment base; however, the FDIC is directed to "offset the effect" of the increased reserve ratio for insured depository institutions with total consolidated assets of less than $10 billion.

Regulation of the Bank

The Bank, as a state-chartered savings bank, is subject to regulation and oversight by the FDIC and the Division extending to all aspects of its operations.

Federal and State Enforcement Authority and Actions. As part of its supervisory authority over Washington-chartered savings banks, the Division may initiate enforcement proceedings to obtain a cease-and-desist order against an institution believed to have engaged in unsafe and unsound practices or to have violated a law, regulation, or other regulatory limit, including a written agreement. The FDIC also has the authority to initiate enforcement actions against insured institutions for similar reasons and may terminate the deposit insurance if it determines that an institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition. Both these agencies may utilize less formal supervisory tools to address their concerns about the condition, operations or compliance status of a savings bank.

In December 2009, the FDIC and the DFI determined that the Bank required supervisory attention and agreed to terms of 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 Division to engage in certain activities. On December 12, 2012, the Bank was notified by the FDIC and the Division that the Bank MOU had been terminated.

Insurance of Accounts and Regulation by the FDIC. The deposit insurance fund, or the DIF of the FDIC insures deposit accounts in the Bank up to $250,000 per separately insured depositor. As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of and to require reporting by FDIC-insured institutions. Our deposit insurance premiums for the year ended September 30, 2013, were $685,000.

The Dodd-Frank Act requires that FDIC deposit insurance assessments be based on assets instead of deposits. The FDIC has issued rules for this purpose, under which specify that the assessment base for a bank is equal to its total average consolidated assets less average tangible equity capital. The FDIC assessment rates range from approximately five basis points to 35 basis points, depending on applicable adjustments for unsecured debt issued by an institution and brokered deposits (and to further adjustment for institutions that hold unsecured debt of other FDIC-insured institutions), until such time as the FDIC's reserve ratio equals 1.15%. Once the FDIC's reserve ratio reaches 1.15% and the reserve ratio for the immediately prior assessment period is less than 2.0%, the applicable assessment rates may range from three basis points to 30 basis points (subject to adjustments as described above). If the reserve ratio for the prior assessment period is equal to, or greater than 2.0% and less than 2.5%, the assessment rates may range from two basis points to 28 basis points and if the prior assessment period is greater than 2.5%, the assessment rates may range from one basis point to 25 basis points (in each case subject to adjustments as described above). No institution may pay a dividend if it is in default on its federal deposit insurance assessment.

The FDIC conducts examinations of and requires reporting by state non-member banks, such as the Bank. The FDIC also may prohibit any insured institution from engaging in any activity determined by regulation or order to pose a serious risk to the deposit insurance fund. The FDIC may terminate the deposit insurance of any insured depository institution, including the Bank, if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance, if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the FDIC. Management is aware of no existing circumstances which would result in termination of the Bank's deposit insurance.

Prompt Corrective Action. Federal statutes establish a supervisory framework based on five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. An institution’s category depends upon where its capital levels are in relation to relevant capital measures, which include a risk-based capital measure, a leverage ratio capital measure and certain other factors. The federal banking agencies have adopted regulations that implement this statutory framework. Under these regulations, an institution is treated as well capitalized if its ratio of total capital to risk-weighted assets is 10% or more, its ratio of core capital to risk-weighted assets is 6% or more, its ratio of core capital to adjusted total assets (leverage ratio) is 5% or more, and it is not subject to any federal supervisory order or directive to meet a specific capital level. In order to be adequately capitalized, an institution must have a total risk-based capital ratio of not less than 8%, a Tier 1 risk-based capital ratio of not less than 4%, and a leverage ratio of not less than 4%. An institution that is not well capitalized is subject to certain restrictions on brokered deposits, including restrictions on the rates it can offer on its deposits generally. Any institution which is neither well capitalized nor adequately capitalized is considered undercapitalized.

Undercapitalized institutions are subject to certain prompt corrective action requirements, regulatory controls and restrictions which become more extensive as an institution becomes more severely undercapitalized. Failure by an institution to comply with applicable capital requirements would, if unremedied, result in progressively more severe restrictions on its activities and lead to enforcement actions, including, but not limited to, the issuance of a capital directive to ensure the maintenance of required capital levels and, ultimately, the appointment of the FDIC as receiver or conservator. Banking regulators will take prompt corrective action with respect to depository institutions that do not meet minimum capital requirements. Additionally, approval of any regulatory application filed for their review may be dependent on compliance with capital requirements.

At September 30, 2013, the Bank was categorized as "well capitalized" under the prompt corrective action regulations of the FDIC. For additional information on capital requirements, see Note 18 of the Notes to the Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplemental Data" of this Form 10-K.

Current Capital Requirements for Timberland Bank. Federally insured savings institutions, such as the Bank, are required to maintain a minimum level of regulatory capital. On July 2, 2013, the Federal Reserve approved a final rule ("Final Rules") to establish a new comprehensive regulatory capital framework for all U.S. financial institutions and their holding companies. On July 9, the Final Rule was approved as an interim final rule by the FDIC. The Final rule implements the "Basel

III" regulatory capital reforms and changes required by the Dodd-Frank Act, which is discussed below in the section entitled "-New Capital Rules." The following is a discussion of the capital requirements the Bank was subject to as of September 30, 2013.

FDIC regulations recognize two types, or tiers, of capital: core ("Tier 1") capital and supplementary ("Tier 2") capital. Tier 1 capital generally includes common shareholders' equity and noncumulative perpetual preferred stock, less most intangible assets. Tier 2 capital, which is limited to 100% of Tier 1 capital, includes such items as qualifying general loan loss reserves, cumulative perpetual preferred stock, mandatory convertible debt, term subordinated debt and limited life preferred stock; however, the amount of term subordinated debt and intermediate term preferred stock (original maturity of at least five years but less than 20 years) that may be included in Tier 2 capital is limited to 50% of Tier 1 capital.

The FDIC currently measures an institution's capital using a leverage limit together with certain risk-based ratios. The FDIC's minimum leverage capital requirement for a bank to be considered adequately capitalized specifies a minimum ratio of Tier 1 capital to average total assets of 4%. At September 30, 2013, the Bank had a Tier 1 leverage capital ratio of 11.1%. The FDIC retains the right to require a particular institution to maintain a higher capital level based on the its particular risk profile.

FDIC regulations also establish a measure of capital adequacy based on ratios of qualifying capital to risk-weighted assets. Assets are placed in one of four categories and given a percentage weight based on the relative risk of that category. In addition, certain off-balance-sheet items are converted to balance-sheet credit equivalent amounts, and each amount is then assigned to one of the four categories. Under the guidelines for a bank to be considered adequately capitalized, the ratio of total capital (Tier 1 capital plus Tier 2 capital) to risk-weighted assets (the Tier 1 risk based capital ratio) must be at least 8%, and the ratio of Tier 1 capital to risk-weighted assets must be at least 4%. In evaluating the adequacy of a bank's capital, the FDIC may also consider other factors that may affect a bank's financial condition. Such factors may include interest rate risk exposure, liquidity, funding and market risks, the quality and level of earnings, concentration of credit risk, risks arising from nontraditional activities, loan and investment quality, the effectiveness of loan and investment policies, and management's ability to monitor and control financial operating risks. At September 30, 2013, the Bank's ratio of total capital to risk-weighted assets was 16.1% and the ratio of Tier 1 capital to risk-weighted assets was 14.8%.

The Division requires that net worth equal at least 5% of total assets. At September 30, 2013, the Bank had a net worth of 10.9% of total assets.

The table below sets forth the Bank's capital position relative to its FDIC capital requirements at September 30, 2013. The definitions of the terms used in the table are those provided in the capital regulations issued by the FDIC.

	At September 30, 2013		
	Amount	Percent of Adjusted Total Assets (1)	
	(Dollars in thousands)		
Tier 1 (leverage) capital	$82,265	11.1	%
Tier 1 (leverage) capital requirement (2)	29,662	4.0	
Excess	$52,603	7.1	%
Tier 1 risk adjusted capital	$82,265	14.8	%
Tier 1 risk adjusted capital requirement	22,255	4.0	
Excess	$60,010	10.8	%
Total risk-based capital	$89,273	16.1	%
Total risk-based capital requirement	44,509	8.0	

Excess	$44,764	8.1	%

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(1) For the Tier 1 (leverage) capital and Washington regulatory capital calculations, percent of total average assets of $741.6 million. For the Tier 1 risk-based capital and total risk-based capital calculations, percent of total risk-weighted assets of $556.4 million.

(2) As a Washington-chartered savings bank, the Bank is subject to the capital requirements of the FDIC and the Division. The FDIC requires state-chartered savings banks, including the Bank, to have a minimum leverage ratio of Tier 1 capital to total assets of at least 3%, provided, however, that all institutions, other than those (i) receiving the highest rating during the examination process and (ii) not anticipating any significant growth, are required to maintain a ratio of 1% to 2% above the stated minimum, with an absolute total capital to risk-weighted assets of at least 8%.

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New Capital Rules. The Final Rules approved by the Federal Reserve and subsequently approved as an interim final rule by the FDIC substantially amends the regulatory risk-based capital rules applicable to Timberland Bancorp and the Bank.

Effective in 2015 (with some changes generally transitioned into full effectiveness over two to four years), the Bank will be subject to new capital requirements adopted by the FDIC. These new requirements create a new required ratio for common equity Tier 1 ("CET1") capital, increases the leverage and Tier 1 capital ratios, changes the risk-weights of certain assets for purposes of the risk-based capital ratios, creates an additional capital conservation buffer over the required capital ratios and changes what qualifies as capital for purposes of meeting these various capital requirements. Beginning in 2016, failure to maintain the required capital conservation buffer will limit the ability of the Bank to pay dividends, repurchase shares or pay discretionary bonuses.

When these new requirements become effective in 2015, the Bank's leverage ratio of 4% of adjusted total assets and total capital ratio of 8% of risk-weighted assets will remain the same; however, the Tier 1 capital ratio requirement will increase from 4.0% to 6.5% of risk-weighted assets. In addition, the Bank will have to meet the new CET1 capital ratio of 4.5% of risk-weighted assets, with CET1 consisting of qualifying Tier 1 capital less all capital components that are not considered common equity.

For all of these capital requirements, there are a number of changes in what constitutes regulatory capital, some of which are subject to a two-year transition period. These changes include the phasing-out of certain instruments as qualifying capital. The Bank does not have any of these instruments. Under the new requirements for total capital, Tier 2 capital is no longer limited to the amount of Tier 1 capital included in total capital.

Mortgage servicing rights, certain deferred tax assets and investments in unconsolidated subsidiaries over designated percentages of common stock will be deducted from capital, subject to a two-year transition period. In addition, Tier 1 capital will include accumulated other comprehensive income (loss), which includes all unrealized gains and losses on available for sale debt and equity securities, subject to a two-year transition period. Because of its asset size, the Bank has the one-time option of deciding in the first quarter of 2015 whether to permanently opt-out of the inclusion of accumulated other comprehensive income (loss) in its capital calculations. The Bank is considering whether to take advantage of this opt-out to reduce the impact of market volatility on its regulatory capital levels.

The new requirements also include changes in the risk-weights of assets to better reflect credit risk and other risk exposures. These include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and for non-residential mortgage loans that are 90 days past due or otherwise on non-accrual status; a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable (currently set at 0%); a 250% risk weight (up from 100%) for mortgage servicing rights and deferred tax assets that are not deducted from capital; and increased risk-weights (0% to 600%) for equity exposures.

In addition to the minimum CET1, Tier 1 and total capital ratios, the Bank will have to maintain a capital conservation buffer consisting of additional CET1 capital equal to 2.5% of risk-weighted assets above the required minimum levels in order to avoid limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses based on percentages of eligible retained income that could be utilized for such actions. This new capital conservation buffer requirement is be phased in beginning in January 2016 at 0.625% of risk-weighted assets and increasing each year until fully implemented at 2.5% in January 2019.

The FDIC's prompt corrective action standards will change when these new capital ratios become effective. Under the new standards, in order to be considered well-capitalized, the Bank would be required to have a CET1 ratio of 6.5% (new), a Tier 1 ratio of 8% (increased from 6%), a total capital ratio of 10% (unchanged) and a leverage ratio of 5%

(unchanged). The Bank has conducted a pro forma analysis of the application of the new capital requirements as of September 30, 2013. We have determined that the Bank meets all new requirements and would remain well-capitalized, even if these new requirements had been effect on that date. Timberland Bancorp has also conducted a pro forma analysis of the application of these new capital requirements as of September 30, 2013. We have determined that Timberland Bancorp meets all new requirements and would remain well-capitalized, even if these new requirements had been in effect on that date.

The application of these stringent capital requirements could, among other things, result in lower returns on invested capital, over time require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in management modifying its business strategy and could limit our ability to make distributions, including paying out dividends or repurchasing shares. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Any additional changes in our regulation and oversight, in the form of new laws, rules and regulations could make compliance more difficult or expensive or otherwise materially adversely affect our business, financial condition or prospects.

Federal Home Loan Bank System. The Bank is a member of the FHLB-Seattle, which is one of 12 regional FHLBs that administer the home financing credit function of savings institutions. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. It makes loans or advances to members in accordance with policies and procedures, established by the Board of Directors of the FHLB, which are subject to the oversight of the Federal Housing Finance Board. All advances from the FHLB are required to be fully secured by sufficient collateral as determined by the FHLB. In addition, all long-term advances are required to provide funds for residential home financing. See “Business – Deposit Activities and Other Sources of Funds – Borrowings.”

As a member, the Bank is required to purchase and maintain stock in the FHLB-Seattle. At September 30, 2013, the Bank had $5.5 million in FHLB stock, which was in compliance with this requirement. Subsequent to December 31, 2008, the FHLB-Seattle announced that it was below its regulatory risk-based capital requirement and was precluded from paying dividends or repurchasing capital stock. In September 2012, the FHLB-Seattle announced that it had been reclassified as adequately capitalized by its regulator, the Federal Housing Finance Agency. The FHLB-Seattle also announced that it had been granted authority to repurchase up to $25 million of excess capital stock per quarter, provided they receive a non-objection from the Federal Housing Finance Agency. During the year ended September 30, 2013, the FHLB-Seattle repurchased $203,000 of its stock, at par, from the Bank. The FHLB-Seattle resumed dividend payments in July 2013 and the Bank received $1,000 in dividends during the year ended September 30, 2013.

The FHLBs continue to contribute to low- and moderately-priced housing programs through direct loans or interest subsidies on advances targeted for community investment and low- and moderate-income housing projects. These contributions have affected adversely the level of FHLB dividends paid and could continue to do so in the future. These contributions could also have an adverse effect on the value of FHLB stock in the future. A reduction in value of the Bank's FHLB stock may result in a decrease in net income and possibly capital.

Standards for Safety and Soundness. The federal banking regulatory agencies have prescribed, by regulation, guidelines for all insured depository institutions relating to: internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, and compensation, fees and benefits. 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. Each insured depository institution must implement a comprehensive written information security program that includes administrative, technical, and physical safeguards appropriate to the institution’s size and complexity and the nature and scope of its activities. The information security program also must be designed to ensure the security and confidentiality of customer information, protect against any unanticipated threats or hazards to the security or integrity of such information, protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer, and ensure the proper disposal of customer and consumer information. Each insured depository institution must also develop and implement a risk-based response program to address incidents of unauthorized access to customer information in customer information systems. If the FDIC determines that the Bank fails to meet any standard prescribed by the guidelines, it may require the Bank to submit to the agency an acceptable plan to achieve compliance with the standard. FDIC regulations establish deadlines for the submission and review of such safety and soundness compliance plans. Management of the Bank is not aware of any conditions relating to these safety and soundness standards which would require submission of a plan of compliance.

Real Estate Lending Standards. FDIC regulations require the Bank to adopt and maintain written policies that establish appropriate limits and standards for real estate loans. These standards, which must be consistent with safe and sound banking practices, must establish loan portfolio diversification standards, prudent underwriting standards (including loan-to-value ratio limits) that are clear and measurable, loan administration procedures, and documentation, approval and reporting requirements. The Bank is obligated to monitor conditions in its real estate markets to ensure that its standards continue to be appropriate for current market conditions. The Bank's Board of Directors is required to review and approve the Bank's standards at least annually. The FDIC has published guidelines for compliance with these regulations, including supervisory limitations on loan-to-value ratios for different categories of real estate loans. Under the guidelines, the aggregate amount of all loans in excess of the supervisory loan-to-value ratios should not exceed 100% of total capital, and the total of all loans for commercial, agricultural, multi-family or other non-one- to four-family residential properties in excess of the supervisory loan-to-value ratio should not exceed 30% of total capital. Loans in excess of the supervisory loan-to-value ratio limitations must be identified in the Bank's records and reported at least quarterly to the Bank's Board of Directors. The Bank is in compliance with the record and reporting requirements. As of September 30, 2013, the Bank's aggregate loans in excess of the supervisory loan-to-value ratios were 21% of total capital and the Bank's loans on commercial, agricultural, multi-family or other non-one- to four-family residential properties in excess of the supervisory loan-to-value ratios were 17% of total capital.

Activities and Investments of Insured State-Chartered Financial Institutions. Federal law generally limits the activities and equity investments of FDIC-insured, state-chartered banks to those that are permissible for national banks. An insured state bank is not prohibited from, among other things, (i) acquiring or retaining a majority interest in a subsidiary, (ii) investing as a limited partner in a partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank's total assets, (iii) acquiring up to 10% of the voting stock of a company that solely provides or reinsures directors' and officers' liability insurance coverage or bankers' blanket bond group insurance coverage for insured depository institutions, and (iv) acquiring or retaining the voting shares of a depository institution owned by another FDIC-insured institution if certain requirements are met.

Washington State has enacted a law regarding financial institution parity. Primarily, the law affords Washington-chartered commercial banks the same powers as Washington-chartered savings banks. In order for a bank to exercise these powers, it must provide 30 days notice to the Director of Financial Institutions and the Director must authorize the requested activity. In addition, the law provides that Washington-chartered savings banks may exercise any of the powers of Washington-chartered commercial banks, national banks and federally-chartered savings banks, subject to the approval of the Director in certain situations. Finally, the law provides additional flexibility for Washington-chartered commercial and savings banks with respect to interest rates on loans and other extensions of credit. Specifically, they may charge the maximum interest rate allowable for loans and other extensions of credit by federally-chartered financial institutions to Washington residents.

Environmental Issues Associated With Real Estate Lending. The Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), is a federal statute that generally imposes strict liability on all prior and present "owners and operators" of sites containing hazardous waste. However, Congress acted to protect secured creditors by providing that the term "owner and operator" excludes a person whose ownership is limited to protecting its security interest in the site. Since the enactment of the CERCLA, this "secured creditor exemption" has been the subject of judicial interpretations which have left open the possibility that lenders could be liable for cleanup costs on contaminated property that they hold as collateral for a loan.

To the extent that legal uncertainty exists in this area, all creditors, including the Bank, that have made loans secured by properties with potential hazardous waste contamination (such as petroleum contamination) could be subject to liability for cleanup costs, which costs often substantially exceed the value of the collateral property.

Federal Reserve System. The Federal Reserve Board requires that all depository institutions maintain reserves on transaction accounts or non-personal time deposits. These reserves may be in the form of cash or non-interest-bearing deposits with the regional Federal Reserve Bank. Negotiable order of withdrawal ("NOW") accounts and other types of accounts that permit payments or transfers to third parties fall within the definition of transaction accounts and are subject to reserve requirements, as are any non-personal time deposits at a savings bank. As of September 30, 2013, the Bank's deposit with the Federal Reserve and vault cash exceeded its Regulation D reserve requirements.

Affiliate Transactions. Federal laws strictly limit the ability of banks to engage in certain transactions with their affiliates, including their bank holding companies. Transactions deemed to be a "covered transaction" under Section 23A of the Federal Reserve Act and between a subsidiary bank and its parent company or the nonbank subsidiaries of the bank holding company are limited to 10% of the bank subsidiary's capital and surplus and, with respect to the parent company and all such nonbank subsidiaries, to an aggregate of 20% of the bank subsidiary's capital and surplus. Further, covered transactions that are loans and extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also requires that covered transactions and certain other transactions listed in Section 23B of the Federal Reserve Act between a bank and its affiliates be on terms as favorable to the bank as transactions with non-affiliates.

Community Reinvestment Act. Banks are also subject to the provisions of the Community Reinvestment Act of 1977 (“CRA”), which requires the appropriate federal bank regulatory agency to assess a bank’s performance under the CRA in meeting the credit needs of the community serviced by the bank, including low and moderate income neighborhoods. The regulatory agency’s assessment of the bank’s record is made available to the public. Further, a bank’s performance must be considered in connection with a bank’s application to, among other things, establish a new branch office that will accept deposits, relocate an existing office or merge or consolidate with, or acquire the assets or assume the liabilities of, a federally regulated financial institution. The Bank received a “satisfactory” rating during its most recent examination.

Dividends. Dividends from the Bank constitute the major source of funds available for dividends which may be paid to the Company shareholders. The amount of dividends payable by the Bank to the Company depends upon the Bank's earnings and capital position, and is limited by federal and state laws, regulations and policies. According to Washington law, the Bank may not declare or pay a cash dividend on its capital stock if it would cause its net worth to be reduced below (i) the amount required for liquidation accounts or (ii) the net worth requirements, if any, imposed by the Director of the Division. In addition, dividends on the Bank's capital stock may not be paid in an aggregate amount greater than the aggregate retained earnings of the Bank, without the approval of the Director of the Division.

The amount of dividends actually paid during any one period will be strongly affected by the Bank's management policy of maintaining a strong capital position. Federal law further provides that no insured depository institution may pay a cash dividend if it would cause the institution to be “undercapitalized,” as defined in the prompt corrective action regulations. Moreover, the federal bank regulatory agencies also have the general authority to limit the dividends paid by insured banks if such payments should be deemed to constitute an unsafe and unsound practice.

Other Consumer Protection Laws and Regulations. The Bank is subject to a broad array of federal and state consumer protection laws and regulations that govern almost every aspect of its business relationships with consumers. While the list set forth below is not exhaustive, these include the Truth-in-Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Right to Financial Privacy Act, the Home Ownership and Equity Protection Act, the Consumer Leasing Act, the Fair Credit Billing Act, the Homeowners Protection Act, the Check Clearing for the 21st Century Act, laws governing flood insurance, laws governing consumer protections in connection with the sale of insurance, federal and state laws prohibiting unfair and deceptive business practices, and various regulations that implement some or all of the foregoing. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans, collecting loans, and providing other services. Failure to comply with these laws and regulations can subject the Bank to various penalties, including but not limited to, enforcement actions, injunctions, fines, civil liability, criminal penalties, punitive damages, and the loss of certain contractual rights.

Regulation of the Company

General. The Company, as the sole shareholder of the Bank, is a bank holding company and is registered as such with the Federal Reserve. Bank holding companies are subject to comprehensive regulation by the Federal Reserve under the Bank Holding Company Act of 1956, as amended (“BHCA”), and the regulations promulgated thereunder. This regulation and oversight is generally intended to ensure that Timberland Bancorp, Inc. limits its activities to those allowed by law and that it operates in a safe and sound manner without endangering the financial health of the Bank.

On February 1, 2010, the Federal Reserve determined that the Company required additional supervisory attention and entered into the Company MOU. Under the Company MOU, the Company was required to obtain prior written approval, or non-objection, from the Federal Reserve 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 Federal Reserve that the Company MOU had been terminated.

As a bank holding company, the Company is required to file quarterly reports with the Federal Reserve and any additional information required by the Federal Reserve and will be subject to regular examinations by the Federal Reserve. The Federal Reserve also has extensive enforcement authority over bank holding companies, including the ability to assess civil money penalties, to issue cease and desist or removal orders and to require that a holding company divest subsidiaries (including its bank subsidiaries). In general, enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices.

The Bank Holding Company Act. Under the BHCA, the Company is supervised by the Federal Reserve. The Federal Reserve has a policy that a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, the Federal Reserve provides that bank holding companies should serve as a source of strength to its subsidiary banks by being prepared to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity, and should maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligation to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice or a violation of the Federal Reserve's regulations or both.

Under the BHCA, the Federal Reserve may approve the ownership of shares by a bank holding company in any company the activities of which the Federal Reserve has determined to be so closely related to the business of banking or managing or controlling banks as to be a proper incident thereto. These activities generally include, among others, operating a savings institution, mortgage company, finance company, escrow company, credit card company or factoring company; performing certain data processing operations; providing certain investment and financial advice; underwriting and acting as an insurance agent for certain types of credit related insurance; leasing property on a full payout, non-operating basis; selling money orders, travelers' checks and U.S. Savings Bonds; real estate and personal property appraising; providing tax planning and preparation services; and, subject to certain limitations, providing securities brokerage services for customers.

Acquisitions. The BHCA prohibits a bank holding company, with certain exceptions, from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank or bank holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. A bank holding company that meets certain supervisory and financial standards and elects to be designated as a financial holding company may also engage in certain securities, insurance and merchant banking activities and other activities determined to be financial in nature or incidental to financial activities. The BHCA prohibits a bank holding company, with certain exceptions, from acquiring ownership or control of more than 5% of the voting shares of any company that is not a bank or bank holding company and from engaging in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries.

Interstate Banking. The Federal Reserve may approve an application of a bank holding company to acquire control of, or acquire all or substantially all of the assets of, a bank located in a state other than such holding company's home state, without regard to whether the transaction is prohibited by the laws of any state except with respect to the acquisition of a bank that has not been in existence for the minimum time period, not exceeding five years, specified by the law of the host state. The Federal Reserve may not approve an application if the applicant controls or would control more than 10% of the insured deposits in the United States or 30% or more of the deposits in the target bank's home state or in any state in which the target bank maintains a branch. Federal law does not affect the authority of states to limit the percentage of total insured deposits in the state that may be held or controlled by a bank holding company to the extent such limitation does not discriminate against out-of-state banks or bank holding companies. Individual states may also waive the 30% state-wide concentration limit contained in the federal law.

The federal banking agencies are authorized to approve interstate merger transactions without regard to whether such transaction is prohibited by the law of any state, unless the home state of one of the banks adopted a law prior to June 1, 1997 which applies equally to all out-of-state banks and expressly prohibits merger transactions involving out-of-state banks. Interstate acquisitions of branches will be permitted only if the law of the state in which the branch is located permits such acquisitions. Interstate mergers and branch acquisitions will also be subject to the nationwide and statewide insured deposit concentration amounts described above.

Dividends. The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve's view that a bank holding company should pay cash dividends only to the extent that the company's net income for the past year is sufficient to cover both the cash dividends and a rate of earning retention that is consistent with the company's capital needs, asset quality and overall financial condition, and that it is inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Under Washington corporate law, the Company generally may not pay dividends if after that payment it would not be able to pay its liabilities as they become due in the usual course of business, or its total assets would be less than its total liabilities.

Stock Repurchases. Bank holding companies, except for certain "well-capitalized" and highly rated bank holding companies, are required to give the Federal Reserve prior written notice of any purchase or redemption of its outstanding equity securities if the consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of their consolidated net worth. The Federal Reserve may disapprove a purchase or redemption if it determines that the proposal would constitute an unsafe or unsound practice or would violate any law, regulation, Federal Reserve order, or any condition imposed by, or written agreement with, the Federal Reserve.

Capital Requirements. The Federal Reserve has established capital adequacy guidelines for bank holding companies that generally parallel the capital requirements of the FDIC for the Bank. The Federal Reserve regulations provide that capital standards will be applied on a consolidated basis in the case of a bank holding company with $500 million or more in total consolidated assets.

The Company's total risk based capital must equal 8% of risk-weighted assets and one half of the 8%, or 4%, must consist of Tier 1 (core) capital and its Tier 1 (core) capital must equal 4% of total assets. As of September 30, 2013, the Company's total risk based capital was 16.6% of risk-weighted assets, its risk based capital of Tier 1 (core) capital was 15.3% of risk-weighted assets and its Tier 1 (core) capital was 11.5% of average assets.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. On July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank-Act imposes new restrictions and an expanded framework of regulatory oversight for financial institutions, including depository institutions and implements new capital regulations that Timberland Bancorp will become subject to and that are discussed above under "- Regulation and Supervision of the Bank - New Capital Rules." In addition, among other changes, the Dodd-Frank Act requires public companies, such as Timberland Bancorp, to (i) provide their shareholders with a non-binding vote (a) at least once every three years on the compensation paid to executive officers and (b) at least once every six years on whether they should have a "say on pay" vote every one, two or three years; (ii) have a separate, non-binding shareholder vote regarding golden parachutes for named executive officers when a shareholder vote takes place on mergers, acquisitions, dispositions or other transactions that would trigger the parachute payments; (iii) provide disclosure in annual proxy materials concerning the relationship between the executive compensation paid and the financial performance of the issuer; and (iv) amend Item 402 of Regulation S-K to require companies to disclose the ratio of the Chief Executive Officer's annual total compensation to the median annual total compensation of all other employees. For certain of these changes, the implementing regulations have not been promulgated, so the full impact of the Dodd-Frank Act on public companies cannot be determined at this time.

Sarbanes-Oxley Act of 2002. As a public company, the Company is subject to the Sarbanes-Oxley Act of 2002, which implements a broad range of corporate governance and accounting measures for public companies designed to promote honesty and transparency in corporate America and better protect investors from corporate wrongdoing. The Sarbanes-Oxley Act of 2002 was signed into law on July 30, 2002 in response to public concerns regarding corporate accountability in connection with several accounting scandals. The stated goals of the Sarbanes-Oxley Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The SEC and Sarbanes-Oxley-related regulations and policies include very specific additional disclosure requirements and new corporate governance rules. The Sarbanes-Oxley Act represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

Taxation

Federal Taxation

General. The Company and the Bank report their operations on a fiscal year basis using the accrual method of accounting and are subject to federal income taxation in the same manner as other corporations. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to the Bank or the Company.

Corporate Alternative Minimum Tax. The Internal Revenue Code imposes a tax on alternative minimum taxable income ("AMTI") at a rate of 20%. In addition, only 90% of AMTI can be offset by net operating loss carryovers. AMTI is increased by an amount equal to 75% of the amount by which the Bank's adjusted current earnings exceeds its AMTI (determined without regard to this preference and prior to reduction for net operating losses).

Dividends-Received Deduction. The Company may exclude from its income 100% of dividends received from the Bank as a member of the same affiliated group of corporations. The corporate dividends-received deduction is generally 70% in the case of dividends received from unaffiliated corporations with which the Company and the Bank will not file a consolidated tax return, except that if the Company or the Bank owns more than 20% of the stock of a corporation distributing a dividend, then 80% of any dividends received may be deducted.

Audits. The Company is no longer subject to United States federal tax examination by tax authorities for years ended on or before September 30, 2009.

Washington Taxation

The Company and the Bank are subject to a business and occupation tax imposed under Washington law at the rate of 1.50% of gross receipts at September 30, 2013. Interest received on loans secured by mortgages or deeds of trust on residential properties, residential mortgage-backed securities, and certain U.S. Government and agency securities is not subject to this tax.

Competition

The Bank operates in an intensely competitive market for the attraction of deposits (generally its primary source of lendable funds) and in the origination of loans. Historically, its most direct competition for deposits has come from commercial banks, thrift institutions and credit unions in its primary market area. In times of high interest rates, the Bank experiences additional significant competition for investors' funds from short-term money market securities and other corporate and government securities. The Bank's competition for loans comes principally from mortgage bankers, commercial banks and other thrift institutions. Such competition for deposits and the origination of loans may limit the Bank's future growth and earnings prospects.

Subsidiary Activities

The Bank has one wholly-owned subsidiary, Timberland Service Corporation ("Timberland Service"), whose primary function is to act as the Bank's escrow department and offer non-deposit investment services.

Personnel

As of September 30, 2013, the Bank had 243 full-time employees and 24 part-time and on-call employees. The employees are not represented by a collective bargaining unit and the Bank believes its relationship with its employees is good.

Executive Officers of the Registrant

The following table sets forth certain information with respect to the executive officers of the Company and the Bank.

Executive Officers of the Company and Bank

		Position	
Name	Age at September 30, 2013	Company	Bank
Michael R. Sand	59	President and Chief Executive Officer	President and Chief Executive Officer
Dean J. Brydon	46	Executive Vice President, Chief Financial Officer and Secretary	Executive Vice President, Chief Financial Officer and Secretary
Robert A. Drugge	62	Executive Vice President	Executive Vice President of Lending
Jonathan A. Fischer	39	Executive Vice President and Chief Operating Officer	Executive Vice President and Chief Operating Officer
Edward C. Foster	56	Senior Vice President and Chief Credit Administrator	Senior Vice President and Chief Credit Administrator
Marci A. Basich	44	Senior Vice President and Treasurer	Senior Vice President and Treasurer
Kathie M. Bailey	61	Senior Vice President	Senior Vice President and Chief Operations Officer

Biographical Information.

Michael R. Sand has been affiliated with the Bank since 1977 and has served as President of the Bank and the Company since January 23, 2003. On September 30, 2003, he was appointed as Chief Executive Officer of the Bank and Company. Prior to appointment as President and Chief Executive Officer, Mr. Sand had served as Executive Vice President and Secretary of the Bank since 1993 and as Executive Vice President and Secretary of the Company since its formation in 1997.

Dean J. Brydon has been affiliated with the Bank since 1994 and has served as the Chief Financial Officer of the Company and the Bank since January 2000 and Secretary of the Company and Bank since January 2004. Mr. Brydon is a Certified Public Accountant.

Robert A. Drugge has been affiliated with the Bank since April 2006 and has served as Executive Vice President of Lending since September 2006. Prior to joining Timberland, Mr. Drugge was employed at Bank of America as a senior officer and most recently served as Senior Vice President and Commercial Banking Manager. Mr. Drugge began his banking career at Seafirst in 1974, which was acquired by Bank America Corp. and became known as Bank of America.

Jonathan A. Fischer has been affiliated with the Bank since October 1997 and has served as Chief Operating Officer since August 23, 2012. Prior to that, Mr. Fischer served as the Chief Risk Officer since October 2010. Mr. Fischer also served as the Compliance Officer, Community Reinvestment Act Officer, and Privacy Officer since January 2000.

Edward C. Foster has been affiliated with the Bank, and has served as Chief Credit Administrator since February 2012. Prior to joining the Bank, Mr. Foster was employed by the FDIC, where he served as a Loan Review Specialist from January 2011 to February 2012. Mr. Foster owned a Credit Administration Consulting Business from February 2010 to January 2011. Prior to that, Mr. Foster served as the Chief Credit Officer for Carson River Community Bank from April 2008 through February 2010. Before joining Carson River Community Bank, Mr. Foster served as a Senior Regional Credit Officer for Omni National Bank from September 2006 through March 2008.

Marci A. Basich has been affiliated with the Bank since 1999 and has served as Treasurer of the Company and the Bank since January 2002. Ms. Basich is a Certified Public Accountant.

Kathie M. Bailey has been affiliated with the Bank since 1984 and has served as Senior Vice President and Chief Operations Officer since 2003. Ms. Bailey will be retiring effective December 31, 2013.

Item 1A. Risk Factors

We assume and manage a certain degree of risk in order to conduct our business strategy. In addition to the risk factors described below, other risks and uncertainties not specifically mentioned, or that are currently known to, or deemed to be immaterial by management, also may materially and adversely affect our financial position, results of operations and/or cash flows. Before making an investment decision, you should carefully consider the risks described below together with all of the other information included in this Form 10-K. If any of the circumstances described in the following risk factors actually occur to a significant degree, the value of our common stock could decline, and you could lose all or part of your investment.

The current weak economic conditions in the market areas we serve may continue to adversely impact our earnings and could increase the credit risk associated with our loan portfolio.

Substantially all of our loans are to businesses and individuals in the state of Washington. A continuing decline in the economies of our local market areas of Grays Harbor, Pierce, Thurston, King, Kitsap and Lewis counties in which we operate, and which we consider to be our primary market areas, could have a material adverse effect on our business, financial condition, results of operations and prospects. In particular, Washington has experienced substantial home price declines and increased foreclosures and has experienced above average unemployment rates.

Continued weakness or a further deterioration in economic conditions in the market areas we serve could result in the following consequences, any of which could have a materially adverse impact on our business, financial condition and results of operations:

- loan delinquencies, problem assets and foreclosures may increase;
- the sale of foreclosed assets may slow;
- demand for our products and services may decline possibly resulting in a decrease in our total loans or assets;
- collateral for loans made may decline further in value, exposing us to increased risk loans, reducing customers' borrowing power, and reducing the value of assets and collateral associated with existing loans;
- the net worth and liquidity of loan guarantors may decline, impairing their ability to honor commitments to us; and
- the amount of our low-cost or non-interest bearing deposits may decrease and the composition of our deposits may be adversely affected.

A return of recessionary conditions could result in increases in our level of non-performing loans and/or reduce demand for our products and services, which could have adverse effect on our results of operations.

The ongoing debate in Congress regarding the national debt ceiling and federal budget deficit and concerns over the United States' credit rating (which was downgraded by Standard & Poor's), the European sovereign debt crisis, the overall weakness in the economy, continued high unemployment in the United States, among other economic indicators, and the recent U.S. government shutdown, have contributed to increased volatility in the capital markets and diminished expectations for the economy.

A return of recessionary conditions and/or continued negative developments in the domestic and international credit markets may significantly affect the markets in which we do business, the value of our loans and investments, and our ongoing operations, costs and profitability. Declines in real estate values and sales volumes and continued relatively high unemployment levels may result in higher than expected loan delinquencies and a decline in demand for our products and services. These negative events may cause us to incur losses and may adversely affect our capital, liquidity, and financial condition.

Furthermore, the Board of Governors of the Federal Reserve System, in an attempt to help the overall economy, has, among other things, kept interest rates low through its targeted federal funds rate and the purchase of mortgage-backed securities. If the Federal Reserve increases the federal funds rate, overall interest rates will likely rise, which may negatively impact the housing markets and the U.S. economic recovery. In addition, deflationary pressures, while possibly lowering our operating costs, could have a significant negative effect on our borrowers, especially our business borrowers, and the values of underlying collateral securing loans, which could negatively affect our financial performance.

Strong competition within our market areas could hurt our profits and slow growth.

Although we consider ourselves competitive in our market areas, we face intense competition in both making loans and attracting deposits. Price competition for loans and deposits might result in our earning less on our loans and paying more on our deposits, which reduces net interest income. Some of the institutions with which we compete have substantially greater resources than we have and may offer services that we do not provide. We expect competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Our profitability will depend upon our continued ability to compete successfully in our market areas.

Our real estate construction and land development loans expose us to significant risks.

We make real estate construction loans to individuals and builders, primarily for the construction of residential properties. We originate these loans whether or not the collateral property underlying the loan is under contract for sale. At September 30, 2013, construction and land development loans totaled $45.1 million, or 7.8% of our total loan portfolio, of which $42.4 million were for residential real estate projects. Approximately $40.8 million of our residential construction loans were made to finance the construction of owner-occupied homes and are structured to be converted to permanent loans at the end of the construction phase. Land development loans, which are loans made with land as security, totaled $515,000, or 0.1% of our total loan portfolio at September 30, 2013. In general, construction and land development lending involves additional risks because of the inherent difficulty in estimating a property's value both before and at completion of the project as well as the estimated cost of the project. Construction costs may exceed original estimates as a result of increased materials, labor or other costs. In addition, because of current uncertainties in the residential real estate market, property values have become more difficult to determine. Construction loans and land development loans often involve the disbursement of funds with repayment dependent, in part, on the success of the project and the ability of the borrower to sell or lease the property or refinance the indebtedness, rather than the ability of the borrower or guarantor to repay principal and interest. These loans are also generally more difficult to monitor. In addition, speculative construction loans to builders are often associated with homes that are not pre-sold, and thus pose a greater potential risk than construction loans to individuals on their personal residences. At September 30, 2013, $1.4 million of our construction portfolio was comprised of speculative one- to four-family construction loans. Approximately $659,000, or 1.5%, of our total real estate construction and land development loans were non-performing at September 30, 2013. A material increase in our non-performing construction and loan development loans could have a material adverse effect on our financial condition and results of operation.

Our emphasis on commercial real estate lending may expose us to increased lending risks.

Our current business strategy includes an emphasis on commercial real estate lending. This type of lending activity, while potentially more profitable than single-family residential lending, is generally more sensitive to regional and local economic conditions, making loss levels more difficult to predict. Collateral evaluation and financial statement analysis in these types of loans requires a more detailed analysis at the time of loan underwriting and on an ongoing basis. In our primary market of western Washington, a further downturn in the real estate market, could increase loan delinquencies, defaults and foreclosures, and significantly impair the value of our collateral and our ability to sell the collateral upon foreclosure. Many of our commercial borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss.

At September 30, 2013, we had $291.3 million of commercial real estate mortgage loans, representing 50.3% of our total loan portfolio. These loans typically involve higher principal amounts than other types of loans, and repayment is dependent upon income generated, or expected to be generated, by the property securing the loan in amounts sufficient to cover operating expenses and debt service, which may be adversely affected by changes in the economy or local market conditions. For example, if the cash flow from the borrower's project is reduced as a result of leases not being obtained or renewed, the borrower's ability to repay the loan may be impaired. Commercial real estate loans also expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans typically cannot be sold as easily as residential real estate. In addition, many of our commercial real estate loans are not fully amortizing and contain large balloon payments upon maturity. Such balloon payments may require the borrower to either sell or refinance the underlying property in order to make the payment, which may increase the risk of default or non-payment.

A secondary market for most types of commercial real estate loans is not readily liquid, so we have less opportunity to mitigate credit risk by selling part or all of our interest in these loans. As a result of these characteristics, if we foreclose on a commercial real estate loan, our holding period for the collateral typically is longer than for one- to four-family residential mortgage loans because there are fewer potential purchasers of the collateral. Accordingly, charge-offs on commercial real estate loans may be larger as a percentage of the total principal outstanding than those incurred with our residential or consumer loan portfolios.

The level of our commercial real estate loan portfolio may subject us to additional regulatory scrutiny.

The FDIC, the Federal Reserve and the Office of the Comptroller of the Currency have promulgated joint guidance on sound risk management practices for financial institutions with concentrations in commercial real estate lending. Under this guidance, a financial institution that, like us, is actively involved in commercial real estate lending should perform a risk assessment to identify concentrations. A financial institution may have a concentration in commercial real estate lending if, among other factors (i) total reported loans for construction, land development, and other land represent 100% or more of total capital, or (ii) total reported loans secured by multi-family and non-farm residential properties, loans for construction, land development and other land, and loans otherwise sensitive to the general commercial real estate market, including loans to commercial real estate related entities, represent 300% or more of total capital. The particular focus of the guidance is on exposure to commercial real estate loans that are dependent on the cash flow from the real estate held as collateral and that are likely to be at greater risk to conditions in the commercial real estate market (as opposed to real estate collateral held as a secondary source of repayment or as an abundance of caution). The purpose of the guidance is to guide banks in developing risk management practices and capital levels commensurate with the level and nature of real estate concentrations. The guidance states that management should employ heightened risk management practices including board and management oversight and strategic planning, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing. We have concluded that we have a concentration in commercial real estate lending under the foregoing standards because our balance in commercial real estate loans at September 30, 2013 represents more than 300% of total capital. While we believe we have implemented policies and procedures with respect to our commercial real estate loan portfolio consistent with this guidance, bank regulators could require us to implement additional policies and procedures consistent with their interpretation of the guidance that may result in additional costs to us.

Repayment of our commercial business loans is often dependent on the cash flows of the borrower, which may be unpredictable, and the collateral securing these loans may fluctuate in value.

At September 30, 2013, we had $17.5 million or 3.0% of total loans in commercial business loans. Commercial business lending involves risks that are different from those associated with residential and commercial real estate lending. Real estate lending is generally considered to be collateral based lending with loan amounts based on predetermined loan to collateral values and liquidation of the underlying real estate collateral being viewed as the primary source of repayment in the event of borrower default. Our commercial business loans are primarily made based on the cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The borrowers' cash flow may be unpredictable, and collateral securing these loans may fluctuate in value. Although commercial business loans are often collateralized by equipment, inventory, accounts receivable, or other business assets, the liquidation of collateral in the event of default is often an insufficient source of repayment because accounts receivable may be uncollectible and inventories may be obsolete or of limited use, among other things. Accordingly, the repayment of commercial business loans depends primarily on the cash flow and credit worthiness of the borrower and secondarily on the underlying collateral provided by the borrower.

Our business may be adversely affected by credit risk associated with residential property.

At September 30, 2013, $137.3 million, or 23.7% of our total loan portfolio, was secured by one- to four-family mortgage loans and home equity loans. This type of lending is generally sensitive to regional and local economic conditions that significantly impact the ability of borrowers to meet their loan payment obligations, making loss levels difficult to predict. The decline in residential real estate values as a result of the downturn in the Washington housing market has reduced the value of the real estate collateral securing these types of loans and increased the risk that we would incur losses if borrowers default on their loans.

Many of our residential mortgage loans are secured by liens on mortgage properties in which the borrowers have little or no equity because either we originated the loan with a relatively high combined loan-to-value ratio or because of the decline in home values in our market areas. Residential loans with combined higher 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 proceeds. Further, a significant amount of our home equity lines of credit consist of second mortgage loans. For those home equity lines secured by a second mortgage, it is unlikely that we will be successful in recovering all or a portion of our loan proceeds in the event of default unless we are prepared to repay the first mortgage loan and such repayment and the costs associated with a foreclosure are justified by the value of the property. For these reasons, we may experience higher rates of delinquencies, default and losses on our residential loans.

Our net charge-offs have increased during the past five years compared to historical averages and we may be required to make further increases in our provision for loan losses and to charge-off additional loans in the future, which could adversely affect our results of operations.

For the fiscal years ended September 30, 2013, 2012, 2011, 2010 and 2009 we recorded net loan charge-offs of $3.6 million, $3.6 million, $6.1 million, $13.5 million and $4.4 million, respectively. During these last five fiscal years, we experienced higher loan delinquencies and credit losses than our historical averages. Our non-performing loans and assets have historically reflected unique operating difficulties for individual borrowers rather than weakness in the overall economy of the Pacific Northwest; however, more recently the deterioration in the general economy has become a significant contributing factor to the increased levels of delinquencies and non-performing loans. Further, our portfolio is concentrated in construction and land development loans, land loans and commercial and commercial real estate loans, all of which have a higher risk of loss than residential mortgage loans.

The housing and real estate markets have recently modestly improved in several of our market areas, however, until general economic conditions improve further, we expect that we will continue to experience further delinquencies and credit losses. As a result, we could be required to make further increases in our provision for loan losses to increase our allowance for loan losses. Our allowance for loan losses was 1.99% of total loans held for investment and 79% of non-performing loans at September 30, 2013. Any increases in the provision for loan losses will result in a decrease in net income and may have a material adverse effect on our financial condition, results of operations and our capital.

Our allowance for loan losses may prove to be insufficient to absorb losses in our loan portfolio.

Lending money is a substantial part of our business and each loan carries a certain risk that it will not be repaid in accordance with its terms or that any underlying collateral will not be sufficient to assure repayment. This risk is affected by, among other things:

- the cash flow of the borrower and/or the project being financed;
- the changes and uncertainties as to the future value of the collateral, in the case of a collateralized loan;
- the duration of the loan;
- the credit history of a particular borrower; and
- changes in economic and industry conditions.

We maintain an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense, which we believe is appropriate to provide for probable losses in our loan portfolio. The amount of this allowance is determined by our management through periodic comprehensive reviews and consideration of several factors, including, but not limited to:

- an ongoing review of the quality, size and diversity of the loan portfolio;
- evaluation of non-performing loans;
- historical default and loss experience;
- existing economic conditions;

- risk characteristics of the various classifications of loans; and
- the amount and quality of collateral, including guarantees; securing the loans.

The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Continuing deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for loan losses. In addition, bank regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for loan losses we will need additional provisions to replenish the allowance for loan losses. Any additional provisions will result in a decrease in net income and possibly capital, and may have a material adverse effect on our financial condition and results of operations.

If our non-performing assets increase, our earnings will be adversely affected.

At September 30, 2013 our non-performing assets (which consist of non-accruing loans, accruing loans 90 days or more past due, non-accrual investment securities, and other real estate owned and other repossessed assets) were $28.0 million, or 3.75% of total assets. Our non-performing assets adversely affect our net income in various ways:

- We do not record interest income on non-accrual loans or non-performing investment securities, except on a cash basis when the collectibility of the principal is not in doubt.
- We must provide for probable loan losses through a current period charge to the provision for loan losses.
- Non-interest expense increases when we must write down the value of properties in our OREO portfolio to reflect changing market values.
- Non-interest income decreases when we must recognize other-than-temporary impairment on non-performing investment securities.
- There are legal fees associated with the resolution of problem assets, as well as carrying costs, such as taxes, insurance, and maintenance costs related to our OREO.
- The resolution of non-performing assets requires the active involvement of management, which can distract them from more profitable activity.

If additional borrowers become delinquent and do not pay their loans and we are unable to successfully manage our non-performing assets, our losses and troubled assets could increase significantly, which could have a material adverse effect on our financial condition and results of operations.

We have classified an additional $18.6 million in loans as performing troubled debt restructurings at September 30, 2013.

If our investments in real estate are not properly valued or sufficiently reserved to cover actual losses, or if we are required to increase our valuation allowances, 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 taken in as OREO, and at certain other times during the assets holding period. Our net book value (“NBV”) in the loan at the time of foreclosure and thereafter is compared to the updated estimated market value of the foreclosed property less estimated selling costs (fair value). A charge-off is recorded for any excess in the asset’s NBV over its fair value. If our valuation process is incorrect or if the property declines in value after foreclosure, the fair value of our OREO may not be sufficient to recover our NBV in such assets, resulting in the need for a valuation allowance.

In addition, bank regulators periodically review our OREO and may require us to recognize further valuation allowances. Significant charge-offs to our OREO, may have a material adverse effect on our financial condition and results of operations.

Other-than-temporary impairment charges in our investment securities portfolio could result in additional losses.

During the year ended September 30, 2013, we recognized a $47,000 other than temporary impairment ("OTTI") charge on private label mortgage backed securities we hold for investment. Management concluded that the decline of the estimated fair value below the cost of these securities was other than temporary and recorded a credit loss through non-interest income. At September 30, 2013 our remaining private label mortgage backed securities portfolio totaled $2.4 million.

We closely monitor our investment securities for changes in credit risk. The valuation of our investment securities also is influenced by external market and other factors, including implementation of Securities and Exchange Commission and Financial Accounting Standards Board guidance on fair value accounting, default rates on residential mortgage securities, rating agency actions, and the prices at which observable market transactions occur. The current market environment limits our ability to mitigate our exposure to valuation changes in our investment securities by selling them. Accordingly, if market conditions deteriorate further and we determine our holdings of private label mortgage backed securities or other investment securities are other than temporarily impaired, our results of operations could be adversely affected.

An increase in interest rates, change in the programs offered by Freddie Mac or our ability to qualify for their programs may reduce our mortgage revenues, which would negatively impact our non-interest income.

The sale of residential mortgage loans to Freddie Mac provides a significant portion of our non-interest income. Any future changes in their program, our eligibility to participate in such program, the criteria for loans to be accepted or laws that significantly affect the activity of Freddie Mac could, in turn, materially adversely affect our results of operations if we could not find other purchasers. Further, in a rising or higher interest rate environment, the demand for mortgage loans, particularly refinancing of existing mortgage loans, tend to fall and our originations of mortgage loans may decrease, resulting in fewer loans that are available to be sold. This would result in a decrease in mortgage revenues and a corresponding decrease in non-interest income. In addition, our results of operations are affected by the amount of non-interest expense associated with our loan sale activities, such as salaries and employee benefits, occupancy, equipment and data processing expense and other operating costs. During periods of reduced loan demand, our results of operations may be adversely affected to the extent that we are unable to reduce expenses commensurate with the decline in loan originations.

Our real estate lending also exposes us to the risk of environmental liabilities.

In the course of our business, we may foreclose and take title to real estate, and we could be subject to environmental liabilities with respect to these properties. We may be held liable by a governmental entity or by third persons for property damage, personal injury, investigation, and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we ever become subject to significant environmental liabilities, our business, financial condition and results of operations could be materially and adversely affected.

Fluctuating interest rates can adversely affect our profitability.

Our profitability is dependent to a large extent upon net interest income, which is the difference, or spread, between the interest earned on loans, securities and other interest-earning assets and the interest paid on deposits, borrowings, and other interest-bearing liabilities. Because of the differences in maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. We principally manage interest rate risk by managing our volume and mix of our earning assets and funding liabilities. In a changing interest rate environment, we may not be able to manage this risk effectively. Changes in interest rates also can affect: (1) our ability to originate and/or sell loans; (2) the fair value of our interest-earning assets, which would negatively impact shareholders' equity, and our ability to realize gains from the sale of such assets; (3) our ability to obtain and retain deposits in competition with other available investment alternatives; (4) the ability of our borrowers to repay adjustable or variable rate loans; and (5) the average duration of our mortgage-backed securities portfolio and the interest-earning assets. Interest rates are highly sensitive to many factors, including government monetary policies, domestic and international economic and political conditions and other factors beyond our control. If we are unable to manage interest rate risk effectively, our business, financial condition and results of operations could be materially affected.

As a result of the relatively low interest rate environment, an increasing percentage of our deposits have been comprised of short-term certificates of deposit and other deposits yielding no or a relatively low rate of interest. At September 30, 2013, we had $111.5 million in certificates of deposit that mature within one year and $434.1 million in non-interest bearing, NOW checking, savings and money market accounts. We would incur a higher cost of funds to retain these deposits in a rising interest rate environment. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings. In addition, a substantial amount of our residential mortgage loans and home equity lines of credit have adjustable interest rates. As a result, these loans may experience a higher rate of default in a rising interest rate environment.

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on our results of operations, any substantial, unexpected or prolonged change in market interest rates could have a material adverse effect on our financial condition and results of operations. Also, our interest rate risk modeling techniques and assumptions likely may not fully predict or capture the impact of actual interest rate changes on our balance sheet.

Historically low interest rates may adversely affect our net interest income and profitability.

During the last four years it has been the policy of the Federal Reserve to maintain interest rates at historically low levels through its targeted federal funds rate and the purchase of mortgage-backed securities. As a result, yields on securities we have purchased, and market rates on the loans we have originated, have been at levels lower than were available prior to 2008. Consequently, the average yield on our interest-earning assets has decreased during the recent low interest rate environment.

However, our ability to lower our interest expense is limited at these interest rate levels, while the average yield on our interest-earning assets may continue to decrease. The Federal Reserve has indicated its intention to maintain low interest rates in the near future. Accordingly, our net interest income may decrease, which may have an adverse affect on our profitability. For information with respect to changes in interest rates, see "-Fluctuating interest rates can adversely affect our profitability."

Increases in deposit insurance premiums and special FDIC assessments can adversely affect our earnings.

The Dodd-Frank Act established 1.35% as the minimum reserve ratio. The FDIC has adopted a plan under which it will meet this ratio by the statutory deadline of September 30, 2020. The Dodd-Frank Act requires the FDIC to offset the effect on institutions with assets less than $10 billion of the increase in the minimum reserve ratio to 1.35% from the former minimum of 1.15%. The FDIC has not announced how it will implement this offset. In addition to the statutory minimum ratio, the FDIC must set a designated reserve ratio, or DRR, which may exceed the statutory minimum. The FDIC has set 2.0% as the DRR.

As required by the Dodd-Frank Act, the FDIC has adopted final regulations under which insurance premiums are based on an institution's average consolidated total assets less average tangible equity capital instead of its deposits. While our FDIC insurance premiums initially have been reduced by these regulations, it is possible that our future insurance premiums will increase under the final regulations.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition, growth and prospects.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on our liquidity. We rely on customer deposits and advances from the FHLB of Seattle, borrowings from the Federal Reserve Bank of San Francisco and other borrowings to fund our operations. At September 30, 2013, we had $45.0 million of FHLB advances outstanding with an additional $190.8 million of available borrowing capacity through the FHLB and the FRB. Although we have historically been able to replace maturing deposits and advances if desired, we may not be able to replace such funds in the future if, among other things, our financial condition, the financial condition of the FHLB or FRB, or market conditions change. Our access to funding sources in amounts adequate to finance our activities or on terms which are acceptable could be impaired by factors that affect us specifically or the financial services industry or economy in general such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry in light of the recent turmoil faced by banking organizations and the continued deterioration in credit markets. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity as a result of a downturn in the Washington markets where our deposits are concentrated or adverse regulatory action against us.

Our financial flexibility will be severely constrained if we are unable to maintain our access to funding or if adequate financing is not available to accommodate future growth at acceptable interest rates. Although we consider our sources of funds adequate for our liquidity needs, we may seek additional debt in the future to achieve our long-term business objectives. Additional borrowings, if sought, may not be available to us or, if available, may not be available on reasonable terms. If additional financing sources are unavailable, or are not available on reasonable terms, our financial condition, results of operations, growth and future prospects could be materially adversely affected. Finally, if we are required to rely more heavily on more expensive funding sources to support future growth, our income may not increase proportionately to cover our costs.

We operate in a highly regulated environment and may be adversely affected by changes in federal and state laws and regulations, that are expected to increase our costs of operations.

The financial services industry is extensively regulated. Timberland Bank is currently subject to extensive examination, supervision and comprehensive regulation by the DFI, our state regulator, and the FDIC, as insurer of our deposits. As a bank holding company, Timberland Bancorp is subject to examination, supervision and regulation by the Federal Reserve. Such regulation and supervision governs the activities in which an institution and its holding company may engage, and are intended primarily for the protection of the deposit insurance fund and consumers and not to benefit our shareholders. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the ability to impose restrictions on our operations, the classification of our assets, and the determination of the level of our allowance for loan losses and level of deposit insurance premiums assessed. Additionally, actions by regulatory agencies or significant litigation against us could require us to devote significant time and resources to defending our business and may lead to penalties that materially affect us. These regulations, along with the currently existing tax, accounting, securities, insurance, and monetary laws, regulations, rules, standards, policies, and interpretations control the methods by which financial institutions conduct business, implement strategic initiatives and tax compliance, and govern financial reporting and disclosures. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on our operations.

As discussed under "Business-Regulation of the Bank- [Financial Regulatory Reform]" in Item I of this Form 10-K, the Dodd-Frank Act has significantly changed the bank regulatory structure and will affect the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting and implementing rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years. It is difficult at this time to predict when or how any new standards will ultimately be applied to us or what specific impact the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on community banks. However, it is expected that at a minimum they will increase our operating and compliance costs and could increase our non-interest expense.

The short-term and long-term impact of the changing regulatory capital requirements and new capital rules is uncertain.

As discussed under "Business-Regulation of the Bank-[New Capital Rules]" in Item I of this Form 10-K, effective January 1, 2015, Timberland Bancorp and Timberland Bank will be subject to new capital requirements under regulations adopted by the federal banking regulators to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. These new requirements establish the following minimum capital ratios: (1) a common equity Tier 1 ("CET1") capital ratio of 4.5% of risk-weighted assets; (2) a Tier 1 capital ratio of 6.0% of risk-weighted assets; (3) a total capital ratio of 8.0% of risk-weighted assets; and (4) a leverage ratio of 4.0%. In addition, there is a new requirement to maintain a capital conservation buffer, comprised of CET1 capital, in an amount greater than 2.5% of risk-weighted assets over the minimum capital required by each of the minimum risk-based capital ratios in order to avoid limitations on the organization's ability to pay dividends, repurchase shares or pay discretionary bonuses. The capital conservation buffer requirement will be phased in, beginning January 1, 2016, requiring during 2016 a buffer amount greater than 0.625% in order to avoid these limitations, and increasing the amount each year until beginning January 1, 2019, the buffer amount must be greater than 2.5% in order to avoid the limitation.

The new regulations also change what qualifies as capital for purposes of meeting these various capital requirements, as well as the risk-weights of certain assets for purposes of the risk-based capital ratios. Under the new regulations, in order to be considered well-capitalized for prompt corrective action purposes, Timberland Bank will be required to maintain the following ratios: (1) a CET1 ratio of at least 6.5% of risk-weighted assets; (2) a Tier 1 capital ratio of at least 8.0% of risk-weighted assets; (3) a total capital ratio of at least 10.0% of risk-weighted assets; and (4) a leverage ratio of at least 5.0%.

We have conducted a pro forma analysis of these new requirements as of September 30, 2013. We have determined that if these requirements were in effect on that date, Timberland Bancorp and Timberland Bank would be considered well-capitalized.

The application of these more stringent capital requirements could, among other things, result in lower returns on invested capital, over time require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in management modifying its business strategy and could limit our ability to make distributions, including paying out dividends or buying back shares. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Any additional changes in our regulation and oversight, in the form of new laws, rules and regulations could make compliance more difficult or expensive or otherwise materially adversely affect our business, financial condition or prospects.

Our growth or future losses may require us to raise additional capital in the future, but that capital may not be available when it is needed or the cost of that capital may be very high.

We are required by federal regulatory authorities to maintain adequate levels of capital to support our operations. At some point, we may need to raise additional capital to support continued growth. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial condition and performance. If we are able to raise capital it may not be on terms that are acceptable to us. Accordingly, we cannot make assurances that we will be able to raise additional capital. If we cannot raise additional capital when needed, our operations could be materially impaired and our financial condition and liquidity could be materially and adversely affected. As a result, we may have to raise additional capital on terms that may be dilutive to our shareholders.

We may experience future goodwill impairment, which could reduce our earnings.

We performed our test for goodwill impairment for fiscal year 2013, and the test concluded that recorded goodwill was not impaired. Our assessment of the fair value of goodwill is based on an evaluation of market capitalizations for similar financial institutions, discounted cash flows from forecasted earnings, our current market capitalization, and a valuation of our assets and liabilities. Our evaluation of the fair value of goodwill involves a substantial amount of judgment. If our judgment was incorrect, or if events or circumstances change, and an impairment of goodwill was deemed to exist, we would be required to write down our goodwill resulting in a charge to earnings, which would adversely affect our results of operations, perhaps materially; however, it would have no impact on our liquidity, operations or regulatory capital.

Our investment in Federal Home Loan Bank of Seattle stock may become impaired.

At September 30, 2013, we owned $5.5 million in FHLB stock. As a condition of membership at the FHLB, we are required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB and is calculated in accordance with the Capital Plan of the FHLB. Our FHLB stock has a par value of $100, is recorded at cost, and it is subject to recoverability testing per applicable accounting standards. The FHLB announced that, as of December 31, 2008, it had a risk-based capital deficiency under the regulations of the Federal Housing Finance Agency (the "FHFA"), its primary regulator and that it would suspend future dividends and the repurchase and redemption of outstanding common stock. In September 2012, the FHLB announced that the FHFA reclassified the FHLB of Seattle to be adequately capitalized. The FHLB also announced that it had been granted authority to repurchase up to $25 million of excess capital stock per quarter, provided they receive a non-objection from the FHFA. As of September 30, 2013, the FHLB had repurchased $203,000 of its stock from the Bank at par value. The FHLB announced in July 2013 that, based on its second quarter 2013 financial results, their Board of Directors had declared a $0.025 per share cash dividend. This represented the first dividend in a number of years and represents a significant milestone in FHLB's return to normal operations. As a result, we have not recorded an impairment on our investment in FHLB stock. Deterioration in the FHLB's financial position may, however, result in future impairment in the value of those securities. We will continue to monitor the financial condition of the FHLB as it relates to, among other things, the recoverability of our investments.

We may experience decreases in the fair value of our mortgage servicing rights, which could reduce our earnings.

Mortgage servicing rights (“MSRs”) are capitalized at estimated fair value when acquired through the origination of loans that are subsequently sold with servicing rights retained. At September 30, 2013 our MSRs totaled $2.3 million. MSRs are amortized to servicing income on loans sold over the period of estimated net servicing income. The estimated fair value of MSRs at the date of the sale of loans is determined based on the discounted present value of expected future cash flows using key assumptions for servicing income and costs and prepayment rates on the underlying loans. On a quarterly basis we evaluate the fair value of MSRs for impairment by comparing actual cash flows and estimated cash flows from the servicing assets to those estimated at the time servicing assets were originated. Our methodology for estimating the fair value of MSRs is highly sensitive to changes in assumptions, such as prepayment speeds. The effect of changes in market interest rates on estimated rates of loan prepayments represents the predominant risk characteristic underlying the MSRs portfolio. For example, a decrease in mortgage interest rates typically increases the prepayment speeds of MSRs and therefore decreases the fair value of the MSRs. We recorded a $475,000 valuation recovery to our MSRs during the year ended September 30, 2013, which increased our earnings. Future decreases in mortgage interest rates could decrease the fair value of our MSRs below their recorded amount, which would decrease our earnings.

Our assets as of September 30, 2013 include a deferred tax asset and we may not be able to realize the full amount of such asset.

We recognize deferred tax assets and liabilities based on differences between the financial statement recorded amounts and the tax bases of assets and liabilities. At September 30, 2013, the net deferred tax asset was approximately $2.8 million. The net deferred tax asset results primarily from our provision for loan losses recorded for financial reporting purposes, which has been larger than net loan charge-offs deducted for tax reporting purposes.

We regularly review our net deferred tax assets for recoverability based on our expectations of future earnings and expected timing of reversals of temporary differences and record a valuation allowance if deemed necessary. Realization of deferred tax assets ultimately depends on the existence of sufficient taxable income, including taxable income in prior carry-back years, as well as future taxable income. We believe the recorded net deferred tax asset at September 30, 2013 is fully realizable; however, if we determine that we will be unable to realize all or part of the net deferred tax asset, we would adjust the net deferred tax asset, which would negatively impact our financial condition and results of operations.

The Series A Preferred Stock impacts net income to our common shareholders and net income per common share and the warrant we issued to Treasury may be dilutive to holders of our common stock.

On November 13, 2012, our outstanding shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A, ("Series A Preferred Stock") with a redemption value of $1,000 per share, originally issued to the U.S. Treasury Department ("Treasury") on December 23, 2008 as part of the CPP, 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 securities, 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 up to 370,899 shares of our common stock at a price of $6.73 per share at any time through December 23, 2018. 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. The dividends declared or accrued on the Series A Preferred Stock reduce the net income to common shareholders and our net income per common share. The Series A Preferred Stock will also receive preferential treatment in the event of liquidation, dissolution or winding up of the Company. Additionally, the ownership interest of the existing holders of our common stock will be diluted to the extent the warrant we issued in conjunction with the sale of the Series A Preferred Stock is exercised. The shares of common stock underlying the warrant represent approximately 5.0% of the shares of our common stock outstanding as of September 30, 2013 (including the shares issuable upon exercise of the warrant in total shares outstanding).

If we are unable to redeem our Series A Preferred Stock by December 2013, the cost of this capital to us will increase substantially.

If we are unable to redeem our Series A Preferred Stock prior to December 23, 2013, the cost of this capital to us will increase substantially on that date, from 5.0% per annum (approximately $603,000 annually) to 9.0% per annum (approximately $1.1 million annually). Depending on our financial condition at the time, this increase in the annual dividend rate on the Series A Preferred Stock could have a material negative effect on our liquidity and ability to pay dividends to common shareholders.

Regulatory and contractual restrictions may limit or prevent us from paying dividends on our common stock.

Holders of our common stock are only entitled to receive such dividends as our Board may declare out of funds legally available for such payments. As an entity separate and distinct from the Bank, the Company derives substantially all of its revenue in the form of dividends from the Bank. Accordingly, the Company is and will be dependent upon dividends from the Bank to satisfy its cash needs and to pay dividends on its common stock. The inability to receive dividends from the Bank could have a material adverse effect on the Company's business, financial condition and results of operations. The Bank's ability to pay dividends is subject to its ability to earn net income and, to meet certain regulatory requirements. The lack of a cash dividend could adversely affect the market price of our common stock.

Changes in accounting standards may affect our performance.

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. From time to time there are changes in the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be difficult to predict and can materially impact how we report and record our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in a retrospective adjustment to prior financial statements.

We are subject to a variety of operational risks, including legal and compliance risk, fraud and theft risk and the risk of operational errors, which may adversely affect our business and results of operations.

We are from time to time subject to claims and proceedings related to our operations. These claims and legal actions, which could include supervisory or enforcement actions by our regulators, or criminal proceedings, could involve large monetary claims, including civil money penalties or fines imposed by government authorities, and significant defense costs. To mitigate the cost of some of these claims, we maintain insurance coverage in amounts and with deductibles that we believe are appropriate for our operations.

Both internal and external fraud and theft are risks. If personal, non-public, confidential or proprietary information of customers in our possession were to be mishandled or misused, we could suffer significant regulatory consequences, reputational damage and financial loss. Such mishandling or misuse could include, for example, if such information were erroneously provided to parties who are not permitted to have the information, either by fault of our systems, employees, or counterparties, or if such information were to be intercepted or otherwise inappropriately taken by third parties.

Operational errors include clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems. Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. Because of our large transaction volume and our necessary dependence upon automated systems to record and process these transactions there is a risk that technical flaws or tampering or manipulation of those automated systems arising from events wholly or partially beyond our control may give rise to a disruption of service to customers and to financial loss or liability. We are exposed to the risk that our business continuity and data security systems may prove to be inadequate.

The occurrence of any of these risks could result in a diminished ability to operate our business, additional costs to correct defects, potentially liability to clients, reputational damage and regulatory intervention, any of which could adversely affect our business, financial condition and results of operations.

We are dependent on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects.

Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of, and experience in, the community banking industry where the Bank conducts its business. The process of recruiting personnel with the combination of skills and attributes required to carry out our strategies is often lengthy. Our success depends to a significant degree upon our ability to attract and retain qualified management, loan origination, finance, administrative, marketing and technical personnel and upon the continued contributions of our management and personnel. In particular, our success has been and continues to be highly dependent upon the abilities of key executives, including our President, and certain other employees. In addition, our success has been and continues to be highly dependent upon the services of our directors, and we may not be able to identify and attract suitable candidates to replace such directors.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

At September 30, 2013 the Bank operated 22 full service facilities. The following table sets forth certain information regarding the Bank's offices, all of which are owned, except for the Tacoma office, the Gig Harbor office and the Lacey office at 1751 Circle Lane SE, which are leased.

Location	Year Opened	Approximate Square Footage	Deposits at September 30, 2013 (In thousands)
Main Office:			
624 Simpson Avenue Hoquiam, Washington 98550	1966	7,700	$71,849
Branch Offices:			
300 N. Boone Street Aberdeen, Washington 98520	1974	3,400	31,804
201Main Street South Montesano, Washington 98563	2004	3,200	29,928
361 Damon Road Ocean Shores, Washington 98569	1977	2,100	23,429
2418 Meridian Avenue East	1980	2,400	37,561

Edgewood, Washington 98371			
202 Auburn Way South Auburn, Washington 98002	1994	4,200	24,949
12814 Meridian Avenue East (South Hill) Puyallup, Washington 98373	1996	4,200	36,331
1201 Marvin Road, N.E. Lacey, Washington 98516	1997	4,400	20,365
101 Yelm Avenue W. Yelm, Washington 98597	1999	3,400	18,581

20464 Viking Way NW Poulsbo, Washington 98370	1999	1,800	13,870
2419 224th Street E. Spanaway, Washington 98387	1999	3,900	29,990
801 Trosper Road SW Tumwater, Washington 98512	2001	3,300	29,784
7805 South Hosmer Street Tacoma, Washington 98408	2001	5,000	30,661
2401 Bucklin Hill Road Silverdale, Washington 98383	2003	4,000	36,144
423 Washington Street SE Olympia, Washington 98501	2003	3,000	19,298
3105 Judson Street Gig Harbor, Washington 98335	2004	2,700	24,405
117 N. Broadway Aberdeen, Washington 98520	2004	3,700	22,640
313 West Waldrip Street Elma, Washington 98541	2004	5,900	23,456
1751 Circle Lane SE Lacey, Washington 98503	2004	900	13,417
101 2nd Street Toledo, Washington 98591	2004	1,800	31,124
209 NE 1st Street Winlock, Washington 98586	2004	3,400	18,191
714 W. Main Street Chehalis, Washington 98532	2009	4,600	20,485
Loan Center/Data Center:			
120 Lincoln Street Hoquiam, Washington 98550	2003	6,000	N/A
Administrative Offices:			
305 8th Street Hoquiam, Washington 98550	2004	4,100	N/A

Management believes that all facilities are appropriately insured and are adequately equipped for carrying on the business of the Bank.

At September 30, 2013 the Bank operated 23 proprietary ATMs that are part of a nationwide cash exchange network.

Item 3. Legal Proceedings

Periodically, there have been various claims and lawsuits involving the Bank, such as claims to enforce liens, condemnation proceedings on properties in which the Bank holds security interests, claims involving the making and servicing of real property loans and other issues incident to the Bank's business. The Bank is not a party to any pending legal proceedings that it believes would have a material adverse effect on the financial condition or operations of the Bank.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's common stock is traded on the Nasdaq Global Market under the symbol "TSBK." As of November 30, 2013, there were 7,047,636 shares of common stock issued and approximately 535 shareholders of record. The following table sets forth the high and low sales prices of, and dividends paid on, the Company's common stock for each quarter during the years ended September 30, 2013 and 2012. The high and low price information was provided by the Nasdaq Stock Market.

Fiscal 2013	High	Low	Dividends per Common Share
First Quarter	$6.94	$5.77	$—
Second Quarter	8.90	6.66	0.03
Third Quarter	8.46	7.98	0.03
Fourth Quarter	9.24	8.25	0.03
Fiscal 2012	High	Low	Dividends per Common Share
First Quarter	$4.60	$3.25	$—
Second Quarter	4.79	3.86	—
Third Quarter	5.31	4.55	—
Fourth Quarter	6.11	4.75	—

Dividends

The timing and amount of cash dividends paid on our common stock depends on our earnings, capital requirements, financial condition and other relevant factors and is subject to the discretion of our board of directors. After consideration of these factors, we resumed our dividend payout in the second quarter of fiscal 2013. There can be no assurance that we will pay dividends on our common stock in the future.

Dividend payments by the Company are dependent primarily on dividends received by the Company from the Bank. Under federal regulations, the dollar amount of dividends the Bank may pay is dependent upon its capital position and recent net income. Generally, if the Bank satisfies its regulatory capital requirements, it may make dividend payments up to the limits prescribed in the FDIC regulations. However, an institution that has converted to a stock form of ownership may not declare or pay a dividend on, or repurchase any of, its common stock if the effect thereof would cause the regulatory capital of the institution to be reduced below the amount required for the liquidation account which was established in connection with the mutual to stock conversion.

The DFI has the power to require any bank to suspend the payment of any and all dividends. In addition, under Washington law, no bank may declare or pay any dividend in an amount greater than its retained earnings without the prior approval of the DFI. Further, under Washington law, Timberland Bancorp is prohibited if, after making such dividend payment, it would be unable to pay its debts as they become due in the usual course of business, or if its total liabilities, plus the amount that would be needed, in the event Timberland Bancorp were to be dissolved at the time of the dividend payment, to satisfy preferential rights on dissolution of holders of preferred stock ranking senior in right of payment to the capital stock on which the applicable distribution is to be made, exceed our total assets.

In addition to the foregoing regulatory considerations, there are numerous governmental requirements and regulations that affect our business activities. A change in applicable statutes, regulations or regulatory policy may have a material effect on our business and on our ability to pay dividends on our common stock.

Equity Compensation Plan Information

The equity compensation plan information presented under subparagraph (d) in Part III, Item 12. of this Form 10-K is incorporated herein by reference.

Stock Repurchases

The Company is subject to certain restrictions on its ability to repurchase its common stock. The Company is required to give the Federal Reserve prior written notice of any purchase or redemption of its outstanding equity securities if the consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of its consolidated net worth. The Federal Reserve may disapprove a purchase or redemption if it determines that the proposal would constitute an unsafe or unsound practice or would violate any law, regulation, Federal Reserve order, or any condition imposed by, or written agreement with, the Federal Reserve. In addition, pursuant to the terms of the Series A Preferred Stock, the Company generally may not repurchase its common stock unless it is current on dividend payments on the Series A Preferred Stock. The Company did not repurchase any shares of its common stock during the year ended September 30, 2013 and there are no common stock repurchase plans currently authorized.

Five-Year Stock Performance Graph

The following graph compares the cumulative total shareholder return on our common stock with the cumulative total return on the Nasdaq U.S. Companies Index and with the SNL $500 million to $1 Billion Asset Thrift Index, peer group indices. Total return assumes the reinvestment of all dividends and that the value of the Company's Common Stock and each index was $100 on September 30, 2008.

	Period Ended					
Index	9/30/2008	9/30/2009	9/30/2010	9/30/2011	9/30/2012	9/30/2013
Timberland Bancorp, Inc.	100.00	66.00	58.02	58.02	86.17	130.64
NASDAQ Composite	100.00	102.54	115.60	119.07	155.56	191.34
SNL $500M-$1B Thrift Index *	100.00	83.72	80.31	83.46	104.95	129.33

* Source: SNL Financial LC, Charlottesville, VA

Item 6. Selected Financial Data

The following table sets forth certain information concerning the consolidated financial position and results of operations of the Company and its subsidiary at and for the dates indicated. The consolidated data is derived in part from, and should be read in conjunction with, the Consolidated Financial Statements of the Company and its subsidiary presented herein.

	At September 30, 2013	2012	2011	2010	2009
	(In thousands)				
SELECTED FINANCIAL CONDITION DATA:					
Total assets	$745,648	$736,954	$738,224	$742,687	$701,676
Loans receivable and loans held for sale, net	548,104	538,480	528,024	527,591	547,208
MBS and other investments held-to-maturity	2,737	3,339	4,145	5,066	7,087
MBS and other investments available-for-sale	4,101	4,945	6,717	11,119	13,471
FHLB Stock	5,452	5,655	5,705	5,705	5,705
Cash and due from financial institutions, interest-bearing deposits in banks and fed funds sold	94,496	96,668	112,065	111,786	66,462
Certificates of deposit held for investment	30,042	23,490	18,659	18,047	3,251
OREO and other repossessed assets	11,720	13,302	10,811	11,519	8,185
Deposits	608,262	597,926	592,678	578,869	505,661
FHLB advances	45,000	45,000	55,000	75,000	95,000
Federal Reserve Bank advances	—	—	—	—	10,000
Shareholders' equity	89,688	90,319	86,205	85,408	87,199

	Year Ended September 30, 2013	2012	2011	2010	2009
	(In thousands, except per share data)				
SELECTED OPERATING DATA:					
Interest and dividend income	$30,237	$31,605	$33,966	$36,596	$38,801
Interest expense	4,439	5,947	8,533	10,961	13,504
Net interest income	25,798	25,658	25,433	25,635	25,297
Provision for loan losses	2,925	3,500	6,758	10,550	10,734
Net interest income after provision for loan losses	22,873	22,158	18,675	15,085	14,563
Non-interest income	10,262	9,781	8,681	5,696	6,949
Non-interest expense	25,864	25,568	25,963	24,641	22,739
Income (loss) before income taxes	7,271	6,371	1,393	(3,860)	(1,227)
Provision (benefit) for federal income taxes	2,514	1,781	304	(1,569)	(985)
Net income (loss)	4,757	4,590	1,089	(2,291)	(242)
Preferred stock dividends	(710)	(832)	(832)	(832)	(643)
Preferred stock accretion	(283)	(240)	(225)	(210)	(129)
Discount on redemption of preferred stock	255	—	—	—	—
Net income (loss) to common shareholders	$4,019	$3,518	$32	$(3,333)	$(1,014)
Net income (loss) per common share:					
Basic	$0.59	$0.52	$—	$(0.50)	$(0.15)
Diluted	$0.58	$0.52	$—	$(0.50)	$(0.15)
Dividends per common share	$0.09	$—	$—	$0.04	$0.39
Dividend payout ratio (1)	15.80%	N/A	N/A	N/A	N/A

(1) Cash dividends to common shareholders divided by net income (loss) to common shareholders.

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	At September 30,				
	2013	2012	2011	2010	2009
OTHER DATA:					
Number of real estate loans outstanding	2,712	2,704	2,796	2,919	3,062
Deposit accounts	54,809	55,848	56,152	55,598	53,941
Full-service offices	22	22	22	22	22

	At or For the Year Ended September 30,									
	2013		2012		2011		2010		2009	
KEY FINANCIAL RATIOS:										
Performance Ratios:										
Return (loss) on average assets (1)	0.64	%	0.62	%	0.15	%	(0.32	)%	(0.04	)%
Return (loss) on average equity (2)	5.27		5.21		1.26		(2.65	)	(0.28	)
Interest rate spread (3)	3.69		3.65		3.58		3.63		3.64	
Net interest margin (4)	3.82		3.81		3.78		3.87		4.01	
Average interest-earning assets to average interest-bearing liabilities	119.93		117.42		115.24		114.51		117.42	
Non-interest expense as a percent of average total assets	3.49		3.48		3.54		3.43		3.35	
Efficiency ratio (5)	71.72		72.15		76.11		78.65		70.52	
Asset Quality Ratios:										
Non-accrual and 90 days or more past due loans as a percent of total loans receivable, net	2.51	%	4.09	%	4.32	%	4.86	%	5.36	%
Non-performing assets as a percent of total assets (6)	3.75		5.19		5.01		5.53		5.52	
Allowance for loan losses as a percent of total loans receivable, net (7)	1.99		2.15		2.21		2.09		2.59	
Allowance for loan losses as a percent of non-performing loans (8)	79.28		52.48		51.18		43.01		47.11	
Net charge-offs to average outstanding loans	0.65		0.66		1.13		2.45		0.79	
Capital Ratios:										
Total equity-to-assets ratio	12.03	%	12.26	%	11.68	%	11.50	%	12.43	%
Average equity to average assets	12.19		11.98		11.81		12.05		12.72	

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(1) Net income (loss) divided by average total assets.
(2) Net income (loss) divided by average total equity.
(3) Difference between weighted average yield on interest-earning assets and weighted average cost of interest-bearing liabilities.
(4) Net interest income (before provision for loan losses) as a percentage of average interest-earning assets.
(5) Non-interest expenses divided by the sum of net interest income and non-interest income.
(6) Non-performing assets include non-accrual loans, loans past due 90 days or more and still accruing, non-accrual investment securities, OREO and other repossessed assets.
(7) Loans receivable includes loans held for sale and is before the allowance for loan losses.
(8)

Non-performing loans include non-accrual loans and loans past due 90 days or more and still accruing. Troubled debt restructured loans that are on accrual status are not included.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to assist in understanding the consolidated financial condition and results of operations of the Company. The information contained in this section should be read in conjunction with the Consolidated Financial Statements and accompanying notes thereto included in Item 8 of this Annual Report on Form 10-K.

Special Note Regarding Forward-Looking Statements

Certain matters discussed on this Annual Report on Form 10-K may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not statements of historical fact and often include the words "believes," "expects," "anticipates," "estimates," "forecasts," "intends," "plans," "targets," "potentially," "probably," "projects," "outlook" or similar expressions or future or conditional verbs such as "may," "will," "should," "would" and "could." Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, assumptions and statements about future economic performance. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause our actual results to differ materially from the results anticipated, including, but not limited to: the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and changes in our allowance for loan losses and provision for loan losses that may be impacted by deterioration in the housing and commercial real estate markets which may lead to increased losses and non-performing loans in our loan portfolio, and may result in our allowance for loan losses not being adequate to cover actual losses, and require us to materially increase our loan loss reserves; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources; fluctuations in the demand for loans, the number of unsold homes, land and other properties and fluctuations in real estate values in our market areas; secondary market conditions for loans and our ability to sell loans in the secondary market; results of examinations of us by the Board of Governors of the Federal Reserve System and of our bank subsidiary by the Federal Deposit Insurance Corporation, the Washington State Department of Financial Institutions, Division of Banks or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, institute a formal or informal enforcement action against us or our bank subsidiary which could require us to increase our allowance for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds or maintain or increase deposits or impose additional requirements or restrictions on us, any of which could adversely affect our liquidity and earnings; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, or the interpretation of regulatory capital or other rules including as a result of Basel III; the impact of the Dodd Frank Wall Street Reform and Consumer Protection Act and implementing regulations; our ability to attract and retain deposits; increases in premiums for deposit insurance; our ability to control operating costs and expenses; the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; difficulties in reducing risks associated with the loans on our consolidated balance sheet; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our work force and potential associated charges; the failure or security breach of computer systems on which we depend; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; our ability to implement our business strategies; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we may acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto; our ability to manage loan delinquency rates; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; our ability to pay dividends on our common and preferred stock; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations; pricing, products and services; and other risks described elsewhere in this Form 10-K.

Any of the forward-looking statements that we make in this Form 10-K and in the other public statements we make are based upon management's beliefs and assumptions at the time they are made. We undertake no obligation to publicly update or revise any forward-looking statements included in this annual report or to update the reasons why actual results could differ from those contained in such statements, whether as a result of new information, future events or otherwise. We caution readers not to place undue reliance on any forward-looking statements. We do not undertake and specifically disclaim any obligation to revise any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements. These risks could cause our actual results for fiscal 2014 and beyond to differ materially from those expressed in any forward-looking statements by, or on behalf of, us, and could negatively affect the Company's results of operations and stock price performance.

Critical Accounting Policies and Estimates

The Company has established various accounting policies that govern the application of accounting principles generally accepted in the United States of America (“GAAP”) in the preparation of the Company's Consolidated Financial Statements. The Company has identified five policies, that as a result of judgments, estimates and assumptions inherent in those policies, are critical to an understanding of the Company's Consolidated Financial Statements. These policies relate to the methodology for the determination of the allowance for loan losses, the valuation of mortgage servicing rights (“MSRs”), the determination of other than temporary impairments in the market value of investment securities, the determination of goodwill impairment and the determination of the recorded value of other real estate owned. These policies and the judgments, estimates and assumptions are described in greater detail in subsequent sections of Management's Discussion and Analysis contained herein and in the notes to the Consolidated Financial Statements contained in Item 8 of this Form 10-K. In particular, Note 1 of the Notes to Consolidated Financial Statements, “Summary of Significant Accounting Policies,” generally describes the Company's accounting policies. Management believes that the judgments, estimates and assumptions used in the preparation of the Company's Consolidated Financial Statements are appropriate given the factual circumstances at the time. However, given the sensitivity of the Company's Consolidated Financial Statements to these critical policies, the use of other judgments, estimates and assumptions could result in material differences in the Company's results of operations or financial condition.

Allowance for Loan Losses. The allowance for loan losses is maintained at a level sufficient to provide for probable loan losses based on evaluating known and inherent risks in the portfolio. The allowance is based upon management's comprehensive analysis of the pertinent factors underlying the quality of the loan portfolio. These factors include changes in the amount and composition of the loan portfolio, delinquency levels, actual loan loss experience, current economic conditions, and detailed analysis of individual loans for which full collectibility may not be assured. The detailed analysis includes methods to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. The appropriate allowance for loan loss level is estimated based upon factors and trends identified by management at the time the consolidated financial statements are prepared.

While the Company believes it has established its existing allowance for loan losses in accordance with GAAP, there can be no assurance that regulators, in reviewing the Company’s loan portfolio, will not request the Company to significantly increase or decrease its allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that substantial increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed elsewhere in this document. Although management believes the level of the allowance as of September 30, 2013 was adequate to absorb probable losses inherent in the loan portfolio, a decline in local economic conditions, results of examinations by the Company’s or the Bank’s regulators or other factors, could result in a material increase in the allowance for loan losses and may adversely affect the Company’s financial condition and results of operations.

Mortgage Servicing Rights. MSRs are capitalized when acquired through the origination of loans that are subsequently sold with servicing rights retained and are amortized to servicing income on loans sold in proportion to and over the period of estimated net servicing income. The value of MSRs at the date of the sale of loans is determined based on the discounted present value of expected future cash flows using key assumptions for servicing income and costs and prepayment rates on the underlying loans.

The estimated fair value is evaluated at least annually by a third party firm for impairment by comparing actual cash flows and estimated cash flows from the servicing assets to those estimated at the time servicing assets were originated. The effect of changes in market interest rates on estimated rates of loan prepayments represents the predominant risk characteristic underlying the MSRs’ portfolio. The Company's methodology for estimating the fair value of MSRs is highly sensitive to changes in assumptions. For example, the determination of fair value uses anticipated prepayment speeds. Actual prepayment experience may differ and any difference may have a material effect on the fair value. Thus, any measurement of MSRs' fair value is limited by the conditions existing and assumptions as of the date made. Those assumptions may not be appropriate if they are applied at different times.

Other-Than-Temporary Impairment (OTTI) in the Estimated Fair Value of Investment Securities. Unrealized investment securities losses on available for sale and held to maturity securities are evaluated at least quarterly by a third-party firm to determine whether declines in value should be considered “other than temporary” and therefore be subject to immediate loss recognition through earnings for the portion related to credit losses. Although these evaluations involve significant judgment, an unrealized loss in the fair value of a debt security is generally deemed to be temporary when the fair value of the security is less than the recorded value primarily as a result of changes in interest rates, when there has not been significant deterioration in the financial condition of the issuer, and the Company has the intent and the ability to hold the security for a sufficient time to recover the recorded value. An unrealized loss in the value of an equity security is generally considered temporary when the fair value of the security is below the recorded value primarily as a result of current market conditions and not a result of deterioration in the financial condition of the underlying borrowers or the underlying collateral (in the case of mutual funds) and the Company has the intent and the ability to hold the security for a sufficient time to recover the recorded value. Other factors that may be considered in determining whether a decline in the value of either a debt or equity security is “other than temporary” include ratings by recognized rating agencies; capital strength and near-term prospects of the issuer, and recommendation of investment advisors or market analysts. Therefore, continued deterioration of current market conditions could result in additional impairment losses recognized within the Company’s investment portfolio.

Goodwill. Goodwill is initially recorded when the purchase price paid for an acquisition exceeds the estimated fair value of the net identified tangible and intangible assets acquired and liabilities assumed. Goodwill is presumed to have an indefinite useful life and is analyzed annually for impairment. An annual test is performed during the third quarter of each fiscal year, or more frequently if indicators of potential impairment exist, to determine if the recorded goodwill is impaired. If the estimated fair value of the Company's sole reporting unit exceeds the recorded value of the reporting unit, goodwill is not considered impaired.

The goodwill impairment tests involves a two-step process. Step one of the goodwill impairment test estimates the fair value of the reporting unit utilizing the allocation of corporate value approach, the income approach and the market approach in order to derive an enterprise value for the Company. If the results of the Company's step one test indicate that the reporting unit's estimated fair value is less than its recorded value, a step two analysis is performed. In the step two analysis, the estimated fair value of assets and liabilities is calculated in order to determine the implied fair value of the Company's goodwill. If the implied value of the goodwill exceeds the recorded value of goodwill, then goodwill is not considered to be impaired.

A significant amount of judgment is involved in determining if an indicator of goodwill impairment has occurred. Such indicators may include, among others; a significant decline in the expected future cash flows; a sustained, significant decline in the Company's stock price and market capitalization; a significant adverse change in legal factors or in the business climate; adverse assessment or action by a regulator; and unanticipated competition. Key assumptions used in the annual goodwill impairment test are highly judgmental and include: selection of comparable companies, amount of control premium, projected cash flows, discount rate applied to projected cash flows and method of estimating the fair value of loans. Any change in these indicators or key assumptions could have a significant negative impact on the Company's financial condition, impact the goodwill impairment analysis or cause the Company to perform a goodwill impairment analysis more frequently than once per year.

During the quarter ended June 30, 2013, the Company engaged a third party firm specializing in goodwill impairment valuations for financial institutions to help perform the annual test for goodwill impairment. The test concluded that recorded goodwill was not impaired. As of September 30, 2013, there have been no events or changes in the circumstances that would indicate a potential impairment. No assurance can be given, however, that the Company will not record an impairment loss on goodwill in the future.

Other Real Estate Owned (“OREO”) and Other Repossessed Assets. OREO and other repossessed assets consist of properties or assets acquired through or in lieu of foreclosure, and are recorded initially at the estimated fair value of the properties less estimated costs of disposal. Costs relating to development and improvement of the properties or assets are capitalized while costs relating to holding the properties or assets are expensed. Valuations are periodically performed by management, and a charge to earnings is recorded if the recorded value of a property exceeds its estimated net realizable value.

New Accounting Pronouncements

For a discussion of new accounting pronouncements and their impact on the Company, see Note 1 of the Notes to the Consolidated Financial Statements contained in “Item 8. Financial Statements and Supplementary Data.”

Operating Strategy

The Company is a bank holding company which operates primarily through its subsidiary, the Bank. The Bank is a community-oriented bank which has traditionally offered a wide variety of savings products to its retail customers while concentrating its lending activities on real estate loans. Weak economic conditions and ongoing stress on the housing and financial markets have prevailed since 2008 in portions of the United States, including Washington State where we hold substantially all of our loans and conduct all of our operations. The majority of our loans are secured by collateral and made to borrowers located in Washington State. Western Washington, which includes our primary market areas, has experienced home price declines, increased foreclosures, and has experienced above average unemployment rates. As a result, our credit losses since 2008 have been at significantly higher levels than our historical experience and our net interest income and other operating revenues and expenses have also been adversely affected. In response to the financial challenges in our market areas we have taken actions to manage our capital, reduce our exposure to speculative construction and land development loans and land loans and maintain higher levels of on balance sheet liquidity. We continue to originate residential fixed rate mortgage loans primarily for sale in the secondary market. We also continue to manage the growth of our commercial and multi-family real estate loan portfolios in a disciplined fashion while continuing to dispose of other real estate owned properties and increase retail deposits.

We believe the resolution of problem financial institutions and continued bank consolidation in western Washington will provide opportunities for the Company to increase market share within the communities it serves. We are currently pursuing the following strategies:

Improve Asset Quality. We are focused on monitoring existing performing loans, resolving non-performing assets and selling foreclosed assets. We have sought to reduce the level of non-performing assets through collections, write-downs, modifications and sales of OREO properties. We have taken proactive steps to resolve our non-performing loans, including negotiating payment plans, forbearances, loan modifications and loan extensions and accepting short payoffs on delinquent loans when such actions have been deemed appropriate.

Expand our presence within our existing market areas by capturing opportunities resulting from changes in the competitive environment. We currently conduct our business primarily in western Washington. We have a community bank strategy that emphasizes responsive and personalized service to our customers. As a result of FDIC bank resolutions and anticipated consolidation of banks in our market areas, we believe there is an opportunity for a community and customer focused bank to expand its customer base. By offering timely decision making, delivering appropriate banking products and services, and providing customer access to our senior managers we believe community banks, such as Timberland Bank, can distinguish themselves from larger banks operating in our market areas. We believe we have a significant opportunity to attract additional borrowers and depositors and expand our market presence and market share within our extensive branch footprint.

Continue generating revenues through mortgage banking operations. The substantial majority of the fixed rate residential mortgage loans we originate are sold into the secondary market with servicing retained. This strategy produces gains on the sale of such loans and reduces the interest rate and credit risk associated with fixed rate residential lending. We will continue to originate custom construction and owner builder loans for sale into the secondary market upon the completion of construction.

Portfolio Diversification. In recent years, we have strictly limited the origination of speculative construction, land development and land loans in favor of loans that possess credit profiles representing less risk to the Bank. We will continue originating owner/builder and custom construction loans, multi-family loans, commercial business loans and certain commercial real estate loans which offer higher risk adjusted returns, shorter maturities and more sensitivity to interest rate fluctuations. We anticipate capturing more of each customer's banking relationship by cross selling our loan and deposit products and offering additional services to our customers.

Increase Core Deposits and other Retail Deposit Products. We focus on establishing a total banking relationship with our customers with the intent of internally funding our loan portfolio. We anticipate that the continued focus on customer relationships will increase our level of core deposits and locally-based retail certificates of deposit. In addition to our retail branches we maintain technology based products such as business cash management and a business remote deposit product that enables us to compete effectively with banks of all sizes.

Limit Exposure to Increasing Interest Rates. For many years the majority of the loans the Bank has retained in its portfolio have generally possessed periodic interest rate adjustment features or have been relatively short term in nature. Loans originated for portfolio retention have generally included ARM loans, short term construction loans, and to a lesser extent commercial business loans with interest rates tied to a market index such as the prime rate. Longer term fixed-rate mortgage loans have generally been originated for sale into the secondary market.

Market Risk and Asset and Liability Management

General. Market risk is the risk of loss from adverse changes in market prices and rates. The Bank's market risk arises primarily from interest rate risk inherent in its lending, investment, deposit and borrowing activities. The Bank, like other financial institutions, is subject to interest rate risk to the extent that its interest-earning assets reprice differently than its interest-bearing liabilities. Management actively monitors and manages its interest rate risk exposure. Although the Bank manages other risks, such as credit quality and liquidity risk, in the normal course of business management considers interest rate risk to be its most significant market risk that could potentially have the largest material effect on the Bank's financial condition and results of operations. The Bank does not maintain a trading account for any class of financial instruments nor does it engage in hedging activities. Furthermore, the Bank is not subject to foreign currency exchange rate risk or commodity price risk.

Qualitative Aspects of Market Risk. The Bank's principal financial objective is to achieve long-term profitability while reducing its exposure to fluctuating market interest rates. The Bank has sought to reduce the exposure of its earnings to changes in market interest rates by attempting to manage the difference between asset and liability maturities and interest rates. The principal element in achieving this objective is to increase the interest-rate sensitivity of the Bank's interest-earning assets by retaining in its portfolio, short-term loans and loans with interest rates subject to periodic adjustments. The Bank relies on retail deposits as its primary source of funds. As part of its interest rate risk management strategy, the Bank promotes transaction accounts and certificates of deposit with terms of up to six years.

The Bank has adopted a strategy that is designed to substantially match the interest rate sensitivity of assets relative to its liabilities. The primary elements of this strategy involve originating ARM loans for its portfolio, maintaining residential construction loans as a portion of total net loans receivable because of their generally shorter terms and higher yields than other one- to four-family residential mortgage loans, matching asset and liability maturities, investing in short-term securities, originating fixed-rate loans for retention or sale in the secondary market, and retaining the related mortgage servicing rights.

Sharp increases or decreases in interest rates may adversely affect the Bank's earnings. Management of the Bank monitors the Bank's interest rate sensitivity through the use of a model provided by FIMAC Solutions, LLC (“FIMAC”), a company that specializes in providing the financial services industry interest risk rate risk and balance sheet management services. Based on a rate shock analysis prepared by FIMAC based on data at September 30, 2013, an immediate increase in interest rates of 200 basis points would increase the Bank’s projected net interest income by approximately 5.3%, primarily because a larger portion of the Bank's interest rate sensitive assets than interest rate sensitive liabilities would reprice within a one year period. See “- Quantitative Aspects of Market Risk” below for additional information. Management has sought to sustain the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread. Pursuant to this strategy, the Bank actively originates adjustable-rate loans for retention in its loan portfolio. Fixed-rate mortgage loans with maturities greater than seven years generally are originated for the immediate or future resale in the secondary mortgage market. At September 30, 2013, adjustable-rate mortgage loans constituted $358.1 million or 72.0%, of the Bank's total mortgage loan portfolio due after one year. Although the Bank has sought to originate ARM loans, the ability to originate such loans depends to a great extent on market interest rates and borrowers' preferences. In lower interest rate environments, borrowers often prefer fixed-rate loans.

Consumer, commercial business and construction and land development loans typically have shorter terms and higher yields than permanent residential mortgage loans, and accordingly reduce the Bank’s exposure to fluctuations in interest rates. At September 30, 2013, the consumer, commercial business and construction and land development portfolios amounted to $39.0 million, $17.5 million and $45.1 million, or 6.7%, 3.0% and 7.8% of total loans receivable (including loans held for sale), respectively.

Quantitative Aspects of Market Risk. The model provided for the Bank by FIMAC estimates the changes in net portfolio value ("NPV") and net interest income in response to a range of assumed changes in market interest rates. The model first estimates the level of the Bank's NPV (market value of assets, less market value of liabilities, plus or minus the market value of any off-balance sheet items) under the current rate environment. In general, market values are estimated by discounting the estimated cash flows of each instrument by appropriate discount rates. The model then recalculates the Bank's NPV under different interest rate scenarios. The change in NPV under the different interest rate scenarios provides a measure of the Bank's exposure to interest rate risk. The following table is provided by FIMAC based on data at September 30, 2013.

Hypothetical Interest Rate Scenario (3) (Basis Points)	Net Interest Income (1)(2) Estimated Value	$ Change from Base	% Change from Base	Current Market Value Estimated Value	$ Change from Base	% Change from Base
	(Dollars in thousands)					
+400	$27,134	$2,245	9.02 %	$149,047	$7,769	5.50 %
+300	26,688	1,799	7.23	147,048	5,770	4.08
+200	26,217	1,328	5.34	145,307	4,029	2.85
+100	25,519	630	2.53	143,222	1,944	1.38
BASE	24,889	—	—	141,278	—	—
-100	24,015	(874)	(3.51)	138,671	(2,607)	(1.85)
-200	23,360	(1,529)	(6.14)	138,663	(2,615)	(1.85)

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(1) Does not include loan fees.
(2) Includes BOLI income, which is included in non-interest income on the Consolidated Financial Statements.
(3) No rates in the model are allowed to go below zero.

Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, loan repayments and deposit decay, and should not be relied upon as indicative of actual results. Furthermore, the computations do not reflect any actions management may undertake in response to changes in interest rates.

In the event of a 100 basis point decrease in interest rates, the Bank would be expected to experience a 1.9% decrease in NPV and a 3.5% decrease in net interest income. In the event of a 200 basis point increase in interest rates, a 2.9% increase in NPV and a 5.3% increase in net interest income would be expected. Based upon the modeling described above, the Bank's asset and liability structure generally results in decreases in net interest income and NPV in a declining interest rate scenario and increases in net interest income and NPV in a rising rate scenario.

As with any method of measuring interest rate risk, certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets have features which restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, expected rates of prepayments on loans and early withdrawals from certificates could possibly deviate significantly from those assumed in calculating the table.

Comparison of Financial Condition at September 30, 2013 and September 30, 2012

The Company's total assets increased by $8.7 million, or 1.2%, to $745.6 million at September 30, 2013 from $737.0 million at September 30, 2012. The increase was primarily attributable to an increase in net loans receivable and an increase in certificates of deposit ("CDs") held for investment. These increases were partially offset by decreases in OREO and other repossessed assets, the prepaid FDIC insurance assessment and other assets.

Net loans receivable increased by $9.6 million, or 1.8%, to $548.1 million at September 30, 2013 from $538.5 million at September 30, 2012, primarily a result of increases in commercial real estate, one-to four-family construction and multi-family loans balances. These increases were partially offset by decreases to commercial real estate construction, land, commercial business and one-to four-family loan balances.

Total deposits increased by $10.3 million, or 1.7%, to $608.3 million at September 30, 2013 from $597.9 million at September 30, 2012, primarily as a result of increases in money market, non-interest bearing, N.O.W. checking and savings account balances. These increases were partially offset by a decrease in CD account balances.

Shareholders' equity decreased by $631,000, or 0.7%, to $89.7 million at September 30, 2013 from $90.3 million at September 30, 2012. The decrease was primarily due to the repurchase of 4,576 shares of Series A Preferred Stock and the payment of dividends on preferred and common stock. These decreases to shareholders' equity were partially offset by net income for the year ended September 30, 2013. As of September 30, 2013, the Company exceeded all regulatory capital requirements required for bank holding company regulatory purposes. For additional details see Note 18 of the Notes to Consolidated Financial Statements contained in "Item 8. Financial Statements and Supplementary Data" and "Item 1. Business - Regulation of the Company - Capital Requirements."

A more detailed explanation of the changes in significant balance sheet categories follows:

Cash and Cash Equivalents and CDs Held for Investment: Cash and cash equivalents and CDs held for investment increased by $4.4 million, or 3.6%, to $124.5 million at September 30, 2013 from $120.2 million at September 30, 2012. The increase was primarily due to a $6.6 million increase in CDs held for investment, which was partially offset by a $2.2 million decrease in total cash and cash equivalents. The Company continued to maintain high levels of liquidity primarily for asset-liability management purposes.

Mortgage-backed Securities and Other Investments: MBS and other investments decreased by $1.5 million, or 17.5%, to $6.8 million at September 30, 2013 from $8.3 million at September 30, 2012. The decrease was primarily as a result of regular amortization and prepayments on MBS and $47,000 of OTTI charges recorded on private label residential MBS. For additional details on MBS and other investments, see "Item 1, Business -Investment Activities" and Note 3 of the Notes to the Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplemental Data."

Loans Receivable and Loans Held for Sale, Net of Allowance for Loan Losses: Net loans receivable, including loans held for sale, increased by $9.6 million, or 1.8% to $548.1 million at September 30, 2013 from $538.5 million at September 30, 2012. The increase was primarily a result of a $35.0 million increase in commercial real estate loan balances, a $7.5 million increase in custom and owner/builder residential construction loan balances, a $3.6 million increase in multi-family loan balances, a $484,000 increase in loans held for sale and a $689,000 decrease in the allowance for loan losses. These increases to net loans receivable were partially offset by an $18.0 million decrease in commercial construction loan balances, an $8.5 million decrease in land loan balances, a $5.1 million decrease in commercial business loan balances, a $3.2 million decrease in one- to four-family loan balances, a $452,000 decrease in speculative one-to four-family construction loan balances and a $2.2 million increase in the undisbursed portion of construction loans in process. The increase in commercial real estate loan balances and the decrease in commercial real estate construction loan balances were in part due to several commercial real estate construction projects completing the construction phase and converting to permanent financing during the year ended September 30, 2013.

Loan originations decreased by 4.6% to $217.8 million for the year ended September 30, 2013 from $228.3 million for the year ended September 30, 2012. The decrease in loan originations was primarily due to a decrease in the level of multi-family loans and commercial business loans originated. The Company continued to sell longer-term fixed rate residential loans for asset-liability management purposes and to generate non-interest income. The Company sold $89.4 million in fixed rate one- to four-family mortgage loans during the year ended September 30, 2013 compared to $97.4 million for the fiscal year ended September 30, 2012. For additional information on loans, see "Item 1, Business Lending Activities" and Note 4 of the Notes to Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplementary Data."

Premises and Equipment: Premises and equipment decreased by $122,000, or 0.7%, to $17.8 million at September 30, 2013 from $17.9 million at September 30, 2012. The decrease was primarily due to the sale of a land parcel adjacent to a branch office and annual depreciation. For additional information on premises and equipment, see "Item 2, Properties" and Note 6 of the Notes to Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplementary Data."

Other Real Estate Owned: OREO and other repossessed assets decreased by $1.6 million, or 11.9% to $11.7 million at September 30, 2013 from $13.3 million at September 30, 2012. The decrease was primarily due to the disposition of $6.0 million in OREO properties and other repossessed assets and lower of cost or fair value losses of $2.1 million. These decreases in OREO were partially offset by the addition of $6.4 million in OREO properties and other repossessed assets and $146,000 in capitalized costs. At September 30, 2013, the OREO balance was comprised of 47 individual properties. The properties consisted of 26 land parcels totaling $4.6 million, six commercial real estate properties totaling $3.2 million, three multi-family properties totaling $2.1 million and twelve single family homes totaling $1.8 million. The largest OREO property was a multi-family property with a balance of $1.3 million. For additional information on OREO and other repossessed assets, see "Item 1, Business Lending Activities Nonperforming Assets" and Note 7 of the Notes to Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplementary Data."

Bank Owned Life Insurance ("BOLI"): BOLI increased $578,000, or 3.5%, to $17.1 million at September 30, 2013 from $16.5 million at September 30, 2012 due to net BOLI earnings.

Goodwill and Core Deposit Intangible ("CDI"): The value of goodwill at $5.7 million at September 30, 2013 remained unchanged from September 30, 2012. The amortized value of CDI decreased by $130,000 to $119,000 at September 30, 2013 from $249,000 at September 30, 2012 due to scheduled amortization. The Company performed its annual review of goodwill during the quarter ended June 30, 2013 and determined that there was no impairment. For additional information on goodwill and CDI, see Note 1 and Note 8 of the Notes to Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplemental Data."

Mortgage Servicing Rights ("MSRs"): MSRs increased $255,000, or 12.7%, to $2.3 million at September 30, 2013 from $2.0 million at September 30, 2012, primarily due to the addition of $728,000 in capitalized MSRs for new loans being serviced and a $475,000 valuation reserve recovery on MSRs reflecting the recent increase in mortgage interest rates. This increase was partially offset by amortization of $948,000 on MSRs during the year ended September 30, 2013. The principal amount of loans serviced for Freddie Mac increased $20.9 million, or 6.8% to $325.7 million at September 30, 2013 from $304.9 million at September 30, 2012. For additional information on MSRs, see Note 5 of the Notes to Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplemental Data."

Prepaid FDIC Insurance Assessment: There was no prepaid FDIC insurance assessment at September 30, 2013 compared to $1.2 million at September 30, 2012 as a portion of the prepaid amount was expensed and the FDIC returned the remaining prepaid amount.

Deposits: Deposits increased by $10.3 million, or 1.7%, to $608.3 million at September 30, 2013 from $597.9 million at September 30, 2012. The increase was primarily a result of an $19.6 million increase in money market account balances, a $12.4 million increase in non-interest account balances, a $6.0 million increase in NOW checking account balances and a $3.9 million increase in savings account balances. These increases were partially offset by a $31.3 million decrease in CD account balances. The increase in money market account balances and the decrease in CD accounts were in part due to the low interest rate environment, as some depositors opted to place maturing CD funds into non-maturity accounts to retain flexibility if interest rates increased. The Company also experienced deposit inflows due to a number of customers transferring funds from other financial institutions during the year ended September 30, 2013. For additional information on deposits, see "Item 1, Business Deposit Activities and Other Sources of Funds" and Note 9 of the Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplementary Data."

FHLB Advances: FHLB advances were $45.0 million at September 30, 2013 and at September 30, 2012. For additional information on borrowings, see "Item 1, Business Deposit Activities and Other Sources of Funds Borrowings" and Note 10 of the Notes to Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplementary Data."

Shareholders' Equity: Total shareholders' equity decreased by $631,000, or 0.7%, to $89.7 million at September 30, 2013 from $90.3 million at September 30, 2012. The decrease was primarily due to the repurchase of 4,576 shares of Series A Preferred Stock for $4.3 million and the payment (and accrual) of $1.5 million in dividends to common and preferred shareholders. These decreases to shareholder's equity were partially offset by net income of $4.8 million for the year ended September 30, 2013. For additional information on shareholders' equity, see the Consolidated Statements of Shareholders' Equity contained in "Item 8, Financial Statements and Supplementary Data."

Comparison of Operating Results for the Years Ended September 30, 2013 and 2012

Net income for the year ended September 30, 2013 increased $167,000, or 3.6%, to $4.76 million from $4.59 million for the year ended September 30, 2012. Net income to common shareholders after adjusting for preferred stock dividends, preferred stock discount accretion and discount on redemption of preferred stock increased $501,000, or 14.2%, to $4.02 million for the year ended September 30, 2013 from $3.52 million for the year ended September 30, 2012. Net income per diluted common share increased $0.06, or 11.5%, to $0.58 for the year ended September 30, 2013 from $0.52 for the year ended September 30, 2012. The increase in net income was primarily due to a decrease in the provision for loan losses, an increase in non-interest income and an increase in net interest income. These increases to net income were partially offset by an increase in non-interest expense and an increase in the provision for income taxes.

The decrease in the provision for loan losses was primarily a result of improved underlying credit quality metrics in the loan portfolio as the level of delinquent loans and loans graded substandard decreased during the year ended September 30, 2013.

The increase in non-interest income was primarily a result of an increase in the valuation recovery on MSRs and a reduction in net OTTI on MBS and other investments. These increases to non-interest income were partially offset by a decrease in service charges on deposits.

The increase in net interest income was primarily attributable to increases in the Company's average loans receivable and a decrease in the average balance of interest-bearing liabilities.

The increase in non-interest expense was primarily attributable to increases in OREO related expenses and salaries and employee benefits expense. These increases to non-interest expense were partially offset by the gain on disposition of premises and a decrease in loan administration and foreclosures expenses.

A more detailed explanation of the income statement categories is presented below.

Net Interest Income: Net interest income increased by $140,000, or 0.5%, to $25.80 million for the year ended September 30, 2013 from $25.66 million for the year ended September 30, 2012. The increase in net interest income was primarily attributable to an increase in the Company's average loans receivable and a decrease in the average balance of interest-bearing liabilities.

Total interest and dividend income decreased by $1.37 million, or 4.3%, to $30.24 million for the year ended September 30, 2013 from $31.61 million for the year ended September 30, 2012 as the yield on interest earning assets decreased to 4.48% from 4.69%. The decrease in the weighted average yield on interest earning assets was primarily a result of a decrease in overall market rates for loans.

Total interest expense decreased by $1.51 million to $4.44 million for the year ended September 30, 2013 from $5.95 million for the year ended September 30, 2012 as the average rate paid on interest-bearing liabilities decreased to 0.79% for the year ended September 30, 2013 from 1.04% for the year ended September 30, 2012. The decrease in funding costs was primarily a result of a decrease in overall market rates, a change in the composition of deposit categories and a decrease in the average level of FHLB advances.

Average loans receivable increased $12.29 million to $556.82 million for the year ended September 30, 2013 from $544.52 million for the year ended September 30, 2012. Average interest-bearing liabilities decreased $11.35 million to $562.83 million for the year ended September 30, 2013 from $574.18 million for the year ended September 30, 2012. The net interest margin increased one basis point to 3.82% for the year ended September 30, 2013 from 3.81% for the year ended September 30, 2012 as funding costs decreased at a greater rate than the yield on interest earning assets.

Provision for Loan Losses: The provision for loan losses decreased by $575,000, or 16.4%, to $2.93 million for the year ended September 30, 2013 from $3.50 million for the year ended September 30, 2012. Net charge-offs decreased by $7,000, or 0.2%, to $3.61 million for the year ended September 30, 2013 from $3.62 million for the year ended September 30, 2012. The net charge-offs to average outstanding loans ratio was 0.65% for the year ended September 30, 2013 and 0.66% for the year ended September 30, 2012. The decrease in the provision for loan losses was primarily due to improved underlying credit quality metrics in the loan portfolio. The level of delinquent loans (loans 30 or more days past due) decreased by $12.17 million, or 40.2%, to $18.07 million at September 30, 2013 from $30.24 million at September 30, 2012 and the level of loans graded substandard decreased by $5.10 million, or 15.4%, to $27.98 million at September 30, 2013 from $33.08 million at September 30, 2012. Non-accruing loans decreased $7.72 million to $13.61 million at September 30, 2013 from $21.33 million at September 30, 2012.

The Company has established a comprehensive methodology for determining the provision for loan losses. On a quarterly basis the Company performs an analysis that considers pertinent factors underlying the quality of the loan portfolio. These factors include changes in the amount and composition of the loan portfolio, historic loss experience for various loan segments, changes in economic conditions, delinquency rates, a detailed analysis of impaired loans, and other factors to determine an appropriate level of allowance for loan losses. Impaired loans are subject to an impairment analysis to determine an appropriate reserve or write-down to be applied against each loan. The aggregate principal impairment amount determined at September 30, 2013 was $3.08 million.

Based on the comprehensive methodology, management deemed the allowance for loan losses of $11.14 million at September 30, 2013 (1.99% of loans receivable and loans held for sale and 79.3% of non-performing loans) adequate to provide for probable losses based on an evaluation of known and inherent risks in the loan portfolio at that date. While the Company believes it has established its existing allowance for loan losses in accordance with GAAP, there can be no assurance that bank regulators, in reviewing the Company's loan portfolio, will not request the Company to increase significantly its allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that, substantial increases will not be necessary should the quality of any loans deteriorate. Any material increase in the allowance for loan losses would adversely affect the Company's financial condition and results of operations. For additional information, see "Item 1, Business - Lending Activities -- Allowance for Loan Losses."

Non-interest Income: Total non-interest income increased by $481,000, or 4.9%, to $10.26 million for the year ended September 30, 2013 from $9.78 million for the year ended September 30, 2012. This increase was primarily a result of a $465,000 increase in the valuation recovery on MSRs and a $167,000 reduction in net OTTI on MBS and other investments. These increases to non-interest income were partially offset by a $132,000 decrease in service charges on deposits.

The Company's valuation recovery on MSRs increased by $465,000 to $475,000 for the year ended September 30, 2013 from $10,000 for the year ended September 30, 2012. The valuation of the MSRs was based on a third party valuation of the MSR asset. At September 30, 2013, the MSR asset had no remaining valuation allowance available for future recovery. The decrease in net OTTI charges on MBS and other investments was primarily due to a reduction in the level of credit related impairment on private label MBS in the Company's investment portfolio during the year ended September 30, 2013. At September 30, 2013, the Company's remaining private label MBS had been reduced to $2.44 million from an original acquired balance of $15.30 million. The reduction in service charges on deposits was a result of fewer overdrafts on checking accounts. Although gain on sale of loans increased slightly to $2.51 million for the year ended September 30, 2013 as compared to $2.47 million for the year ended September 30, 2012, the recent increase in mortgage rates may, however, reduce future volumes of loans originated for sale as refinancing activity declines.

Non-interest Expense: Total non-interest expense increased by $296,000, or 1.2%, to $25.86 million for the year ended September 30, 2013 from $25.57 million for the year ended September 30, 2012. The increase was primarily attributable to a $605,000 increase in OREO and other repossessed assets expense, a $555,000 increase in salaries and employee benefits and smaller increases in several other expense categories. These increases to non-interest expense were partially offset by a $431,000 gain on the disposition of premises and equipment, a $386,000 decrease to loan administration and foreclosure expenses and smaller decreases in several other expense categories.

The increase in OREO related expenses was primarily a result of a $1.02 million increase in the level of valuation write-downs based on updated appraisals received on OREO properties. The increase in OREO expenses due to valuation write-downs was partially offset by net gains on sales of OREO and other repossessed assets that totaled $266,000 for the year ended September 30, 2013 compared to a net loss of $(373,000) for the year ended September 30, 2012. The increase in salaries and employee benefits expense was primarily due to annual salary adjustments and the hiring of additional lending department personnel. The gain on disposition of premises was a result of the sale of a land parcel adjacent to a branch office. The decrease in loan administration and foreclosure expense was primarily a result of decreased foreclosure related activity.

The Company's efficiency ratio improved to 71.72% for the year ended September 30, 2013 from 72.15% for the year ended September 30, 2012.

Provision for Federal Income Taxes: The provision for federal and state income taxes increased by $733,000, or 41.2% to $2.51 million for the year ended September 30, 2013 from $1.78 million for the year ended September 30, 2012, primarily due to increased income before income taxes and a deferred tax valuation allowance adjustment related to the expiration of a capital loss carry-forward. The Company's effective federal and state income tax rate was 34.6% for the year ended September 30, 2013 compared to 28.0% for the year ended September 30, 2012. The difference in the effective tax rate was primarily due to adjustments to the Company's deferred tax valuation allowance. During the year ended September 30, 2013, the provision for income taxes was increased by $236,000 due to the expiration of a capital loss carry-forward. During the year ended September 30, 2012, the provision for income taxes was reduced by $205,000 due to a deferred tax valuation recovery based on the expectation of certain tax planning strategies. For additional information on federal income taxes, see Note 13 of the Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplementary Data."

Comparison of Operating Results for the Years Ended September 30, 2012 and 2011

Net income was $4.59 million for the year ended September 30, 2012 compared to $1.10 million for the year ended September 30, 2011. Net income to common shareholders after adjusting for preferred stock dividends and preferred stock discount accretion was $3.52 million for the year ended September 30, 2012 compared to $32,000 for the year ended September 30, 2011. Net income per diluted common share was $0.52 for the year ended September 30, 2012 compared to $0.00 per diluted common share for the year ended September 30, 2011. The increase in net income was primarily due to a decrease in the provision for loan losses, and an increase in non-interest income partially offset by an increase in the provision for income taxes. Also contributing to the improvement in net income were an increase in net interest income and a decrease in non-interest expense.

The decrease in the provision for loan losses was primarily a result of a decrease in the level of net charge-offs for the year ended September 30, 2012 compared to the prior year.

The increase in non-interest income was primarily a result of an increase in gain on sale of loans, an increase in ATM and debit card interchange transaction fees and a reduction in net OTTI on MBS and other investments. These increases to non-interest income were partially offset by a reduction in the valuation recovery on MSRs and a decrease in service charges on deposits.

The increase in net interest income was primarily attributable to an increase in the Company's net interest margin.

The decrease in non-interest expense was primarily attributable to decreases in salaries and employee benefits expense, FDIC insurance expense, other insurance expense and loan administration and foreclosure expense. These decreases to non-interest expense were partially offset by an increase in OREO related expenses.

A more detailed explanation of the income statement categories is presented below.

Net Interest Income: Net interest income increased by $225,000, or 0.9%, to $25.66 million for the year ended September 30, 2012 from $25.43 million for the year ended September 30, 2011. The increase in net interest income was primarily attributable to increases in the Company's average loan receivable and its net interest margin.

Total interest and dividend income decreased by $2.36 million, or 7.0%, to $31.61 million for the year ended September 30, 2012 from $33.97 million for the year ended September 30, 2011 as the yield on interest earning assets decreased to 4.69% from 5.04%. The decrease in the weighted average yield on interest earning assets was primarily a result of a decrease in overall market rates.

Total interest expense decreased by $2.59 million to $5.95 million for the year ended September 30, 2012 from $8.53 million for the year ended September 30, 2011 as the average rate paid on interest-bearing liabilities decreased to 1.04% for the year ended September 30, 2012 from 1.46% for the year ended September 30, 2011. The decrease in funding costs was primarily a result of a decrease in overall market rates, a change in the composition of deposit categories and a decrease in the average level of FHLB advances.

Average loans receivable increased $6.78 million to $544.52 million for the year ended September 30, 2012 as compared to $537.74 million for the year ended September 30, 2011. The net interest margin increased three basis points to 3.81% for the year ended September 30, 2012 from 3.78% for the year ended September 30, 2011 as funding costs decreased at a greater rate than the yield on interest earning assets.

Provision for Loan Losses: The provision for loan losses decreased by $3.26 million, or 48.2%, to $3.50 million for the year ended September 30, 2012 from $6.76 million for the year ended September 30, 2011. Net charge-offs decreased by $2.46 million, or 40.4%, to $3.62 million for the year ended September 30, 2012 from $6.08 million for the year ended September 30, 2011. The net charge-offs to average outstanding loans ratio was 0.66% for the year ended September 30, 2012 and 1.13% for the year ended September 30, 2011.

Non-interest Income: Total non-interest income increased by $1.10 million, or 12.7%, to $9.78 million for the year ended September 30, 2012 from $8.68 million for the year ended September 30, 2011. This increase was primarily a result of a $924,000 increase in gains on sale of loans, a $261,000 increase in ATM and debit card interchange transaction fees and a $233,000 reduction in net OTTI on MBS and other investments. These increases to non-interest income were partially offset by a $395,000 decrease in the valuation recovery on MSRs and a $112,000 decrease in service charges on deposits.

The increased income from loan sales was primarily a result of an increase in the amount of residential loans sold in the secondary market for the year ended September 30, 2012. The sale of one-to four-family mortgage loans increased to $97.4 million for the year ended September 30, 2012 from $62.5 million for the year ended September 30, 2011. The increased loan sales were primarily due to increased refinance activity that was attributable to decreased interest rates for fixed rate mortgage loans. The increased ATM and debit card interchange transaction fees were primarily due to several deposit promotions designed to increase ATM and debit card usage. The decrease in OTTI charges on MBS and other investments was primarily due to a reduction in the level of private label MRS in the Company's investment portfolio. At September 30, 2012 the Company's remaining private label MBS had be reduced to $2.78 million from an original acquired balance of $15.30 million.

The Company's valuation recovery on MSRs decreased by $395,000 to $10,000 for the year ended September 30, 2012 from $405,000 for the year ended September 30, 2011. The valuation of the MSRs was based on a third party valuation of the MSR asset. At September 30, 2012, the MSR asset had a remaining valuation allowance of $475,000 available for future recovery.

The reduction in service charges on deposits was a result of fewer overdrafts on checking accounts.

Non-interest Expense: Total non-interest expense decreased by $395,000, or 1.5%, to $25.57 million for the year ended September 30, 2012 from $25.96 million for the year ended September 30, 2011. The decrease was primarily attributable to a $528,000 decrease in salaries and employee benefits, a $219,000 decrease in FDIC insurance expense, a $147,000 decrease in other insurance expense and $143,000 decrease in loan administration and foreclosure expense. These decreased to non-interest expense were partially offset by a $608,000 increase in OREO and other repossessed assets expense.

The decrease in salaries and employee benefits expense was partially a result of an increased level of loan originations. Under GAAP, the portion of a loan origination fees that is attributable to the estimated employee costs to generate the loan is recorded as a reduction to salaries and employee benefit expense. With the increase in loan originations, the loan originations fees that reduced salaries and employee benefit expense increased by $480,000 during the year ended September 30, 2012 compared to the year ended September 30, 2011.

The decrease in FDIC insurance expense was primarily due to changes in the assessment calculation as a result of the implementation of the Dodd-Frank Act. The decrease in other insurance expenses was primarily a result of reduced insurance premiums. The decrease in loan administration and foreclosure expense was primarily a result of decreased foreclosure related expenses.

The increase in OREO related expenses and loan foreclosure related expenses were primarily a result of an increase in the number of OREO properties held and valuation write-downs based on updated appraisals received for several properties.

The Company's efficiency ratio improved to 72.15% for the year ended September 30, 2012 from 76.11% for the year ended September 30, 2011.

Provision for Federal Income Taxes: The provision for federal income taxes increased by $1.48 million, or 485.9%, to $1.78 million for the year ended September 30, 2012 from $304,000 for the year ended September 30, 2011, primarily due to increased income before taxes. The Company's effective federal and state income tax rate was 28.0% for the year ended September 30, 2012 compared to 21.8% for the year ended September 30, 2011. The difference in the effective tax rate was primarily due to a higher percentage of income subject to tax. Also impacting the effective tax rate were changes to the Company's deferred tax valuation allowance. During the year ended September 30, 2012, the provision for income taxes was reduced by approximately $205,000 due to a deferred tax valuation recovery based on the expected implementation of certain tax planning strategies. The deferred tax valuation allowance relates to a capital loss carry-forward on the sale of securities in fiscal 2008.

Average Balances, Interest and Average Yields/Cost

The earnings of the Company depend largely on the spread between the yield on interest-earning assets and the cost of interest-bearing liabilities, as well as the relative amount of the Company's interest-earning assets and interest- bearing liability portfolios.

The following table sets forth, for the periods indicated, information regarding average balances of assets and liabilities as well as the total dollar amounts of interest income from average interest-earning assets and interest expense on average interest-bearing liabilities and average yields and costs. Such yields and costs for the periods indicated are derived by dividing income or expense by the average daily balance of assets or liabilities, respectively, for the periods presented.

	Year Ended September 30,											
	2013				2012				2011			
	Average Balance	Interest and Dividends	Yield/ Cost		Average Balance	Interest and Dividends	Yield/ Cost		Average Balance	Interest and Dividends	Yield/ Cost	
					(Dollars in thousands)							
Interest-earning assets:												
Loans receivable (1)(2)	$556,815	$29,591	5.31	%	$544,524	$30,831	5.66	%	$537,740	$32,976	6.13	%
Mortgage-backed securities and other investments	6,595	281	4.26		8,479	404	4.75		11,625	612	5.26	
FHLB stock and equity securities	6,561	29	0.44		6,707	32	0.48		6,680	31	0.46	
Interest-bearing deposits	105,055	336	0.32		114,514	338	0.30		117,491	347	0.29	
Total interest-earning assets	675,026	30,237	4.48		674,224	31,605	4.69		673,536	33,966	5.04	
Non-interest-earning assets	65,803				60,927				59,792			
Total assets	$740,829				$735,151				$733,328			
Interest-bearing liabilities:												
Savings accounts	90,376	55	0.06		$87,020	245	0.28		$73,696	459	0.62	
Money market accounts	86,558	246	0.28		70,111	334	0.48		57,996	435	0.75	
NOW accounts	151,980	463	0.30		152,983	651	0.43		157,095	1,415	0.90	
Certificates of deposit	188,564	1,804	0.96		215,759	2,721	1.26		240,174	3,827	1.59	
Short-term borrowings (3)	352	—	0.05		699	—	0.05		511	—	0.05	
Long-term borrowings (4)	45,000	1,871	4.16		47,603	1,996	4.19		55,000	2,397	4.35	
Total interest bearing liabilities	562,830	4,439	0.79		574,175	5,947	1.04		584,472	8,533	1.46	
Non-interest bearing liabilities	87,698				72,888				62,225			
Total liabilities	650,528				647,063				646,697			
Shareholders' equity	90,301				88,088				86,631			
Total liabilities and shareholders' equity	$740,829				$735,151				$733,328			
Net interest income		$25,798				$25,658				$25,433		
Interest rate spread.			3.69	%			3.65	%			3.58	%
Net interest margin (5)			3.82	%			3.81	%			3.78	%
			119.93	%			117.42	%			115.24	%

Ratio of average interest-earning assets to average interest-bearing liabilities

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(1) Does not include interest on loans on non-accrual status. Includes loans originated for sale. Amortized net deferred loan fees, late fees, extension fees and prepayment penalties (2013, $522; 2012, $802; and 2011, $835) included with interest and dividends.
(2) Average balance includes non-accrual loans.
(3) Includes FHLB, FRB and PCBB advances with original maturities of less than one year and other short-term borrowings-repurchase agreements.
(4) Includes FHLB advances with original maturities of one year or greater.
(5) Net interest income divided by total average interest earning assets.

Rate/Volume Analysis

The following table sets forth the effects of changing rates and volumes on net interest income on the Company. Information is provided with respect to the (i) effects on interest income attributable to changes in volume (changes in volume multiplied by prior rate), and (ii) effects on interest income attributable to changes in rate (changes in rate multiplied by prior volume), and (iii) the net change (sum of the prior columns). Changes in both rate and volume have been allocated to rate and volume variances based on the absolute values of each.

	Year Ended September 30, 2013 Compared to Year Ended September 30, 2012 Increase (Decrease) Due to			Year Ended September 30, 2012 Compared to Year Ended September 30, 2011 Increase (Decrease) Due to		
	Rate	Volume	Net Change	Rate	Volume	Net Change
			(In thousands)			
Interest-earning assets:						
Loans receivable (1)	$(1,925)	$685	$(1,240)	$(2,555)	$411	$(2,144)
Mortgage-backed securities and other investments	(39)	(84)	(123)	(55)	(154)	(209)
FHLB stock and equity securities	(3)	—	(3)	1	—	1
Interest-bearing deposits	27	(29)	(2)	—	(9)	(9)
Total net change in income on interest-earning assets	(1,940)	572	(1,368)	(2,609)	248	(2,361)
Interest-bearing liabilities:						
Savings accounts	(199)	9	(190)	(286)	72	(214)
Money market accounts	(155)	67	(88)	(180)	79	(101)
NOW accounts	(184)	(4)	(188)	(728)	(36)	(764)
Certificates of deposit	(602)	(315)	(917)	(744)	(362)	(1,106)
Long-term borrowings	(17)	(108)	(125)	(88)	(313)	(401)
Total net change in expense on interest-bearing liabilities	(1,157)	(351)	(1,508)	(2,026)	(559)	(2,586)
Net change in net interest income	$(783)	$923	$140	$(583)	$808	$225

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(1) Excludes interest on loans on non-accrual status. Includes loans originated for sale.

Liquidity and Capital Resources

The Bank's primary sources of funds are customer deposits, proceeds from principal and interest payments on loans, the sale of loans, maturing securities and FHLB advances. While the maturity and scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

The Bank must maintain an adequate level of liquidity to ensure the availability of sufficient funds to fund loan originations and deposit withdrawals, to satisfy other financial commitments and to take advantage of investment opportunities. The Bank generally maintains sufficient cash and short-term investments to meet short-term liquidity needs. At September 30, 2013, the Bank's regulatory liquidity ratio (net cash, and short-term and marketable assets, as a percentage of net deposits and short-term liabilities) was 19.17%. At September 30, 2013, the Bank maintained an uncommitted credit facility with the FHLB that provided for immediately available advances up to an aggregate amount equal to 25% of total assets, limited by available collateral, under which $45.0 million was outstanding. The Bank maintains a short-term borrowing line with the FRB with total credit based on eligible collateral. At September 30, 2013 the Bank had no outstanding balance on this borrowing line. The Bank also maintains a $10.0 million overnight borrowing line with PCBB. At September 30, 2013, the Bank did not have an outstanding balance on this borrowing line.

Liquidity management is both a short and long-term responsibility of the Bank's management. The Bank adjusts its investments in liquid assets based upon management's assessment of (i) expected loan demand, (ii) projected loan sales, (iii) expected deposit flows, and (iv) yields available on interest- bearing deposits. Excess liquidity is invested generally in interest-bearing overnight deposits and other short-term government and agency obligations. If the Bank requires funds beyond its ability to generate them internally, it has additional borrowing capacity with the FHLB and collateral for repurchase agreements.

The Bank's primary investing activity is the origination of mortgage loans. During the years ended September 30, 2013, 2012 and 2011, the Bank originated $203.1 million, $215.0 million and $142.4 million of mortgage loans, respectively. At September 30, 2013, the Bank had loan commitments totaling $41.6 million and undisbursed loans in process totaling $18.5 million. The Bank anticipates that it will have sufficient funds available to meet current loan commitments. Certificates of deposit that are scheduled to mature in less than one year from September 30, 2013 totaled $111.5 million. Historically, the Bank has been able to retain a significant amount of its deposits as they mature.

The Bank’s liquidity is also affected by the volume of loans sold and loan principal payments. During the years ended September 30, 2013, 2012 and 2011, the Bank sold $89.4 million, $97.4 million and $62.5 million in fixed rate, one- to four-family mortgage loans, respectively. During the years ended September 30, 2013, 2012 and 2011, the Bank received $113.2 million, $121.1 million and $96.7 million in principal repayments, respectively.

The Bank’s liquidity has been impacted by increases in deposit levels. During the years ended September 30, 2013, 2012 and 2011, deposits increased by $10.3 million, $5.2 million and $13.8 million, respectively.

Cash and cash equivalents, certificate of deposits held for investment and mortgage-backed securities and other investments increased to $131.4 million at September 30, 2013 from $128.4 million at September 30, 2012.

Timberland Bancorp is a separate legal entity from the Bank and must provide for its own liquidity and pay its own operating expenses. Sources of capital and liquidity for Timberland Bancorp include principal and interest payments on the loan receivable from the Employee Stock Ownership Plan ("ESOP"), distributions from the Bank and the issuance of debt or equity securities, although there are regulatory restrictions on the ability of the Bank to pay dividends. At September 30, 2013, Timberland Bancorp (on an unconsolidated basis) had liquid assets of $505,000.

Bank holding companies and federally-insured state-chartered banks are required to maintain minimum levels of regulatory capital. At September 30, 2013, Timberland Bancorp and the Bank were in compliance with all applicable capital requirements. For additional details see Note 18 of the Notes to Consolidated Financial Statements contained in “Item 8. Financial Statements and Supplementary Data” and “Item 1. Business - Regulation of the Bank - Capital Requirements.”

Contractual obligations. The following table presents, as of September 30, 2013, the Company’s significant fixed and determinable contractual obligations, within the categories described below, by payment date or contractual maturity. These contractual obligations, except for the operating lease obligations are included in the Consolidated Balance Sheet. The payment amounts represent those amounts contractually due at September 30, 2013.

	Payments due by period				
Contractual obligations	Less than 1 year	1 year through 3 years	After 3 years through 5 years	After 5 years	Total
	(In thousands)				
Short-term debt obligations	$—	$—	$—	$—	$—

Long-term debt obligations	—	—	45,000	—	45,000
Operating lease obligations	183	384	148	166	881
Total contractual obligations	$183	$384	$45,148	$166	$45,881

Effect of Inflation and Changing Prices

The consolidated financial statements and related financial data presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America which require the measurement of financial position and operating results in terms of historical dollars, without considering the change in the relative purchasing power of money over time due to inflation. The primary impact of inflation on the operation of the Company is reflected in increased operating costs. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than do general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The information contained under “Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations - Market Risk and Asset and Liability Management” of this Form 10-K is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data

Management’s Report on Internal Control Over Financial Reporting

The Company’s management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. The Company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. All internal control systems, no matter how well designed, have inherent limitations, including the possibility of human error and the circumvention of overriding controls. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company’s management conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in Internal Control -- Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission as of September 30, 2013. Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as of September 30, 2013.

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TIMBERLAND BANCORP, INC. AND SUBSIDIARY

Index to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Shareholders of Timberland Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of Timberland Bancorp, Inc. and Subsidiary (collectively, "the Company") as of September 30, 2013 and 2012, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended September 30, 2013. The Company's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Timberland Bancorp, Inc. and Subsidiary as of September 30, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the three-year period ended September 30, 2013 in conformity with accounting principles generally accepted in the United States of America.

/s/ Delap LLP

Lake Oswego, Oregon
December 11, 2013

Consolidated Balance Sheets
(Dollars in Thousands, Except Per Share Amounts)

Timberland Bancorp, Inc. and Subsidiary
September 30, 2013 and 2012

	2013	2012
Assets		
Cash and cash equivalents:		
Cash and due from financial institutions	$12,879	$11,008
Interest-bearing deposits in banks	81,617	85,660
Total cash and cash equivalents	94,496	96,668
Certificates of deposit (“CDs”) held for investment (at cost, which approximates fair value)	30,042	23,490
Mortgage-backed securities (“MBS”) and other investments - held to maturity, at amortized cost (estimated fair value of $3,533 and $3,632)	2,737	3,339
MBS and other investments - available for sale	4,101	4,945
Federal Home Loan Bank of Seattle (“FHLB”) stock	5,452	5,655
Loans receivable, net of allowance for loan losses of $11,136 and $11,825	546,193	537,053
Loans held for sale	1,911	1,427
Net loans receivable	548,104	538,480
Premises and equipment, net	17,764	17,886
Other real estate owned (“OREO”) and other repossessed assets, net	11,720	13,302
Accrued interest receivable	1,972	2,183
Bank owned life insurance (“BOLI”)	17,102	16,524
Goodwill	5,650	5,650
Core deposit intangible (“CDI”)	119	249
Mortgage servicing rights (“MSRs”), net	2,266	2,011
Prepaid Federal Deposit Insurance Corporation (“FDIC”) insurance assessment	—	1,186
Other assets	4,123	5,386
Total assets	$745,648	$736,954
Liabilities and shareholders’ equity		
Liabilities:		
Deposits:		
Non-interest-bearing demand	$87,657	$75,296
Interest-bearing	520,605	522,630
Total deposits	608,262	597,926
FHLB advances	45,000	45,000
Repurchase agreements	—	855
Other liabilities and accrued expenses	2,698	2,854
Total liabilities	655,960	646,635

Commitments and contingencies (See Note 16)
See notes to consolidated financial statements

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Consolidated Balance Sheets (Continued)
(Dollars in Thousands, Except Per Share Amounts)

Timberland Bancorp, Inc. and Subsidiary
September 30, 2013 and 2012

Shareholders' equity	2013	2012
Fixed Rate Cumulative Perpetual Preferred Stock, Series A, $0.01 par value; 1,000,000 shares authorized; redeemable at $1,000 per share: 12,065 shares issued and outstanding - September 30, 2013 16,641 shares issued and outstanding - September 30, 2012	$11,936	$16,229
Common stock, $0.01 par value; 50,000,000 shares authorized; 7,045,036 shares issued and outstanding	10,570	10,484
Unearned shares issued to Employee Stock Ownership Plan ("ESOP")	(1,454)	(1,719)
Retained earnings	68,998	65,788
Accumulated other comprehensive loss	(362)	(463)
Total shareholders' equity	89,688	90,319
Total liabilities and shareholders' equity	$745,648	$736,954

See notes to consolidated financial statements

Consolidated Statements of Income
(Dollars in Thousands, Except Per Share Amounts)

Timberland Bancorp, Inc. and Subsidiary
Years Ended September 30, 2013, 2012, and 2011

	2013	2012	2011
Interest and dividend income			
Loans receivable	$29,591	$30,831	$32,976
MBS and other investments	281	404	612
Dividends from mutual funds and FHLB stock	29	32	31
Interest-bearing deposits in banks	336	338	347
Total interest and dividend income	30,237	31,605	33,966
Interest expense			
Deposits	2,568	3,951	6,136
FHLB advances	1,871	1,996	2,397
Total interest expense	4,439	5,947	8,533
Net interest income	25,798	25,658	25,433
Provision for loan losses	2,925	3,500	6,758
Net interest income after provision for loan losses	22,873	22,158	18,675
Non-interest income			
Other than temporary impairment ("OTTI") on MBS and other investments	(15)	(206)	(236)
Adjustment for portion recognized in other comprehensive loss (before taxes)	(32)	(8)	(211)
Net OTTI on MBS and other investments	(47)	(214)	(447)
Realized losses on MBS and other investments	—	—	(2)
Gain on sales of MBS and other investments	—	22	79
Service charges on deposits	3,663	3,795	3,907
ATM and debit card interchange transaction fees	2,142	2,172	1,911
BOLI net earnings	577	607	517
Gain on sales of loans, net	2,507	2,472	1,548
Escrow fees	184	118	73
Fee income from non-deposit investment sales	82	71	92
Valuation recovery on MSRs, net	475	10	405
Other	679	728	598
Total non-interest income, net	10,262	9,781	8,681

See notes to consolidated financial statements

Consolidated Statements of Income (continued)
(Dollars in Thousands, Except Per Share Amounts)

Timberland Bancorp, Inc. and Subsidiary
Years Ended September 30, 2013, 2012, and 2011

	2013	2012	2011
Non-interest expense			
Salaries and employee benefits	$12,605	$12,050	$12,578
Premises and equipment	2,835	2,676	2,632
(Gain) loss on disposition of premises and equipment, net	(431)	—	16
Advertising	742	726	800
OREO and other repossessed assets, net	2,587	1,982	1,374
ATM	857	794	802
Postage and courier	443	501	540
Amortization of CDI	130	148	167
State and local taxes	576	608	622
Professional fees	856	822	753
FDIC insurance	685	942	1,161
Other insurance	174	212	359
Loan administration and foreclosure	430	816	959
Data processing and telecommunications	1,232	1,265	1,172
Deposit operations	607	776	675
Other	1,536	1,250	1,353
Total non-interest expense	25,864	25,568	25,963
Income before income taxes	7,271	6,371	1,393
Provision for federal income taxes	2,514	1,781	304
Net income	4,757	4,590	1,089
Preferred stock dividends	(710)	(832)	(832)
Preferred stock discount accretion	(283)	(240)	(225)
Discount on redemption of preferred stock	255	—	—
Net income to common shareholders	$4,019	$3,518	$32
Net income per common share			
Basic	$0.59	$0.52	$—
Diluted	$0.58	$0.52	$—

See notes to consolidated financial statements

Consolidated Statements of Comprehensive Income
(Dollars in Thousands)

Timberland Bancorp, Inc. and Subsidiary
Years Ended September 30, 2013, 2012, and 2011

	2013	2012	2011
Comprehensive income:			
Net income	$4,757	$4,590	$1,089
Unrealized holding gain on securities available for sale, net of tax	23	14	14
Change in OTTI on securities held to maturity, net of tax:			
Additions	—	(27)	(65)
Additional amount recognized related to credit loss for which OTTI was previously recognized	15	8	16
Amount reclassified to credit loss for previously recorded market loss	6	24	188
Accretion of OTTI securities held to maturity, net of tax	57	46	43
Total comprehensive income	$4,858	$4,655	$1,285

See notes to consolidated financial statements

Consolidated Statements of Shareholders' Equity
(Dollars in Thousands, Except Per Share Amounts)

Timberland Bancorp, Inc. and Subsidiary
Years Ended September 30, 2013, 2012 and 2011

	Number of Shares		Amount					
	Preferred Stock	Common Stock	Preferred Stock	Common Stock	Unearned Shares Issued to ESOP	Retained Earnings	Accumulated Other Compre-hensive Loss	Total
September 30, 2010	16,641	7,045,036	$15,764	$10,377	$(2,247)	$62,238	$ (724)	$85,408
Net income	—	—	—	—	—	1,089	—	1,089
Accretion of preferred stock discount	—	—	225	—	—	(225)	—	—
5% preferred stock dividend	—	—	—	—	—	(832)	—	(832)
Earned ESOP shares, net of tax	—	—	—	(61)	264	—	—	203
MRDP (1) compensation expense, net of tax	—	—	—	134	—	—	—	134
Stock option compensation expense	—	—	—	7	—	—	—	7
Unrealized holding gain on securities available for sale, net of tax	—	—	—	—	—	—	14	14
Change in OTTI on securities held to maturity, net of tax	—	—	—	—	—	—	139	139
Accretion of OTTI on securities held to maturity, net of tax	—	—	—	—	—	—	43	43
September 30, 2011	16,641	7,045,036	15,989	10,457	(1,983)	62,270	(528)	86,205
Net income	—	—	—	—	—	4,590	—	4,590
Accretion of preferred stock discount	—	—	240	—	—	(240)	—	—
5% preferred stock dividend	—	—	—	—	—	(832)	—	(832)
Earned ESOP shares, net of tax	—	—	—	(65)	264	—	—	199
MRDP compensation expense, net of tax	—	—	—	77	—	—	—	77
Stock option compensation expense	—	—	—	15	—	—	—	15
Unrealized holding gain on securities available for sale, net of tax	—	—	—	—	—	—	14	14
Change in OTTI on securities held to maturity, net of tax	—	—	—	—	—	—	5	5
Accretion of OTTI on securities held to maturity, net of tax	—	—	—	—	—	—	46	46
September 30, 2012	16,641	7,045,036	16,229	10,484	(1,719)	65,788	(463)	90,319

(1) 1998 Management Recognition and Development Plan (“MRDP”).

See notes to consolidated financial statements

Consolidated Statements of Shareholders' Equity (continued)
(Dollars in Thousands, Except Per Share Amounts)

Timberland Bancorp, Inc. and Subsidiary
Years Ended September 30, 2013, 2012 and 2011

	Number of Shares		Amount					
	Preferred Stock	Common Stock	Preferred Stock	Common Stock	Unearned Shares Issued to ESOP	Retained Earnings	Accumulated Other Compre-hensive Loss	Total
September 30, 2012	16,641	7,045,036	$16,229	$10,484	$(1,719)	$65,788	$ (463)	$90,319
Net income	—	—	—	—	—	4,757	—	4,757
Accretion of preferred stock discount	—	—	283	—	—	(283)	—	—
Redemption of preferred stock	(4,576)	—	(4,576)	—	—	255	—	(4,321)
5% preferred stock dividends	—	—	—	—	—	(885)	—	(885)
Common stock dividends ($0.09 per common share)	—	—	—	—	—	(634)	—	(634)
Earned ESOP shares, net of tax	—	—	—	6	265	—	—	271
MRDP compensation expense, net of tax	—	—	—	31	—	—	—	31
Stock option compensation expense	—	—	—	49	—	—	—	49
Unrealized holding gain on securities available for sale, net of tax	—	—	—	—	—	—	23	23
Change in OTTI on securities held to maturity, net of tax	—	—	—	—	—	—	21	21
Accretion of OTTI on securities held to maturity, net of tax	—	—	—	—	—	—	57	57
September 30, 2013	12,065	7,045,036	$11,936	$10,570	$(1,454)	$68,998	$ (362)	$89,688

See notes to consolidated financial statements

Consolidated Statements of Cash Flows
(Dollars in Thousands)

Timberland Bancorp, Inc. and Subsidiary
Years Ended September 30, 2013, 2012, and 2011

	2013	2012	2011
Cash flows from operating activities			
Net income	$4,757	$4,590	$1,089
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	1,095	940	992
Deferred federal income taxes	777	154	156
Amortization of CDI	130	148	167
Earned ESOP shares	265	264	264
MRDP compensation expense	39	105	171
Stock option compensation expense	49	15	7
Gains on sale of MBS and other investments	—	(22)	(79)
Net OTTI on MBS and other investments	47	214	447
Realized losses on MBS and other investments	—	—	2
(Gain) loss on sale of OREO and other repossessed assets, net	(264)	373	(548)
Gains on sale of loans, net	(2,507)	(2,472)	(1,548)
(Gain) loss on disposition of premises and equipment, net	(431)	—	16
Provision for loan losses	2,925	3,500	6,758
Provision for OREO losses	2,064	1,048	1,402
Loans originated for sale	(87,329)	(93,073)	(63,945)
Amortization of MSRs	948	805	681
Proceeds from sales of loans	89,352	97,357	63,738
Recovery of MSRs valuation allowance	(475)	(10)	(405)
BOLI net earnings	(577)	(607)	(517)
Decrease in deferred loan origination fees	(60)	(180)	(287)
Net change in accrued interest receivable and other assets, and other liabilities and accrued expenses	767	2,239	2,138
Net cash provided by operating activities	11,572	15,388	10,699
Cash flows from investing activities			
Net increase in CDs held for investment	(6,552)	(4,831)	(612)
Activity in MBS and other investments held to maturity: Maturities and prepayments	689	751	850
Activity in MBS and other investments available for sale: Maturities and prepayments	891	1,042	2,243
Proceeds from sales	—	743	2,272
Redemption of FHLB stock	203	50	—
Increase in loans receivable, net	(15,819)	(22,860)	(10,157)
Additions to premises and equipment	(1,302)	(1,436)	(1,015)
Proceeds from sales of OREO and other repossessed assets	3,596	2,555	4,181
Proceeds from disposition of premises and equipment, net	760	—	—
Purchase of BOLI	—	—	(2,000)
Net cash used in investing activities	(17,534)	(23,986)	(4,238)

See notes to consolidated financial statements

Consolidated Statements of Cash Flows (continued)
(Dollars in Thousands)

Timberland Bancorp, Inc. and Subsidiary
Years Ended September 30, 2013, 2012, and 2011

	2013	2012	2011
Cash flows from financing activities			
Net increase in deposits	$10,336	$5,248	$13,809
Repayment of FHLB advances	—	(10,000)	(20,000)
Net increase (decrease) in repurchase agreements	(855)	126	107
ESOP tax effect	6	(65)	(61)
MRDP compensation tax effect	(8)	(28)	(37)
Repurchase of preferred stock	(4,321)	—	—
Payment of dividends	(1,368)	(2,080)	—
Net cash provided by (used in) financing activities	3,790	(6,799)	(6,182)
Net increase (decrease) in cash and cash equivalents	(2,172)	(15,397)	279
Cash and cash equivalents			
Beginning of period	96,668	112,065	111,786
End of period	$94,496	$96,668	$112,065
Supplemental disclosure of cash flow information			
Income taxes paid	$1,793	$2,343	$2,097
Interest paid	4,523	6,089	8,725
Supplemental disclosure of non-cash investing activities			
Loans transferred to OREO and other repossessed assets	$6,375	$9,443	$5,782
Loans originated to facilitate the sale of OREO	2,708	3,095	1,538

See notes to consolidated financial statements

Notes to Consolidated Financial
Statements

Timberland Bancorp, Inc and Subsidiary
September 30, 2013 and 2012

Note 1 - Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Timberland Bancorp, Inc. ("Timberland Bancorp"); its wholly owned subsidiary, Timberland Bank (the "Bank"); and the Bank's wholly owned subsidiary, Timberland Service Corp. (collectively, "the Company"). All significant intercompany transactions and balances have been eliminated in consolidation.

Nature of Operations

Timberland Bancorp is a bank holding company which operates primarily through its subsidiary, the Bank. The Bank was established in 1915 and, through its 22 branches located in Grays Harbor, Pierce, Thurston, Kitsap, King and Lewis counties in Washington State, attracts deposits from the general public, and uses those funds, along with other borrowings, primarily to provide residential real estate, construction, commercial real estate, commercial business and consumer loans to borrowers primarily in western Washington.

Consolidated Financial Statement Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and prevailing practices within the banking industry. The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities, as of the date of the consolidated balance sheet, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the determination of OTTI in the estimated fair value of mortgage-backed securities, the valuation of MSRs, the valuation of OREO and the determination of goodwill impairment.

Certain prior year amounts have been reclassified to conform to the fiscal 2013 presentation with no change to net income or shareholders' equity previously reported.

Segment Reporting

The Company has one reportable operating segment which is defined as community banking in western Washington under the operating name, "Timberland Bank."

Preferred Stock Sold in 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 stock is redeemed by the Company.

The proceeds received in connection with the issuance of the Series A Preferred Stock were allocated between the preferred stock and detachable warrant based on their relative fair values on the date of issuance. As a result, the preferred stock's initial recorded value was at a discount from the liquidation value or stated value. The discount from the liquidation value is accreted to the expected redemption date and charged to retained earnings. This accretion is recorded using the level-yield method.

On November 13, 2012, the Company’s outstanding 16,641 shares of Series A Preferred Stock were sold by the Treasury as part of Treasury's efforts to manage and recover its investments under the TARP. While the sale of this preferred stock 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 securities, 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 up to 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 discount from liquidation value of $255,000. The discount from liquidation value on the repurchased shares was recorded as an increase to retained earnings.

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

MBS and Other Investments

MBS and other investments are classified upon acquisition as either held to maturity or available for sale. Securities that the Company has the positive intent and ability to hold to maturity are classified as held to maturity and reflected at amortized cost. Securities classified as available for sale are reflected at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income (loss), net of tax effects. Premiums and discounts are amortized to earnings using the interest method over the contractual life of the securities. Gains and losses on sales of securities are recognized on the trade date and determined using the specific identification method.

In estimating whether there are any OTTI losses, management considers 1) the length of time and the extent to which the fair value has been less than amortized cost, 2) the financial condition and near term prospects of the issuer, 3) the impact of changes in market interest rates and 4) the intent and ability of the Company to retain its investment for a period of time sufficient to allow for any anticipated recovery in fair value.

Declines in the fair value of individual securities available for sale that are deemed to be other than temporary are reflected in earnings when identified. The fair value of the security then becomes the new cost basis. For individual securities which the Company does not intend to sell and it is not more likely than not that the Company will be required to sell before recovery of its amortized cost basis, the other than temporary decline in the fair value of the security related to 1) credit loss is recognized in earnings and 2) market or other factors is recognized in other comprehensive income (loss). Credit loss is recorded if the present value of cash flows is less than the amortized cost. For individual securities which the Company intends to sell or more likely than not will not recover all of its amortized cost, the OTTI is recognized in earnings equal to the entire difference between the security's cost basis and its fair value at the consolidated balance sheet date. For individual securities for which credit loss has been recognized in earnings, interest accruals and amortization and accretion of premiums and discounts are suspended when the credit loss is recognized. Interest received after accruals have been suspended is recognized on a cash basis.

FHLB Stock

The Company, as a member of the FHLB, is required to maintain an investment in capital stock of the FHLB in an amount equal to the greater of 1% of its outstanding home loans or 5% of advances from the FHLB. No ready market exists for this stock, and it has no quoted market value. However, redemption of this stock has historically been at par value. Accordingly, $100 per share par value is deemed to be a reasonable estimate of fair value.

The Company evaluated its investment in the FHLB stock for OTTI, consistent with its accounting policy. Based on the Company's evaluation of the underlying investment, including the long-term nature of the investment, the liquidity position of the FHLB, the actions being taken by the FHLB to address its regulatory situation and the Company's intent and ability to hold the investment for a period of time sufficient to recover the par value, the Company does not believe that its investment in the FHLB is impaired. Further, during the year ended September 30, 2012, the Federal Housing Finance Agency ("Finance Agency") upgraded the FHLB's capital classification to "adequately capitalized" and granted the FHLB authority to repurchase up to $25 million of excess capital stock per quarter at par value, provided they receive a non-objection for each quarter's repurchase from the Finance Agency. The FHLB announced in July 2013 that, based on its second quarter 2013 financial results, their board of directors had declared a $0.025 per share cash dividend. This represented the first dividend in a number of years. Even though the Company did not determine its investment in the FHLB stock was impaired at September 30, 2013, future deterioration of the FHLB’s financial condition may result in future impairment losses.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are stated in the aggregate at the lower of cost or estimated fair value. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. Gains or losses on sales of loans are recognized at the time of sale. The gain or loss is the difference between the net sales proceeds and the recorded value of the loans, including any remaining unamortized deferred loan origination fees.

Loans Receivable

Loans are stated at the amount of unpaid principal, reduced by the undisbursed portion of construction loans in process, deferred loan origination fees and the allowance for loan losses.

Non-Performing Loans

Loans on non-accrual status and loans past due 90 days or more and still accruing interest are considered to be non-performing loans.

Troubled Debt Restructured Loans

A troubled debt restructured loan is a loan for which the Company, for reasons related to a borrower’s financial difficulties, grants a significant concession to the borrower that the Company would not otherwise consider.

The loan terms which have been modified or restructured due to a borrower’s financial difficulty, include but are not limited to: a reduction in the stated interest rate; an extension of the maturity at an interest rate below current market rates; a reduction in the face amount of the debt; a reduction in the accrued interest; or re-amortizing, extensions, deferrals and renewals. Troubled debt restructured loans are considered impaired and are individually evaluated for impairment. Troubled debt restructured loans are classified as non-performing unless they have been performing in accordance with modified terms for a period of at least six months.

Impaired Loans

A loan is generally considered impaired when it is probable that the Company will be unable to collect all contractual principal and interest payments due in accordance with the original or modified terms of the loan agreement. When a loan is considered collateral dependent, impairment is measured using the estimated fair value of the underlying collateral, less any prior liens, and when applicable, less estimated selling costs. For impaired loans that are not collateral dependent, impairment is measured using the present value of expected future cash flows, discounted at the loan’s original effective interest rate.

The categories of non-accrual loans and impaired loans overlap, although they are not coextensive. The Company considers all circumstances regarding the loan and borrower on an individual basis when determining whether an impaired loan should be placed on non-accrual status.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level sufficient to provide for estimated loan losses based on evaluating known and inherent risks in the loan portfolio. The allowance is provided based upon management's comprehensive analysis of the pertinent factors underlying the quality of the loan portfolio. These factors include changes in the amount and composition of the loan portfolio, delinquency levels, actual loan loss experience, current economic conditions, and a detailed analysis of individual loans for which full collectability may not be assured. The detailed analysis includes methods to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. The allowance consists of specific and general components. The specific component relates to loans that are deemed impaired. For such loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value less selling costs, if applicable, or observable market price) of the impaired loan is lower than the recorded value of that loan. The general component covers non-classified loans and classified loans that are not evaluated individually for impairment and is based on historical loss experience adjusted for qualitative factors. The Company's historical loss experience is determined by evaluating the average net charge-offs over the most recent economic cycle, but not to exceed six years. Qualitative factors are determined by loan type and allow management to augment reserve levels to reflect the current general economic environment and portfolio performance trends including recent charge-off trends. Allowances are provided based on management’s continuing evaluation of the pertinent factors underlying the quality of the loan portfolio, including changes in the size and composition of the loan portfolio, actual loan loss experience, current economic conditions, collateral values, geographic concentrations, seasoning of the loan portfolio, specific industry conditions, the duration of the current business cycle and regulatory requirements. The appropriateness of the allowance for loan losses is estimated based upon these factors and trends identified by management at the time consolidated financial statements are prepared.

In accordance with the Financial Accounting Standards Board (“FASB”) guidance for receivables, a loan is considered impaired when it is probable that a creditor will be unable to collect all amounts (principal and interest) due according to the contractual terms of the loan agreement. Smaller balance homogenous loans, such as residential mortgage loans and consumer loans, may be collectively evaluated for impairment. When a loan has been identified as being impaired, the amount of the impairment is measured by using discounted cash flows, except when, as an alternative, the current estimated fair value of the collateral, reduced by estimated costs to sell (if applicable), is used. The valuation of real estate collateral is subjective in nature and may be adjusted in future periods because of changes in economic conditions. Management considers third-party appraisals, as well as independent fair market value assessments from realtors or persons involved in selling real estate in determining the estimated fair value of particular properties. In addition, as certain of these third-party appraisals and independent fair market value assessments are only updated periodically, changes in the values of specific properties may have occurred subsequent to the most recent appraisals. Accordingly, the amounts of any such potential changes and any related adjustments are generally recorded at the time such information is received. When the measurement of the impaired loan is less than the recorded investment in the loan (including accrued interest and net deferred loan origination fees or costs), impairment is recognized by creating or adjusting an allocation of the allowance for loan losses and uncollected accrued interest is reversed against interest income. If ultimate collection of principal is in doubt, all cash receipts on impaired loans are applied to reduce the principal balance.

A provision for loan losses is charged against operations and is added to the allowance for loan losses based on a quarterly comprehensive analysis of the loan portfolio. The allowance for loan losses is allocated to certain loan categories based on the relative risk characteristics, asset classifications and actual loss experience of the loan portfolio. While management has allocated the allowance for loan losses to various loan portfolio segments, the allowance is general in nature and is available for the loan portfolio in its entirety.

The ultimate recovery of all loans is susceptible to future market factors beyond the Company’s control. These factors may result in losses or recoveries differing significantly from those provided in the consolidated financial statements. The Company has experienced a significant decline in valuations for some real estate collateral since October 2008. If real estate values continue to decline and as updated appraisals are received on collateral for impaired loans, the Company may need to increase the allowance for loan losses appropriately. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company’s allowance for loan losses, and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

Interest on Loans and Loan Fees

Interest on loans is accrued daily based on the principal amount outstanding. Generally, the accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due or when they are past due 90 days as to either principal or interest (based on contractual terms), unless they are well secured and in the process of collection. In determining whether a borrower may be able to meet payments as they become due, management considers circumstances such as the financial strength of the borrower, the estimated collateral value, reasons for the delays in payments, payment record, the amounts past due and the number of days past due. All interest accrued but not collected for loans that are placed on non-accrual status or charged off is reversed against interest income. Subsequent collections on a cash basis are applied proportionately to past due principal and interest, unless collectability of principal is in doubt, in which case all payments are applied to principal. Loans are returned to accrual status when the loan is deemed current, and the collectability of principal and interest is no longer doubtful, or, in the case of one- to four-family loans, when the loan is less than 90 days delinquent.

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The Company charges fees for originating loans. These fees, net of certain loan origination costs, are deferred and amortized to income, on the level-yield basis, over the loan term. If the loan is repaid prior to maturity, the remaining unamortized deferred loan origination fee is recognized in income at the time of repayment.

MSRs

The Company holds rights to service loans that it has originated and sold to the Federal Home Loan Mortgage Corporation ("Freddie Mac"). MSRs are capitalized at estimated fair value when acquired through the origination of loans that are subsequently sold with the servicing rights retained and are amortized to servicing income on loans sold in proportion to and over the period of estimated net servicing income. The value of MSRs at the date of the sale of loans is estimated based on the discounted present value of expected future cash flows using key assumptions for servicing income and costs and prepayment rates on the underlying loans. The estimated fair value is periodically evaluated for impairment by comparing actual cash flows and estimated future cash flows from the servicing assets to those estimated at the time servicing assets were originated. Fair values are estimated using discounted cash flows based on current market rates of interest. For purposes of measuring impairment, the rights must be stratified by one or more predominant risk characteristics of the underlying loans. The Company stratifies its capitalized MSRs based on product type and term of the underlying loans. The amount of impairment recognized is the amount, if any, by which the amortized cost of the MSRs exceeds their fair value. Impairment, if deemed temporary, is recognized through a valuation allowance to the extent that fair value is less than the recorded amount.

BOLI

BOLI policies are recorded at their cash surrender value less applicable cash surrender charges. Income from BOLI is recognized when earned.

Goodwill

Goodwill is initially recorded when the purchase price paid for an acquisition exceeds the estimated fair value of the net identified tangible and intangible assets acquired. Goodwill is presumed to have an indefinite useful life and is analyzed annually for impairment. An annual review is performed during the third quarter of each fiscal year, or more frequently if indicators of potential impairment exist, to determine if the recorded goodwill is impaired. If the estimated fair value of the Company's sole reporting unit exceeds the recorded value of the reporting unit, goodwill is not considered impaired and no additional analysis is necessary.

The Company performed its fiscal year 2013 goodwill impairment test during the quarter ended June 30, 2013 with the assistance of a third-party firm specializing in goodwill impairment valuations for financial institutions. The third-party analysis was conducted as of May 31, 2013 and concluded that the fair value of goodwill was $45.0 million, which exceeded the recorded value of $5.7 million by 689%.

The goodwill impairment test involved a two-step process. Step one of the goodwill impairment test estimated the fair value of the reporting unit utilizing the allocation of corporate value approach, the income approach and the market approach in order to derive an enterprise value for the Company.

The allocation of corporate value approach applies the aggregate market value of the Company and divides it among the reporting units. The Company has a single reporting unit. The aggregate market value was based on the Company's common stock market price on May 31, 2013, adjusted for a control premium and the value of preferred stock (at its liquidation value). A key assumption in this approach is the control premium applied to the aggregate market value. A control premium is utilized to adjust the value of a company to its value from the perspective of a controlling interest which is generally higher than the value determined using a widely quoted market price per share. The Company used an expected control premium of 30%, which was based on comparable transaction history.

The income approach uses a reporting unit's projection of estimated operating results and cash flows that are discounted using a rate that reflects current market conditions. The projection uses management's estimates of economic and market conditions over the projected period including growth rates in loans and deposits, estimates of future expected changes in net interest margins and cash expenditures. Key assumptions used by the Company in its discounted cash flow model (income approach) included an annual revenue growth rate that approximated 3.0% and a return on assets that ranged from 0.54% to 1.01% (average of 0.73%). In addition to the above projections of estimated operating results, key assumptions used to determine the

fair value estimate under the income approach were the discount rate of 15.0% utilized for the Company's cash flow estimate and a terminal value of 1.25 times the ending book value of the reporting unit. The Company used a build-up approach in
developing the discount rate including an assessment of the risk free interest rate, the rate of return expected from publicly traded stocks based on an analysis of historical data, the industry the Company operates in and the size of the Company.

The market approach estimates the fair value by applying cash flow multiples to the reporting unit's operating performance. The multiples were derived from comparable publicly traded companies with operating and investment characteristics similar to those of the reporting unit. In applying the market approach method, the Company selected six publicly traded institutions based on a variety of financial metrics (e.g., tangible equity, return on assets, return on equity, net interest margin, non-performing assets, net charge-offs and reserves for loan losses) and other relevant factors (e.g., geographical location, lines of business, risk profile, availability of financial information, etc.).

The Company calculated a fair value of its reporting unit of $89 million using the corporate value approach, $82 million using the income approach and $96 million using the market approach. The concluded fair value based on the three methods under the step one test was $87 million, with the most weighting given to the income approach. The results of the Company's step one test indicated that the reporting unit's fair value was less than its recorded value and therefore the Company performed a step two analysis.

The Company then calculated the implied fair value of its reporting unit under step two of the goodwill impairment test. Under this approach, the Company calculated the fair value for the assets and liabilities of the reporting unit. The calculated implied fair value of the Company's goodwill exceeded the recorded value by $39.3 million.

Under the step two process significant adjustments were made to determine the estimated fair value of the Company's loans receivable compared to its recorded value. The Company utilized a discounted cash flow approach and a comparable sales transaction approach to determine the fair value of its loans receivable.

The discounted cash flow approach was utilized to value performing loans with credit quality grades of pass. A key assumption in the discounted cash flow approach was determining an appropriate discount rate. In determining the discount rate for pass loans, the Company started with its contractual cash flows and its current lending rate for comparable loans and adjusted these for credit factors, estimated prepayments and liquidity premiums. Based on an analysis of these factors, performing loans with credit quality grades of pass were discounted by 5%.

The comparable sales transaction approach using comparable loan sales was utilized for performing loans with credit quality grades of watch, special mention or substandard and for non-performing loans. In the comparable sales transaction approach a weighted average discount rate was used that approximated the discount for similar loan sales by the FDIC. A key assumption used by the Company in the comparable sales transaction approach was determining the appropriate discount rate to apply to each loan category. Performing loans with credit quality grades of watch, special mention or substandard were discounted by 25% and non-performing loans were discounted by 50%. These weighted average discount rates approximated the discount for similar loan sales by the FDIC. Increases in the pricing for future reported loan sale transactions could have a significant impact on the implied fair value of goodwill under the step two process.

A significant amount of judgment is involved in determining if an indicator of goodwill impairment has occurred. Such indicators may include, among others; a significant decline in the expected future cash flows; a sustained, significant decline in the Company's stock prices and market capitalization; a significant adverse change in legal factors or in the business climate; adverse assessment or action by a regulator; and unanticipated competition. Key assumptions used in the annual goodwill impairment test are highly judgmental and include: selection of comparable companies, amount of control premium, projected cash flows, discount rate applied to projected cash flows and method of estimating the fair value of loans. Any change in these indicators or key assumptions could have a significant negative impact on the Company's financial condition, impact the goodwill impairment analysis or cause the Company to perform a goodwill impairment analysis more frequently than once per year.

As of September 30, 2013, management believes that there have been no events or changes in the circumstances that would indicate a potential impairment of goodwill. No assurances can be given, however, that the Company will not record an impairment loss on goodwill in the future.

CDI

The CDI is amortized to non-interest expense using an accelerated method over a ten-year period.

Premises and Equipment

Premises and equipment are recorded at cost. Depreciation is computed using the straight-line method over the following estimated useful lives: buildings and improvements - five to 40 years; furniture and equipment - three to seven years; and automobiles - five years. The cost of maintenance and repairs is charged to expense as incurred. Gains and losses on dispositions are reflected in earnings.

Impairment of Long-Lived Assets

Long-lived assets, consisting of premises and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the recorded amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the recorded amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the recorded amount of the assets exceeds the discounted recovery amount or estimated fair value of the assets. No events or changes in circumstances have occurred during the years ended September 30, 2013 or 2012 that would cause management to evaluate the recoverability of the Company's long-lived assets.

OREO and Other Repossessed Assets

OREO and other repossessed assets consist of properties or assets acquired through or in lieu of foreclosure, and are recorded initially at the estimated fair value of the properties less estimated costs of disposal. Costs relating to development and improvement of the properties or assets are capitalized, while costs relating to holding the properties or assets are expensed. The valuation of real estate collateral is subjective in nature and may be adjusted in future periods because of changes in economic conditions. Management considers third-party appraisals, as well as independent fair market value assessments from realtors or persons involved in selling real estate, in determining the estimated fair value of particular properties. In addition, as certain of these third-party appraisals and independent fair market value assessments are only updated periodically, changes in the values of specific properties may have occurred subsequent to the most recent appraisals. Accordingly, the amounts of any such potential changes and any related adjustments are generally recorded at the time such information is received.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Income Taxes

The Company files a consolidated federal income tax return. The Bank provides for income taxes separately and remits to (receives from) Timberland Bancorp amounts currently due (receivable).

Deferred federal income taxes result from temporary differences between the tax basis of assets and liabilities, and their reported amounts in the consolidated financial statements. These temporary differences will result in differences between income (loss) for tax purposes and income (loss) for financial reporting purposes in future years. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision (benefit) for income taxes. Valuation allowances are established to reduce the net recorded amount of deferred tax assets if it is determined to be more likely than not, that all or some portion of the potential deferred tax asset will not be realized.

With respect to accounting for uncertainty in incomes taxes a tax provision is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely to be realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. The Company recognizes interest and/or penalties related to income tax matters as income tax expense. The Company is no longer subject to United States federal income tax examination by tax authorities for years ended on or before September 30, 2009.

ESOP

The Bank sponsors a leveraged ESOP that is accounted for in accordance with GAAP. Accordingly, the debt of the ESOP is recorded as other borrowed funds of the Bank, and the shares pledged as collateral are reported as unearned shares issued to the ESOP on the consolidated balance sheets. The debt of the ESOP is payable to Timberland Bancorp and is therefore eliminated in the consolidated financial statements. As shares are released from collateral, compensation expense is recorded equal to the average market price of the shares for the period, and the shares become available for net income per common share calculations. Dividends paid on unallocated shares reduce the Company’s cash contributions to the ESOP.

Cash and Cash Equivalents and Cash Flows

The Company considers amounts included in the consolidated balance sheets’ captions “Cash and due from financial institutions,” and “Interest-bearing deposits in banks,” all of which mature within ninety days, to be cash equivalents for purpose of reporting cash flows. Cash flows from loans, deposits, FHLB advances and repurchase agreements are reported net in the accompanying consolidated statements of cash flows.

Interest-bearing deposits in banks as of September 30, 2013 and 2012 included deposits with the FRB of $72,955,000 and $75,325,000, respectively. The Company also maintains balances in correspondent bank accounts which, at times, may exceed FDIC insurance limits of $250,000. Management believes that its risk of loss associated with such balances is minimal due to the financial strength of the FRB and the correspondent banks.

Advertising

Costs for advertising and marketing are expensed as incurred.

Stock-Based Compensation

The Company measures compensation cost for all stock-based awards based on the grant-date fair value and recognizes compensation cost over the service period of stock-based awards.

The fair value of stock options is determined using the Black-Scholes valuation model. The fair value of stock grants under the MRDP is equal to the fair value of the shares at the grant date.

The Company’s stock compensation plans are described more fully in Note 15.

Net Income Per Common Share

Basic net income per common share is computed by dividing net income to common shareholders by the weighted average number of common shares outstanding during the period, without considering any dilutive items. Diluted net income per common share is computed by dividing net income to common shareholders by the weighted average number of common shares and common stock equivalents for items that are dilutive, net of shares assumed to be repurchased using the treasury stock method at the average share price for the Company’s common stock during the period. The 5% dividend and related accretion for the amount of the Company's Series A Perferred Stock outstanding for the respective year is deducted from net income, and the discount on the redemption of Series A Preferred Stock is added to net income in computing net income to common shareholders. Common stock equivalents arise from assumed conversion of outstanding stock options and the outstanding warrant to purchase common stock. Shares owned by the Bank’s ESOP that have not been allocated are not considered to be outstanding for the purpose of computing net income per common share.

Related Party Transactions

The Chairman of the Board of the Bank and Timberland Bancorp is a member of the law firm that provides general counsel to the Company. Legal fees paid to this law firm for the years ended September 30, 2013, 2012 and 2011 totaled $166,000, $203,000 and $176,000, respectively.

Recent Accounting Pronouncements

In February 2013, the FASB issued Accounting Standard Update ("ASU") No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This guidance requires an entity to provide information about the amount reclassified out of accumulated other comprehensive income by component and to present either on the face of the statement where net income is presented, or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. The guidance was effective for annual and interim reporting periods beginning on or after December 15, 2012. The adoption of ASU 2013-02 did not have a material impact on the Company's consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exits. The guidance clarifies when it is appropriate for an unrecognized tax benefit, or portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset. ASU 2013-11 is effective for interim and annual periods beginning after December 15, 2013. Early adoption is permitted. The guidance should be applied prospectively to all unrecognized tax benefits that exist at the effective date, however, retrospective application is also permitted. Adoption of ASU 2013-11 is not expected to have a significant impact on the Company's consolidated financial statements.

Note 2 - Restricted Assets

Federal Reserve Board regulations require that the Bank maintain certain minimum reserve balances on hand or on deposit with the FRB, based on a percentage of transaction account deposits. The amounts of the reserve requirement balances as of September 30, 2013 and 2012 were approximately $840,000 and $874,000, respectively.

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Note 3 - Mortgage-Backed Securities and Other Investments

Mortgage-backed securities and other investments were as follows as of September 30, 2013 and 2012 (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
September 30, 2013				
Held to Maturity				
MBS:				
U.S. government agencies	$1,202	$31	$(2)	$1,231
Private label residential	1,521	781	(15)	2,287
U.S. agency securities	14	1	—	15
Total	$2,737	$813	$(17)	$3,533
Available for Sale				
MBS:				
U.S. government agencies	$2,144	$87	$(2)	$2,229
Private label residential	804	120	(10)	914
Mutual funds	1,000	—	(42)	958
Total	$3,948	$207	$(54)	$4,101
September 30, 2012				
Held to Maturity				
MBS:				
U.S. government agencies	$1,493	$44	$(3)	$1,534
Private label residential	1,819	309	(60)	2,068
U.S. agency securities	27	3	—	30
Total	$3,339	$356	$(63)	$3,632
Available for Sale				
MBS:				
U.S. government agencies	$2,828	$147	$—	$2,975
Private label residential	1,001	65	(109)	957
Mutual funds	1,000	13	—	1,013
Total	$4,829	$225	$(109)	$4,945

The following table summarizes the estimated fair value and gross unrealized losses for all securities and the length of time these unrealized losses existed as of September 30, 2013 (dollars in thousands):

	Less Than 12 Months			12 Months or Longer			Total	
	Estimated Fair Value	Gross Unrealized Losses	Qty	Estimated Fair Value	Gross Unrealized Losses	Qty	Estimated Fair Value	Gross Unrealized Losses
Held to Maturity MBS:								
U.S. government agencies	$3	$—	6	$88	$(2)	4	$91	$(2)
Private label residential	80	(4)	4	239	(11)	14	319	(15)
Total	$83	$(4)	10	$327	$(13)	18	$410	$(17)
Available for Sale MBS:								
U.S. government agencies	$96	$(2)	3	$—	$—	1	$96	$(2)
Private label residential	—	—	—	108	(10)	2	108	(10)
Mutual Funds	958	(42)	1	—	—	—	958	(42)
Total	$1,054	$(44)	4	$108	$(10)	3	$1,162	$(54)

The following table summarizes the estimated fair value and gross unrealized losses for all securities and the length of time the unrealized losses existed as of September 30, 2012 (dollars in thousands):

	Less Than 12 Months			12 Months or Longer			Total	
	Estimated Fair Value	Gross Unrealized Losses	Qty	Estimated Fair Value	Gross Unrealized Losses	Qty	Estimated Fair Value	Gross Unrealized Losses
Held to Maturity MBS:								
U.S. government agencies	$7	$—	1	$100	$(3)	4	$107	$(3)
Private label residential	17	(1)	1	423	(59)	28	440	(60)
Total	$24	$(1)	2	$523	$(62)	32	$547	$(63)
Available for Sale MBS:								
Private label residential	—	—	—	651	(109)	4	651	(109)

Total	$—	$—	—	$651	$(109	)	4	$651	$(109	)

The Company has evaluated these securities and has determined that the decline in their value is temporary. The unrealized losses are primarily due to unusually large spreads in the market for private label mortgage-related products. The fair value of the mortgage-backed securities is expected to recover as the securities approach their maturity date and/or as the pricing spreads narrow on mortgage-related securities. The Company has the ability and the intent to hold the investments until the market value recovers. Furthermore, as of September 30, 2013, management does not have the intent to sell any of the securities classified as available for sale where the estimated fair value is below the recorded value and believes that it is more likely than not that the Company will not have to sell such securities before a recovery of cost (or recorded value if previously written down).

During the year ended September 30, 2013, the Company recorded net OTTI charges through earnings on residential MBS of $47,000. For the year ended September 30, 2012, the Company recorded net OTTI charges through earnings on residential MBS of $214,000. In accordance with GAAP, the Company bifurcates OTTI into (i) amounts related to credit losses which are recognized through earnings and (ii) amounts related to all other factors which are recognized as a component of other comprehensive income (loss).

To determine the component of the gross OTTI related to credit losses, the Company compared the amortized cost basis of the OTTI security to the present value of its revised expected cash flows, discounted using its pre-impairment yield. The revised expected cash flow estimates for individual securities are based primarily on an analysis of default rates, prepayment speeds and third-party analytic reports. Significant judgment by management is required in this analysis that includes, but is not limited to, assumptions regarding the collectability of principal and interest, net of related expenses, on the underlying loans.

The following table presents a summary of the significant inputs utilized to measure management's estimates of the credit loss component on OTTI securities as of September 30, 2013, 2012 and 2011:

	Range Minimum	Maximum	Weighted Average
September 30, 2013			
Constant prepayment rate	6.00 %	15.00 %	12.33 %
Collateral default rate	0.73 %	22.53 %	7.84 %
Loss severity rate	20.48 %	75.02 %	52.69 %
September 30, 2012			
Constant prepayment rate	6.00 %	15.00 %	8.77 %
Collateral default rate	0.06 %	28.40 %	8.74 %
Loss severity rate	0.52 %	76.03 %	48.28 %
September 30, 2011			
Constant prepayment rate	6.00 %	15.00 %	10.71 %
Collateral default rate	0.43 %	24.23 %	8.03 %
Loss severity rate	11.93 %	64.54 %	39.22 %

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The following table presents the OTTI losses for the years ended September 30, 2013, 2012 and 2011 (dollars in thousands):

	2013 Held To Maturity	Available For Sale	2012 Held To Maturity	Available For Sale	2011 Held To Maturity	Available For Sale
Total OTTI losses	$(13)	$(2)	$(156)	$(50)	$(210)	$(26)
Portion of OTTI losses recognized in other comprehensive loss (before taxes) (1)	(32)	—	(8)	—	(211)	—
Net OTTI recognized in earnings (2)	$(45)	$(2)	$(164)	$(50)	$(421)	$(26)

(1) Represents OTTI related to all other factors.
(2) Represents OTTI related to credit losses.

The following table presents a roll forward of the credit loss component of held to maturity and available for sale debt securities that have been written down for OTTI with the credit loss component recognized in earnings for the years ended September 30, 2013, 2012 and 2011 (dollars in thousands):

	2013	2012	2011
Balance, beginning of year	$2,703	$3,361	$4,725
Additions:			
Credit losses for which OTTI was not previously recognized	7	81	53
Additional increases to the amount related to credit loss for which OTTI was previously recognized	45	133	398
Subtractions:			
Realized losses previously recorded as credit losses	(671)	(872)	(1,811)
Recovery of prior credit loss	—	—	(4)
Balance, end of year	$2,084	$2,703	$3,361

During the year ended September 30, 2013 there were no realized gains on sale of securities. During the year ended September 30, 2012 there was a realized gain on one available for sale security in the amount of $22,000. During the year ended September 30, 2011, there was a realized gain on two available for sale securities in the amount of $79,000. During the year ended September 30, 2013, the Company recorded a $671,000 realized loss (as a result of securities being deemed worthless) on eighteen held to maturity and five available for sale residential MBS, all of which had been recognized previously as a credit loss. During the year ended September 30, 2012, the Company recorded a $872,000 realized loss (as a result of securities being deemed worthless) on twenty-five held to maturity and five available for sale residential MBS, all of which had been recognized previously as a credit loss. During the year ended September 30, 2011, the Company recorded a $1,813,000 realized loss (as a result of securities being deemed worthless) on twenty-eight held to maturity and one available for sale residential MBS of which $1,811,000 had been recognized previously as a credit loss.

The recorded amount of residential mortgage-backed and agency securities pledged as collateral for public fund deposits, federal treasury tax and loan deposits, FHLB collateral, retail repurchase agreements and other non-profit organization deposits totaled $4,537,000 and $5,699,000 at September 30, 2013 and 2012, respectively.

The contractual maturities of debt securities at September 30, 2013, are as follows (dollars in thousands). Expected maturities may differ from scheduled maturities due to the prepayment of principal or call provisions.

	Held to Maturity		Available for Sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due after one year to five years	$22	$23	$28	$28
Due after five to ten years	22	22	28	29
Due after ten years	2,693	3,488	2,892	3,086
Total	$2,737	$3,533	$2,948	$3,143

Note 4 - Loans Receivable and Allowance for Loan Losses

Loans receivable and loans held for sale by portfolio segment consisted of the following at September 30, 2013 and 2012 (dollars in thousands):

	2013	2012
Mortgage loans:		
One- to four-family	$102,387	$105,552
Multi-family	51,108	47,521
Commercial	291,297	256,254
Construction – custom and owner/builder	40,811	33,345
Construction – speculative one- to four-family	1,428	1,880
Construction – commercial	2,239	20,247
Construction – multi-family	143	345
Construction – land development	515	589
Land	31,144	39,655
Total mortgage loans	521,072	505,388
Consumer loans:		
Home equity and second mortgage	33,014	32,814
Other	5,981	6,183
Total consumer loans	38,995	38,997
Commercial business loans	17,499	22,588
Total loans receivable	577,566	566,973
Less:		
Undisbursed portion of construction loans in process	18,527	16,325
Deferred loan origination fees	1,710	1,770
Allowance for loan losses	11,136	11,825
	31,373	29,920
Loans receivable, net	546,193	537,053
Loans held for sale (one- to four-family)	1,911	1,427

Total loans receivable and loans held for sale, net	$548,104	$538,480

Certain related parties of the Company, principally Bank directors and officers, are loan customers of the Bank in the ordinary course of business. Their loans were performing according to their repayment terms at September 30, 2013 and 2012. Activity in related party loans during the years ended September 30, 2013 and 2012 was as follows (dollars in thousands):

	2013	2012
Balance, beginning of year	$1,113	$2,498
New loans or advances	276	175
Repayments and reclassifications	(294)	(1,560)
Balance, end of year	$1,095	$1,113

Loan Segment Risk Characteristics
The Company believes that its loan classes are the same as its loan segments.

One- To Four-Family Residential Lending: The Company originates both fixed rate and adjustable rate loans secured by one- to four-family residences. A portion of the fixed-rate one- to four-family loans are sold in the secondary market for asset/liability management purposes and to generate non-interest income. The Company's lending policies generally limit the maximum loan-to-value on one- to four-family loans to 90% of the lesser of the appraised value or the purchase price. However, the Company usually obtains private mortgage insurance on the portion of the principal amount that exceeds 80% of the appraised value of the property.

Multi-Family Lending: The Company originates loans secured by multi-family dwelling units (more than four units). Multi-family lending generally affords the Company an opportunity to receive interest at rates higher than those generally available from one- to four-family residential lending. However, loans secured by multi-family properties usually are greater in amount, more difficult to evaluate and monitor and, therefore, involve a greater degree of risk than one- to four-family residential mortgage loans. Because payments on the loans secured by multi-family properties are often dependent on the successful operation and management of the properties, repayment of such loans may be affected by adverse conditions in the real estate market or economy. The Company attempts to minimize these risks by scrutinizing the financial condition of the borrower, the quality of the collateral and the management of the property securing the loan.

Commercial Mortgage Lending: The Company originates commercial real estate loans secured by properties such as office buildings, retail/wholesale facilities, motels, restaurants, mini-storage facilities and other commercial properties. Commercial real estate lending generally affords the Company an opportunity to receive interest at higher rates than those available from one- to four-family residential lending. However, loans secured by such properties usually are greater in amount, more difficult to evaluate and monitor and, therefore, involve a greater degree of risk than one- to four-family residential mortgage loans. Because payments on loans secured by commercial properties often depend upon the successful operation and management of the properties, repayment of these loans may be affected by adverse conditions in the real estate market or economy. The Company attempts to mitigate these risks by generally limiting the maximum loan-to-value ratio to 80% and scrutinizing the financial condition of the borrower, the quality of the collateral and the management of the property securing the loan.

Construction Lending: The Company currently originates the following types of construction loans: custom construction loans, owner/builder construction loans, speculative construction loans (on a very limited basis), commercial real estate construction loans, and multi-family construction loans. The Company is not currently originating land development loans.

Construction lending affords the Company the opportunity to achieve higher interest rates and fees with shorter terms to maturity than does its single-family permanent mortgage lending. Construction lending, however, is generally considered to involve a higher degree of risk than one-to four family residential lending because of the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost of the project. The nature of these loans is such that they are generally more difficult to evaluate and monitor. If the estimated cost of construction proves to be inaccurate, the Company may be required to advance funds beyond the amount originally committed to complete the project. If the estimate of value upon completion proves to be inaccurate, the Company may be confronted with a project whose value is insufficient to assure full repayment, and it may incur a loss. Projects may also be jeopardized by disagreements between borrowers and builders and by the failure of builders to pay subcontractors. Loans to construct homes for which no purchaser has been identified carry more risk because the payoff for the loan depends on the builder's ability to sell the property prior to the time that the construction loan is due. The Company attempts to mitigate these risks by adhering to its underwriting policies, disbursement procedures, and monitoring practices.

Construction Lending – Custom and Owner/Builder: Custom construction loans are made to home builders who, at the time of construction, have a signed contract with a home buyer who has a commitment to purchase the finished home. Owner/builder construction loans are originated to home owners rather than home builders and are typically refinanced into permanent loans at the completion of construction.

Construction Lending – Speculative One- To Four-Family: Speculative one-to four-family construction loans are made to home builders and are termed "speculative" because the home builder does not have, at the time of the loan origination, a signed contract with a home buyer who has a commitment for permanent financing with the Company or another lender for the finished home. The home buyer may be identified either during or after the construction period. The Company is currently originating speculative one-to four-family construction loans on a very limited basis.

Construction Lending – Commercial: Commercial construction loans are originated to construct properties such as office buildings, hotels, retail rental space and mini-storage facilities.

Construction Lending – Multi-Family: Multi-family construction loans are originated to construct apartment buildings and condominium projects.

Construction Lending – Land Development: The Company historically originated loans to real estate developers for the purpose of developing residential subdivisions. The Company is not currently originating any land development loans.

Land Lending: The Company has historically originated loans for the acquisition of land upon which the purchaser can then build or make improvements necessary to build or to sell as improved lots. Currently, the Company is originating new land loans on a very limited basis. Loans secured by undeveloped land or improved lots involve greater risks than one- to four-family residential mortgage loans because these loans are more difficult to evaluate. If the estimate of value proves to be inaccurate, in the event of default or foreclosure, the Company may be confronted with a property value which is insufficient to assure full repayment. The Company attempts to minimize this risk by generally limiting the maximum loan-to-value ratio on land loans to 75%.

Consumer Lending – Home Equity and Second Mortgages: The Company originates home equity lines of credit and second mortgage loans. Home equity lines of credit and second mortgage loans have a greater credit risk than one- to four-family residential mortgage loans because they are secured by mortgages subordinated to the existing first mortgage on the property, which may or may not be held by the Company. The Company attempts to mitigate these risks by adhering to its underwriting policies in evaluating the collateral and the credit-worthiness of the borrower.

Consumer Lending – Other: The Company originates other consumer loans, which include automobile loans, boat loans, motorcycle loans, recreational vehicle loans, savings account loans and unsecured loans. Other consumer loans generally have shorter terms to maturity than mortgage loans. Other consumer loans generally entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The Company attempts to mitigate these risks by adhering to its underwriting policies in evaluating the credit-worthiness of the borrower.

Commercial Business Lending: The Company originates commercial business loans which are generally secured by business equipment, accounts receivable, inventory or other property. The Company also generally obtains personal guarantees from the principals based on a review of personal financial statements. Commercial business lending generally involves risks that are different from those associated with residential and commercial real estate lending. Real estate lending is generally considered to be collateral based lending with loan amounts based on predetermined loan to collateral values, and liquidation of the underlying real estate collateral is viewed as the primary source of repayment in the event of borrower default. Although commercial business loans are often collateralized by equipment, inventory, accounts receivable, or other business assets, the liquidation of collateral in the event of a borrower default is often an insufficient source of repayment, because accounts receivable may be uncollectible and inventories and equipment may be obsolete or of limited use. Accordingly, the repayment of a commercial business loan depends primarily on the credit-worthiness of the borrower (and any guarantors), while the liquidation of collateral is a secondary and potentially insufficient source of repayment. The Company attempts to mitigate

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these risks by adhering to its underwriting policies in evaluating the management of the business and the credit-worthiness of the borrowers and the guarantors.

Allowance for Loan Losses
The following table sets forth information for the year ended September 30, 2013 regarding activity in the allowance for loan losses by portfolio segment (dollars in thousands):

	Beginning Allowance	Provision (Credit)	Charge-offs	Recoveries	Ending Allowance
Mortgage loans:					
One-to four-family	$1,558	$565	$769	$95	$1,449
Multi-family	1,156	(407)	—	—	749
Commercial	4,247	1,640	667	55	5,275
Construction – custom and owner/builder	386	(124)	26	26	262
Construction – speculative one- to four-family	128	(32)	—	—	96
Construction – commercial	429	(373)	—	—	56
Construction – multi-family	—	116	116	—	—
Construction – land development	—	(129)	17	146	—
Land	2,392	1,801	2,307	54	1,940
Consumer loans:					
Home equity and second mortgage	759	202	184	5	782
Other	254	(40)	14	—	200
Commercial business loans	516	(294)	—	105	327
Total	$11,825	$2,925	$4,100	$486	$11,136

The following table sets forth information for the year ended September 30, 2012 regarding activity in the allowance for loan losses by portfolio segment (dollars in thousands):

	Beginning Allowance	Provision (Credit)	Charge-offs	Recoveries	Ending Allowance
Mortgage loans:					
One-to four-family	$760	$1,000	$276	$74	$1,558
Multi-family	1,076	80	14	14	1,156
Commercial	4,035	1,427	1,215	—	4,247
Construction – custom and owner/builder	222	164	—	—	386
Construction – speculative one- to four-family	169	(42)	—	1	128
Construction – commercial	794	257	622	—	429
Construction – multi-family	354	(780)	24	450	—
Construction – land development	79	106	239	54	—
Land	2,795	751	1,251	97	2,392
Consumer loans:					
Home equity and second mortgage	460	517	232	14	759
Other	415	(137)	24	—	254
Commercial business loans	787	157	430	2	516

Total	$11,946	$3,500	$4,327	$706	$11,825

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The following table sets forth information for the year ended September 30, 2011 regarding activity in the allowance for loan losses by portfolio segment (dollars in thousands):

	Beginning Allowance	Provision (Credit)	Charge-offs	Recoveries	Ending Allowance
Mortgage loans:					
One-to four-family	$530	$622	$543	$151	$760
Multi-family	393	642	—	41	1,076
Commercial	3,173	804	47	105	4,035
Construction – custom and owner/builder	481	(211)	48	—	222
Construction – speculative one- to four-family	414	(142)	103	—	169
Construction – commercial	245	1,993	1,444	—	794
Construction – multi-family	245	1,328	1,219	—	354
Construction – land development	240	993	1,158	4	79
Land	3,709	744	1,704	46	2,795
Consumer loans:					
Home equity and second mortgage	922	(354)	150	42	460
Other	451	(8)	30	2	415
Commercial business loans	461	347	22	1	787
Total	$11,264	$6,758	$6,468	$392	$11,946

The following table presents information on the loans evaluated individually and collectively for impairment in the allowance for loan losses by portfolio segment at September 30, 2013 (dollars in thousands):

	Allowance for Loan Losses			Recorded Investment in Loans		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
Mortgage loans:						
One- to four-family	$600	$849	$1,449	$8,984	$95,314	$104,298
Multi-family	334	415	749	5,184	45,924	51,108
Commercial	1,763	3,512	5,275	19,510	271,787	291,297
Construction – custom and owner/builder	—	262	262	—	22,788	22,788
Construction – speculative one- to four family	88	8	96	687	236	923
Construction – commercial	—	56	56	—	2,239	2,239
Construction – multi-family	—	—	—	143	1	144
Construction – land development	—	—	—	515	—	515
Land	234	1,706	1,940	2,391	28,753	31,144
Consumer loans:						
Home equity and second mortgage	57	725	782	679	32,335	33,014

Other	—	200	200	6	5,975	5,981
Commercial business loans	—	327	327	—	17,499	17,499
Total	$3,076	$8,060	$11,136	$38,099	$522,851	$560,950

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The following table presents information on the loans evaluated individually and collectively for impairment in the allowance for loan losses by portfolio segment at September 30, 2012 (dollars in thousands):

	Allowance for Loan Losses			Recorded Investment in Loans		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
Mortgage loans:						
One- to four-family	$678	$880	$1,558	$5,282	$101,697	$106,979
Multi-family	711	445	1,156	6,879	40,642	47,521
Commercial	667	3,580	4,247	17,192	239,062	256,254
Construction – custom and owner/ builder	15	371	386	309	20,159	20,468
Construction – speculative one- to four family	109	19	128	1,027	495	1,522
Construction – commercial	—	429	429	—	17,157	17,157
Construction – multi-family	—	—	—	345	—	345
Construction – land development	—	—	—	589	—	589
Land	686	1,706	2,392	8,613	31,042	39,655
Consumer loans:						
Home equity and second mortgage	36	723	759	562	32,252	32,814
Other	—	254	254	7	6,176	6,183
Commercial business loans	—	516	516	—	22,588	22,588
Total	$2,902	$8,923	$11,825	$40,805	$511,270	$552,075

The following table presents an age analysis of past due status of loans by portfolio segment at September 30, 2013 (dollars in thousands):

	30–59 Days Past Due	60-89 Days Past Due	Non-Accrual(1)	Past Due 90 Days or More and Still Accruing	Total Past Due	Current	Total Loans
Mortgage loans:							
One- to four-family	$14	$1,218	$6,985	$—	$8,217	$96,081	$104,298
Multi-family	—	—	—	—	—	51,108	51,108
Commercial	—	2,537	3,435	—	5,972	285,325	291,297
Construction – custom and owner/ builder	—	—	—	—	—	22,788	22,788
Construction – speculative one- to four family	—	—	—	—	—	923	923
Construction – commercial	—	—	—	—	—	2,239	2,239
Construction – multi-family	—	—	144	—	144	—	144
Construction – land development	—	—	515	—	515	—	515
Land	—	—	2,146	284	2,430	28,714	31,144

Consumer loans:							
Home equity and second mortgage	101	20	380	152	653	32,361	33,014
Other	1	39	5	—	45	5,936	5,981
Commercial business loans	83	15	—	—	98	17,401	17,499
Total	$199	$3,829	$13,610	$436	$18,074	$542,876	$560,950

(1) Includes non-accrual loans past due 90 days or more and other loans classified as non-accrual.

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The following table presents an age analysis of past due status of loans by portfolio segment at September 30, 2012 (dollars in thousands):

	30–59 Days Past Due	60-89 Days Past Due	Non-Accrual(1)	Past Due 90 Days or More and Still Accruing	Total Past Due	Current	Total Loans
Mortgage loans:							
One- to four-family	$1,987	$—	$3,382	$142	$5,511	$101,468	$106,979
Multi-family	3,402	—	1,449	—	4,851	42,670	47,521
Commercial	1,071	—	6,049	6	7,126	249,128	256,254
Construction – custom and owner/ builder	—	—	309	—	309	20,159	20,468
Construction – speculative one-to four family	—	—	327	700	1,027	495	1,522
Construction – commercial	—	—	—	—	—	17,157	17,157
Construction – multi-family	—	—	345	—	345	—	345
Construction – land development	—	—	589	—	589	—	589
Land	943	—	8,613	200	9,756	29,899	39,655
Consumer loans:							
Home equity and second mortgage	277	14	261	150	702	32,112	32,814
Other	4	—	7	—	11	6,172	6,183
Commercial business loans	—	15	—	—	15	22,573	22,588
Total	$7,684	$29	$21,331	$1,198	$30,242	$521,833	$552,075

(1) Includes non-accrual loans past due 90 days or more and other loans classified as non-accrual.

Credit Quality Indicators

The Company uses credit risk grades which reflect the Company's assessment of a loan's risk or loss potential. The Company categorizes loans into risk grade categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors such as the estimated fair value of the collateral. The Company uses the following definitions for credit risk ratings as part of the on-going monitoring of the credit quality of its loan portfolio:

Pass: Pass loans are defined as those loans that meet acceptable quality underwriting standards.

Watch: Watch loans are defined as those loans that still exhibit acceptable quality, but have some concerns that justify greater attention. If these concerns are not corrected, a potential for further adverse categorization exists. These concerns could relate to a specific condition peculiar to the borrower or its industry segment or the general economic environment.

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

Substandard: Substandard loans are defined as those loans that are inadequately protected by the current net worth and paying capacity of the obligor, or of the collateral pledged. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. If the weakness or weaknesses are not corrected, there is the distinct possibility that some loss will be sustained.

Loss: Loans in this classification are considered uncollectible and of such little value that continuance as an asset is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless loan even though partial recovery may be realized in the future.

The following table lists the loan credit risk grades by portfolio segment utilized by the Company that serve as credit quality indicators at September 30, 2013 (dollars in thousands):

	Loan Grades				
	Pass	Watch	Special Mention	Substandard	Total
Mortgage loans:					
One- to four-family	$91,291	$4,032	$769	$8,206	$104,298
Multi-family	41,863	132	8,337	776	51,108
Commercial	262,502	3,309	12,522	12,964	291,297
Construction – custom and owner / builder	22,788	—	—	—	22,788
Construction – speculative one- to four-family	236	687	—	—	923
Construction – commercial	2,239	—	—	—	2,239
Construction – multi-family	—	—	—	144	144
Construction – land development	—	—	—	515	515
Land	20,627	5,101	1,129	4,287	31,144
Consumer loans:					
Home equity and second mortgage	31,096	782	55	1,081	33,014
Other	5,937	39	—	5	5,981
Commercial business loans	17,029	366	104	—	17,499
Total	$495,608	$14,448	$22,916	$27,978	$560,950

The following table lists the loan credit risk grades by portfolio segment utilized by the Company that serve as credit quality indicators at September 30, 2012 (dollars in thousands):

	Loan Grades				
	Pass	Watch	Special Mention	Substandard	Total
Mortgage loans:					
One- to four-family	$93,668	$4,000	$4,343	$4,968	$106,979
Multi-family	35,703	107	10,220	1,491	47,521
Commercial	228,036	1,722	11,515	14,981	256,254
Construction – custom and owner / builder	17,621	—	2,538	309	20,468
Construction – speculative one- to four-family	304	191	700	327	1,522
Construction – commercial	17,157	—	—	—	17,157
Construction – multi-family	—	—	—	345	345
Construction – land development	—	—	—	589	589
Land	22,700	5,788	2,554	8,613	39,655

Consumer loans:					
Home equity and second mortgage	29,777	1,488	788	761	32,814
Other	6,136	40	—	7	6,183
Commercial business loans	20,777	834	286	691	22,588
Total	$471,879	$14,170	$32,944	$33,082	$552,075

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Impaired Loans

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

The categories of non-accrual loans and impaired loans overlap, although they are not coextensive. The Company considers all circumstances regarding the loan and borrower on an individual basis when determining whether an impaired loan should be placed on non-accrual status, such as the financial strength of the borrower, the estimated collateral value, reasons for the delay, payment record, the amount past due and the number of days past due.

Notes to Consolidated Financial Statements

Timberland Bancorp, Inc and Subsidiary
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The following table is a summary of information related to impaired loans by portfolio segment as of and for the year ended September 30, 2013 (dollars in thousands):

	September 30, 2013			For the Year Ended September 30, 2013	
	Recorded Investment	Unpaid Principal Balance (Loan Balance Plus Charge Off)	Related Allowance	Average Recorded Investment	Interest Income