TFS Financial CORP
Form 10-Q
May 08, 2014

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended March 31, 2014
or
.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For transition period from to
Commission File Number 001-33390

TFS FINANCIAL CORPORATION
(Exact Name of Registrant as Specified in its Charter)

United States of America (State or Other Jurisdiction of Incorporation or Organization)	52-2054948 (I.R.S. Employer Identification No.)
7007 Broadway Avenue Cleveland, Ohio	44105
(Address of Principal Executive Offices)	(Zip Code)

(216) 441-6000
Registrant’s telephone number, including area code:
Not Applicable
(Former name or former address, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	ý	Accelerated filer	¨

Non-accelerated filer ¨ (do not check if a smaller reporting company) Smaller Reporting Company ¨

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

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

As of May 5, 2014 there were 305,853,224 shares of the Registrant's common stock, par value $0.01 per share, outstanding, of which 227,119,132 shares, or 74.3% of the Registrant's common stock, were held by Third Federal Savings and Loan Association of Cleveland, MHC, the Registrant's mutual holding company.

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GLOSSARY OF TERMS

TFS Financial Corporation provides the following list of acronyms as a tool for the reader. The acronyms identified below are used in the Consolidated Financial Statements, the Notes to Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

AOCI: Accumulated Other Comprehensive Income
ARM: Adjustable Rate Mortgage
ASC: Accounting Standards Codification
ASU: Accounting Standards Update
Association: Third Federal Savings and Loan Association of Cleveland
BAAS: OCC Bank Accounting Advisory Series
CDs: Certificates of Deposit
CFPB: Consumer Financial Protection Bureau
CLTV: Combined Loan-to-Value
Company: TFS Financial Corporation and its subsidiaries
DFA: Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
DIF: Depository Insurance Fund
EaR: Earnings at Risk
ESOP: Third Federal Employee (Associate) Stock Ownership Plan
EVE: Economic Value of Equity
FASB: Financial Accounting Standards Board
FDIC: Federal Deposit Insurance Corporation
FHFA: Federal Housing Finance Agency
FHLB: Federal Home Loan Bank
Fannie Mae: Federal National Mortgage Association
FRB-Cleveland: Federal Reserve Bank of Cleveland
FRS: Board of Governors of the Federal Reserve System
GAAP: Generally Accepted Accounting Principles
GVA: General Valuation Allowances
HARP: Home Affordable Refinance Program
High LTV: High loan-to-value
HPI: Home Price Index
IRR: Interest Rate Risk
IRS: Internal Revenue Service
IVA: Individual Valuation Allowance
LIP: Loans-in-Process
MGIC: Mortgage Guaranty Insurance Corporation
MOU: Memorandum of Understanding
MVA: Market Valuation Allowances
NOW: Negotiable Order of Withdrawal
OCC: Office of the Comptroller of the Currency
OCI: Other Comprehensive Income
OTS: Office of Thrift Supervision
PMI: Private Mortgage Insurance
PMIC: PMI Mortgage Insurance Co.
QTL: Qualified Thrift Lender
REMICs: Real Estate Mortgage Investment Conduits
REIT: Real Estate Investment Trust
SEC: United States Securities and Exchange Commission
SVA: Specific Valuation Allowances
TDR: Troubled Debt Restructuring
Third Federal Savings, MHC: Third Federal Savings and Loan Association of Cleveland, MHC

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Item 1. Financial Statements
TFS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CONDITION (unaudited)
(In thousands, except share data)

	March 31, 2014	September 30, 2013
ASSETS		
Cash and due from banks	$35,366	$34,694
Interest-earning cash equivalents	232,436	251,302
Cash and cash equivalents	267,802	285,996
Investment securities:		
Available for sale (amortized cost $490,181 and $480,664, respectively)	486,625	477,376
Mortgage loans held for sale, at lower of cost or market ($1,164 and $3,369 measured at fair value, respectively)	1,509	4,179
Loans held for investment, net:		
Mortgage loans	10,444,046	10,185,674
Other consumer loans	4,076	4,100
Deferred loan fees, net	(7,913)	(13,171)
Allowance for loan losses	(83,391)	(92,537)
Loans, net	10,356,818	10,084,066
Mortgage loan servicing assets, net	12,845	14,074
Federal Home Loan Bank stock, at cost	40,405	35,620
Real estate owned	19,912	22,666
Premises, equipment, and software, net	58,195	58,517
Accrued interest receivable	31,382	31,489
Bank owned life insurance contracts	186,909	183,724
Other assets	72,039	71,639
TOTAL ASSETS	$11,534,441	$11,269,346
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	$8,415,490	$8,464,499
Borrowed funds	1,070,132	745,117
Borrowers' advances for insurance and taxes	65,229	71,388
Principal, interest, and related escrow owed on loans serviced	53,412	75,745
Accrued expenses and other liabilities	46,050	41,120
Total liabilities	9,650,313	9,397,869
Commitments and contingent liabilities		
Preferred stock, $0.01 par value, 100,000,000 shares authorized, none issued and outstanding	—	—
Common stock, $0.01 par value, 700,000,000 shares authorized; 332,318,750 shares issued; 307,199,672 and 309,230,591 outstanding at March 31, 2014 and September 30, 2013, respectively	3,323	3,323
Paid-in capital	1,699,328	1,696,370
Treasury stock, at cost; 25,119,078 and 23,088,159 shares at March 31, 2014 and September 30, 2013, respectively	(302,723)	(278,215)
Unallocated ESOP shares	(68,251)	(70,418)
Retained earnings—substantially restricted	561,133	529,021
Accumulated other comprehensive loss	(8,682)	(8,604)
Total shareholders' equity	1,884,128	1,871,477

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$11,534,441	$11,269,346

See accompanying notes to unaudited interim consolidated financial statements.

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TFS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (unaudited)
(In thousands, except share and per share data)

	For the Three Months Ended March 31,		For the Six Months Ended March 31,	
	2014	2013	2014	2013
INTEREST AND DIVIDEND INCOME:				
Loans, including fees	$90,545	$95,241	$180,946	$193,930
Investment securities available for sale	2,305	1,079	4,405	2,192
Other interest and dividend earning assets	495	515	1,013	1,101
Total interest and dividend income	93,345	96,835	186,364	197,223
INTEREST EXPENSE:				
Deposits	21,962	28,030	45,224	59,165
Borrowed funds	2,349	875	4,311	1,712
Total interest expense	24,311	28,905	49,535	60,877
NET INTEREST INCOME	69,034	67,930	136,829	136,346
PROVISION FOR LOAN LOSSES	5,000	10,000	11,000	28,000
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	64,034	57,930	125,829	108,346
NON-INTEREST INCOME:				
Fees and service charges, net of amortization	2,393	2,146	4,682	4,449
Net gain on the sale of loans	533	1,257	872	4,279
Increase in and death benefits from bank owned life insurance contracts	1,583	1,577	3,196	3,182
Other	1,025	1,126	1,862	2,443
Total non-interest income	5,534	6,106	10,612	14,353
NON-INTEREST EXPENSE:				
Salaries and employee benefits	23,325	21,824	45,407	42,427
Marketing services	3,360	3,127	6,613	6,252
Office property, equipment and software	5,283	5,293	10,272	10,314
Federal insurance premium and assessments	2,547	3,243	5,094	6,957
State franchise tax	1,731	1,749	3,418	3,412
Real estate owned expense, net	3,008	1,516	4,953	2,681
Other operating expenses	5,677	8,477	12,033	15,720
Total non-interest expense	44,931	45,229	87,790	87,763
INCOME BEFORE INCOME TAXES	24,637	18,807	48,651	34,936
INCOME TAX EXPENSE	8,252	6,017	16,242	10,993
NET INCOME	$16,385	$12,790	$32,409	$23,943
Earnings per share—basic and diluted	$0.05	$0.04	$0.11	$0.08
Weighted average shares outstanding				
Basic	300,261,921	301,753,966	300,450,112	301,664,171
Diluted	301,529,980	302,651,575	301,697,091	302,451,344

See accompanying notes to unaudited interim consolidated financial statements.

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TFS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)
(In thousands)

	For the Three Months Ended March 31,		For the Six Months Ended March 31,	
	2014	2013	2014	2013
Net income	$ 16,385	$ 12,790	$ 32,409	$ 23,943
Other comprehensive income (loss), net of tax				
Change in net unrealized income (loss) on securities available for sale	1,773	(214)	(174)	(924)
Change in pension obligation	48	90	96	180
Total other comprehensive income (loss)	1,821	(124)	(78)	(744)
Total comprehensive income	$ 18,206	$ 12,666	$ 32,331	$ 23,199

See accompanying notes to unaudited interim consolidated financial statements.

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TFS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (unaudited)
Six Months Ended March 31, 2014 and 2013
(In thousands)

	Common stock	Paid-in capital	Treasury stock	Unallocated common stock held by ESOP	Retained earnings	Accumulated other comprehensive loss	Total shareholders' equity
Balance at September 30, 2012	$ 3,323	$ 1,691,884	$ (280,937)	$ (74,751)	$ 473,247	$ (5,916)	$ 1,806,850
Net income	—	—	—	—	23,943	—	23,943
Other comprehensive loss, net of tax	—	—	—	—	—	(744)	(744)
ESOP shares allocated or committed to be released	—	(91)	—	2,167	—	—	2,076
Compensation costs for stock-based plans	—	3,259	—	—	—	—	3,259
Treasury stock allocated to restricted stock plan	—	(1,231)	1,308	—	(77)	—	—
Balance at March 31, 2013	$ 3,323	$ 1,693,821	$ (279,629)	$ (72,584)	$ 497,113	$ (6,660)	$ 1,835,384
Balance at September 30, 2013	$ 3,323	$ 1,696,370	$ (278,215)	$ (70,418)	$ 529,021	$ (8,604)	$ 1,871,477
Net income	—	—	—	—	32,409	—	32,409
Other comprehensive loss, net of tax	—	—	—	—	—	(78)	(78)
ESOP shares allocated or committed to be released	—	416	—	2,167	—	—	2,583
Compensation costs for stock-based plans	—	3,591	—	—	—	—	3,591
Excess tax effect from stock-based compensation	—	43	—	—	—	—	43
Purchase of treasury stock (2,156,250 shares)			(26,058)				(26,058)
Treasury stock allocated to restricted stock plan	—	(1,092)	1,550	—	(297)	—	161
Balance at March 31, 2014	$ 3,323	$ 1,699,328	$ (302,723)	$ (68,251)	$ 561,133	$ (8,682)	$ 1,884,128

See accompanying notes to unaudited interim consolidated financial statements.

TFS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)
(In thousands)

	For the Six Months Ended March 31, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$32,409	$23,943
Adjustments to reconcile net income to net cash provided by operating activities:		
ESOP and stock-based compensation expense	6,335	5,335
Excess tax effect related to stock-based compensation	43	—
Depreciation and amortization	5,976	12,197
Provision for loan losses	11,000	28,000
Net gain on the sale of loans	(872)	(4,279)
Other net losses	1,626	1,987
Principal repayments on and proceeds from sales of loans held for sale	16,513	36,744
Loans originated for sale	(13,480)	(31,589)
Increase in bank owned life insurance contracts	(3,202)	(3,191)
Net (increase) decrease in interest receivable and other assets	(538)	5,267
Net increase (decrease) in accrued expenses and other liabilities	5,083	(8,207)
Other	202	162
Net cash provided by operating activities	61,095	66,369
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans originated	(1,155,941)	(1,019,128)
Principal repayments on loans	836,092	1,186,955
Proceeds from principal repayments and maturities of:		
Securities available for sale	59,947	111,624
Proceeds from sale of:		
Loans	24,738	189,534
Real estate owned	12,708	13,568
Purchases of:		
FHLB stock	(4,785)	—
Securities available for sale	(71,292)	(152,210)
Premises and equipment	(2,230)	(4,646)
Other	18	(12)
Net cash (used in) provided by investing activities	(300,745)	325,685
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net decrease in deposits	(49,009)	(224,137)
Net decrease in borrowers’ advances for insurance and taxes	(6,159)	(7,111)
Net decrease in principal and interest owed on loans serviced	(22,333)	(12,650)
Net increase (decrease) in short term borrowed funds	128,344	(305,892)
Proceeds from long term borrowed funds	230,000	140,000
Repayment of long term borrowed funds	(33,329)	(6,380)
Purchase of treasury shares	(26,058)	—
Net cash provided by (used in) financing activities	221,456	(416,170)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(18,194)	(24,116)
CASH AND CASH EQUIVALENTS—Beginning of period	285,996	308,262
CASH AND CASH EQUIVALENTS—End of period	$267,802	$284,146

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest on deposits	$44,943	$59,482
Cash paid for interest on borrowed funds	3,968	1,604
Cash paid for income taxes	6,000	13,200
SUPPLEMENTAL SCHEDULES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Transfer of loans to real estate owned	11,230	12,460
Transfer of loans from held for sale to held for investment	—	144,841
Transfer of loans from held for investment to held for sale	24,619	323,027

See accompanying notes to unaudited interim consolidated financial statements.

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TFS FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands unless otherwise indicated)

1. BASIS OF PRESENTATION

TFS Financial Corporation, a federally chartered stock holding company, conducts its principal activities through its wholly owned subsidiaries. The principal line of business of the Company is retail consumer banking, including mortgage lending, deposit gathering, and, to a much lesser extent other financial services. On March 31, 2014, approximately 74% of the Company’s outstanding shares were owned by a federally chartered mutual holding company, Third Federal Savings and Loan Association of Cleveland, MHC. The thrift subsidiary of TFS Financial Corporation is Third Federal Savings and Loan Association of Cleveland.

The accounting and reporting policies followed by the Company conform in all material respects to accounting principles generally accepted in the United States of America and to general practices in the financial services industry. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. The allowance for loan losses, the valuation of mortgage loan servicing rights, the valuation of deferred tax assets, and the determination of pension obligations and stock-based compensation are particularly subject to change.

The unaudited interim consolidated financial statements were prepared without an audit and reflect all adjustments of a normal recurring nature which, in the opinion of management, are necessary to present fairly the consolidated financial condition of the Company at March 31, 2014, and its results of operations and cash flows for the periods presented. In accordance with Regulation S-X for interim financial information, these statements do not include certain information and footnote disclosures required for complete audited financial statements. The Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2013 contains consolidated financial statements and related notes, which should be read in conjunction with the accompanying interim consolidated financial statements. The results of operations for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2014 or for any other period.

2. EARNINGS PER SHARE

Basic earnings per share is the amount of earnings available to each share of common stock outstanding during the reporting period. Diluted earnings per share is the amount of earnings available to each share of common stock outstanding during the reporting period adjusted to include the effect of potentially dilutive common shares. For purposes of computing earnings per share amounts, outstanding shares include shares held by the public, shares held by the ESOP that have been allocated to participants or committed to be released for allocation to participants, the 227,119,132 shares held by Third Federal Savings, MHC, and, for purposes of computing dilutive earnings per share, stock options and restricted stock units with a dilutive impact. At March 31, 2014 and 2013, respectively, the ESOP held 6,825,100 and 7,258,440 shares that were neither allocated to participants nor committed to be released to participants.

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The following is a summary of the Company's earnings per share calculations.

	For the Three Months Ended March 31,					
	2014			2013		
	Income	Shares	Per share amount	Income	Shares	Per share amount
	(Dollars in thousands, except per share data)					
Net income	$16,385			$12,790		
Less: income allocated to restricted stock units	79			68		
Basic earnings per share:						
Income available to common shareholders	$16,306	300,261,921	$0.05	$12,722	301,753,966	$0.04
Diluted earnings per share:						
Effect of dilutive potential common shares		1,268,059			897,609	
Income available to common shareholders	$16,306	301,529,980	$0.05	$12,722	302,651,575	$0.04

	For the Six Months Ended March 31,					
	2014			2013		
	Income	Shares	Per share amount	Income	Shares	Per share amount
	(Dollars in thousands, except per share data)					
Net income	$32,409			$23,943		
Less: income allocated to restricted stock units	156			126		
Basic earnings per share:						
Income available to common shareholders	$32,253	300,450,112	$0.11	$23,817	301,664,171	$0.08
Diluted earnings per share:						
Effect of dilutive potential common shares		1,246,979			787,173	
Income available to common shareholders	$32,253	301,697,091	$0.11	$23,817	302,451,344	$0.08

The following is a summary of outstanding stock options and restricted stock units that are excluded from the computation of diluted earnings per share because their inclusion would be anti-dilutive.

	For the Three Months Ended March 31,		For the Six Months Ended March 31,	
	2014	2013	2014	2013
Options to purchase shares	3,907,600	5,395,509	3,923,600	6,509,209
Restricted stock units	—	30,000	—	30,000

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3. INVESTMENT SECURITIES

Investments available for sale are summarized as follows:

	March 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agency obligations	$2,000	$31	$—	$2,031
Freddie Mac certificates	604	35	—	639
Ginnie Mae certificates	10,424	288	—	10,712
REMICs	465,445	1,708	(6,135)	461,018
Fannie Mae certificates	11,123	760	(243)	11,640
Money market accounts	585	—	—	585
Total	$490,181	$2,822	$(6,378)	$486,625

	September 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agency obligations	$2,000	$37	$—	$2,037
Freddie Mac certificates	894	56	—	950
Ginnie Mae certificates	11,919	423	—	12,342
REMICs	448,881	1,506	(5,810)	444,577
Fannie Mae certificates	11,495	805	(305)	11,995
Money market accounts	5,475	—	—	5,475
Total	$480,664	$2,827	$(6,115)	$477,376

Gross unrealized losses on securities and the estimated fair value of the related securities, aggregated by investment category and length of time the individual securities have been in a continuous loss position, at March 31, 2014 and September 30, 2013, were as follows:

	March 31, 2014					
	Less Than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Available for sale—						
REMICs	$210,446	$4,094	$91,345	$2,041	$301,791	$6,135
Fannie Mae certificates	4,807	243	—	—	4,807	243
Total	$215,253	$4,337	$91,345	$2,041	$306,598	$6,378

	September 30, 2013					
	Less Than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Available for sale—						
REMICs	$237,774	$4,984	$45,768	$826	$283,542	$5,810
Fannie Mae certificates	4,806	305	—	—	4,806	305
Total	$242,580	$5,289	$45,768	$826	$288,348	$6,115

The unrealized losses on investment securities were attributable to interest rate increases. The contractual terms of U.S. government and agency obligations do not permit the issuer to settle the security at a price less than the par value of the investment. The contractual cash flows of mortgage-backed securities are guaranteed by Fannie Mae, Freddie Mac and Ginnie

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Mae. REMICs are issued by or backed by securities issued by these governmental agencies. It is expected that the securities would not be settled at a price substantially less than the amortized cost of the investment. The U.S. Treasury Department established financing agreements in 2008 to ensure Fannie Mae and Freddie Mac meet their obligations to holders of mortgage-backed securities that they have issued or guaranteed.

Since the decline in value is attributable to changes in interest rates and not credit quality and because the Association has neither the intent to sell the securities nor is it more likely than not the Association will be required to sell the securities for the time periods necessary to recover the amortized cost, these investments are not considered other-than-temporarily impaired. At March 31, 2014, the amortized cost and fair value of U.S. government and agency obligations available for sale due in more than one year but less than five years are $2,000 and $2,031, respectively as compared to $2,000 and $2,037 at September 30, 2013.

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans held for investment consist of the following:

	March 31, 2014	September 30, 2013
Real estate loans:		
Residential non-Home Today	$8,486,701	$8,118,511
Residential Home Today	165,226	178,353
Home equity loans and lines of credit	1,758,811	1,858,398
Construction	70,236	72,430
Real estate loans	10,480,974	10,227,692
Other consumer loans	4,076	4,100
Less:		
Deferred loan fees—net	(7,913)	(13,171)
LIP	(36,928)	(42,018)
Allowance for loan losses	(83,391)	(92,537)
Loans held for investment, net	$10,356,818	$10,084,066

At March 31, 2014 and September 30, 2013, respectively, $1,509 and $4,179 of long-term loans were classified as mortgage loans held for sale.

A large concentration of the Company’s lending is in Ohio and Florida. As of March 31, 2014 and September 30, 2013, the percentages of residential real estate loans held in Ohio were 72% and 74%, respectively, and the percentages held in Florida were 18% as of both dates. As of both March 31, 2014 and September 30, 2013, home equity loans and lines of credit were concentrated in the states of Ohio (39%), Florida (29%), California (12%) and New Jersey (5%). The economic conditions and market for real estate in those states, including to a greater extent Florida, have impacted the ability of borrowers in those areas to repay their loans.

Home Today is an affordable housing program targeted to benefit low- and moderate-income home buyers. Through this program the Association provided the majority of loans to borrowers who would not otherwise qualify for the Association’s loan products, generally because of low credit scores. Although the credit profiles of borrowers in the Home Today program might be described as sub-prime, Home Today loans generally contain the same features as loans offered to our non-Home Today borrowers. Borrowers in the Home Today program must complete financial management education and counseling and must be referred to the Association by a sponsoring organization with which the Association has partnered as part of the program. Borrowers must also meet a minimum credit score threshold. Because the Association applied less stringent underwriting and credit standards to the majority of Home Today loans, loans originated under the program have greater credit risk than its traditional residential real estate mortgage loans. While effective March 27, 2009, the Home Today underwriting guidelines were changed to be substantially the same as the Association’s traditional first mortgage product, the majority of loans in this program were originated prior to that date. As of March 31, 2014 and September 30, 2013, the principal balance of Home Today loans originated prior to March 27, 2009 was $162,074 and $174,974, respectively. The Association does not offer, and has not offered, loan products frequently considered to be designed to target sub-prime borrowers containing features such as higher fees or higher rates, negative amortization, a loan-to-value ratio greater than 100%, or pay option adjustable-rate mortgages.

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The recorded investment of loan receivables in non-accrual status is summarized in the following table. Balances are net of deferred fees.

	March 31, 2014	September 30, 2013
Real estate loans:		
Residential non-Home Today	$80,915	$91,048
Residential Home Today	31,469	34,813
Home equity loans and lines of credit	30,162	29,943
Construction	151	41
Total real estate loans	142,697	155,845
Other consumer loans	—	—
Total non-accrual loans	$142,697	$155,845

Loans are placed in non-accrual status when they are contractually 90 days or more past due. Loans modified in troubled debt restructurings that were in non-accrual status prior to the restructurings remain in non-accrual status for a minimum of six months after restructuring. Additionally, home equity loans and lines of credit where the customer has a severely delinquent first mortgage and loans in Chapter 7 bankruptcy status where all borrowers have been discharged of their obligation are placed in non-accrual status. At March 31, 2014 and September 30, 2013, respectively, the recorded investment in non-accrual loans includes $54,869 and $54,311 in troubled debt restructurings which are current according to the terms of their agreement, of which $33,270 and $34,001 are performing loans classified as troubled debt restructurings due to Chapter 7 bankruptcy status primarily where all borrowers have been discharged of their obligations. Additionally, at March 31, 2014 and September 30, 2013, the recorded investment in non-accrual status loans includes $3,490 and $5,277, respectively, of performing second lien loans subordinate to first mortgages delinquent greater than 90 days.

Interest on loans in accrual status, including certain loans individually reviewed for impairment, is recognized in interest income as it accrues, on a daily basis. Accrued interest on loans in non-accrual status is reversed by a charge to interest income and income is subsequently recognized only to the extent cash payments are received. Cash payments on loans in non-accrual status are applied to the oldest scheduled, unpaid payment first. Cash payments on loans with a partial charge-off are applied fully to principal, then to recovery of the charged off amount prior to interest income being recognized. A non-accrual loan is generally returned to accrual status when contractual payments are less than 90 days past due. However, a loan may remain in non-accrual status when collectability is uncertain, such as a troubled debt restructuring that has not met minimum payment requirements, a loan with a partial charge-off, an equity loan or line of credit with a delinquent first mortgage greater than 90 days, or a loan in Chapter 7 bankruptcy status where all borrowers have been discharged of their obligations. The number of days past due is determined by the number of scheduled payments that remain unpaid, assuming a period of 30 days between each scheduled payment.

An age analysis of the recorded investment in loan receivables that are past due at March 31, 2014 and September 30, 2013 is summarized in the following tables. When a loan is more than one month past due on its scheduled payments, the loan is considered 30 days or more past due. Balances are net of deferred fees and any applicable loans-in-process.

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total
March 31, 2014						
Real estate loans:						
Residential non-Home Today	$11,773	$4,428	$44,391	$60,592	$8,414,444	$8,475,036
Residential Home Today	6,541	2,325	16,222	25,088	137,607	162,695
Home equity loans and lines of credit	5,903	3,341	13,107	22,351	1,742,985	1,765,336
Construction	—	—	151	151	32,915	33,066

Total real estate loans	24,217	10,094	73,871	108,182	10,327,951	10,436,133
Other consumer loans	—	—	—	—	4,076	4,076
Total	$24,217	$10,094	$73,871	$108,182	$10,332,027	$10,440,209

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	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total
September 30, 2013						
Real estate loans:						
Residential non-Home Today	$15,398	$4,874	$56,484	$76,756	$8,024,657	$8,101,413
Residential Home Today	8,597	5,989	18,341	32,927	142,666	175,593
Home equity loans and lines of credit	7,495	4,776	12,042	24,313	1,841,111	1,865,424
Construction	—	—	41	41	30,032	30,073
Total real estate loans	31,490	15,639	86,908	134,037	10,038,466	10,172,503
Other consumer loans	—	—	—	—	4,100	4,100
Total	$31,490	$15,639	$86,908	$134,037	$10,042,566	$10,176,603

During the quarter ended March 31, 2014, $1,300 in recoveries were recorded representing the cumulative one-time payment received as a result of PMIC increasing the cash percentage of the partial claim payment plan as discussed later in this note. During the quarter ended December 31, 2013, $5,321 of residential loans were deemed uncollectible and fully charged-off as a result of implementing a new practice of charging off the remaining balance on loans that had remained delinquent and stalled in the foreclosure process for greater than 1,500 days. These loans previously were recorded at estimated net realizable value, with the potential for additional loss recognized within the allowance for loan losses. Any future foreclosure proceeds on these loans would result in recoveries of prior charge-offs.

Activity in the allowance for loan losses is summarized as follows:

	For the Three Months Ended March 31, 2014				
	Beginning Balance	Provisions	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
Residential non-Home Today	$33,462	$1,865	$(3,707)	$1,022	$32,642
Residential Home Today	20,479	(2,412)	(2,388)	1,240	16,919
Home equity loans and lines of credit	31,227	5,624	(4,258)	1,192	33,785
Construction	114	(77)	—	8	45
Total real estate loans	85,282	5,000	(10,353)	3,462	83,391
Other consumer loans	—	—	—	—	—
Total	$85,282	$5,000	$(10,353)	$3,462	$83,391

	For the Three Months Ended March 31, 2013				
	Beginning Balance	Provisions	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
Residential non-Home Today	$33,091	$6,084	$(5,264)	$261	$34,172
Residential Home Today	24,383	7,138	(3,839)	61	27,743
Home equity loans and lines of credit	47,246	(3,073)	(6,670)	1,465	38,968
Construction	481	(149)	(48)	50	334
Total real estate loans	105,201	10,000	(15,821)	1,837	101,217
Other consumer loans	—	—	—	—	—
Total	$105,201	$10,000	$(15,821)	$1,837	$101,217

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	For the Six Months Ended March 31, 2014				
	Beginning Balance	Provisions	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
Residential non-Home Today	$35,427	$6,946	$(11,183)	$1,452	$32,642
Residential Home Today	24,112	(3,219)	(5,321)	1,347	16,919
Home equity loans and lines of credit	32,818	7,381	(8,935)	2,521	33,785
Construction	180	(108)	(41)	14	45
Total real estate loans	92,537	11,000	(25,480)	5,334	83,391
Other consumer loans	—	—	—	—	—
Total	$92,537	$11,000	$(25,480)	$5,334	$83,391

	For the Six Months Ended March 31, 2013				
	Beginning Balance	Provisions	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
Residential non-Home Today	$31,618	$11,861	$(9,899)	$592	$34,172
Residential Home Today	22,588	12,376	(7,373)	152	27,743
Home equity loans and lines of credit	45,508	4,186	(12,978)	2,252	38,968
Construction	750	(423)	(53)	60	334
Total real estate loans	100,464	28,000	(30,303)	3,056	101,217
Other consumer loans	—	—	—	—	—
Total	$100,464	$28,000	$(30,303)	$3,056	$101,217

The recorded investment in loan receivables at March 31, 2014 and September 30, 2013 is summarized in the following table. The table provides details of the recorded balances according to the method of evaluation used for determining the allowance for loan losses, distinguishing between determinations made by evaluating individual loans and determinations made by evaluating groups of loans not individually evaluated. Balances of recorded investments are net of deferred fees and any applicable loans-in-process.

	March 31, 2014			September 30, 2013		
	Individually	Collectively	Total	Individually	Collectively	Total
Real estate loans:						
Residential non-Home Today	$136,820	$8,338,216	$8,475,036	$149,102	$7,952,311	$8,101,413
Residential Home Today	71,997	90,698	162,695	79,065	96,528	175,593
Home equity loans and lines of credit	35,810	1,729,526	1,765,336	34,387	1,831,037	1,865,424
Construction	151	32,915	33,066	487	29,586	30,073
Total real estate loans	244,778	10,191,355	10,436,133	263,041	9,909,462	10,172,503
Other consumer loans	—	4,076	4,076	—	4,100	4,100
Total	$244,778	$10,195,431	$10,440,209	$263,041	$9,913,562	$10,176,603

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An analysis of the allowance for loan losses at March 31, 2014 and September 30, 2013 is summarized in the following table. The analysis provides details of the allowance for loan losses according to the method of evaluation, distinguishing between allowances for loan losses determined by evaluating individual loans and allowances for loan losses determined by evaluating groups of loans not individually evaluated.

	March 31, 2014			September 30, 2013		
	Individually	Collectively	Total	Individually	Collectively	Total
Real estate loans:						
Residential non-Home Today	$8,632	$24,010	$32,642	$7,138	$28,289	$35,427
Residential Home Today	6,195	10,724	16,919	7,677	16,435	24,112
Home equity loans and lines of credit	537	33,248	33,785	1,018	31,800	32,818
Construction	—	45	45	5	175	180
Total real estate loans	15,364	68,027	83,391	15,838	76,699	92,537
Other consumer loans	—	—	—	—	—	—
Total	$15,364	$68,027	$83,391	$15,838	$76,699	$92,537

At March 31, 2014 and September 30, 2013, individually evaluated loans that required an allowance were comprised only of loans evaluated for impairment based on the present value of cash flows, such as performing troubled debt restructurings, and loans with a further deterioration in the fair value of collateral not yet identified as uncollectible. All other individually evaluated loans received a charge-off, if applicable.

Because many variables are considered in determining the appropriate level of general valuation allowances, directional changes in individual considerations do not always align with the directional change in the balance of a particular component of the general valuation allowance. At March 31, 2014 and September 30, 2013, respectively, allowances on individually reviewed loans evaluated for impairment based on the present value of cash flows, such as performing troubled debt restructurings were $15,263 and $15,749, and allowances on loans with further deteriorations in the fair value of collateral not yet identified as uncollectible were $101 and $89.

Residential non-Home Today mortgage loans represent the largest portion of the residential real estate portfolio. The Company believes overall credit risk is low based on the nature, composition, collateral, products, lien position and performance of the portfolio. The portfolio does not include loan types or structures that have recently experienced severe performance problems at other financial institutions (sub-prime, no documentation or pay option adjustable rate mortgages).

As described earlier in this footnote, Home Today loans have greater credit risk than traditional residential real estate mortgage loans. At March 31, 2014 and September 30, 2013, respectively, approximately 47% and 50% of Home Today loans include private mortgage insurance coverage. The majority of the coverage on these loans was provided by PMI Mortgage Insurance Co., which the Arizona Department of Insurance seized in 2011 and indicated that all claims payments would be reduced by 50%. In March 2013, PMIC notified the Association that all payments would be paid at 55% of the claim with the remainder deferred. In March 2014, PMIC notified the Association that the cash percentage of the partial claim payment plan would increase further to 67% of the claim. Appropriate adjustments have been made to the Association's affected valuation allowances and charge-offs, and estimated loss severity factors were adjusted accordingly for loans evaluated collectively. The amount of loans in our owned portfolio covered by mortgage insurance provided by PMIC as of March 31, 2014 and September 30, 2013, respectively, was $214,514 and $236,713 of which $197,398 and $214,920 was current. The amount of loans in our owned portfolio covered by mortgage insurance provided by Mortgage Guaranty Insurance Corporation as of March 31, 2014 and September 30, 2013, respectively, was $84,117 and $91,478 of which $82,731 and $90,099 was current. As of March 31, 2014, MGIC's long-term debt rating, as published by the major credit rating agencies, did not meet the requirements to qualify as "high credit quality"; however, MGIC continues to make claims payments in accordance with its contractual obligations and the Association has not increased its estimated loss severity factors related to MGIC's claim paying ability. No other loans were covered by mortgage insurers that were deferring claim payments or which were assessed as being non-investment grade.

Home equity lines of credit represent a significant portion of the residential real estate portfolio. The state of the economy and low housing prices continue to have an adverse impact on this portfolio since the home equity lines generally are in a second lien position. When the Association began to offer new home equity lines of credit again, the product was designed with prudent property and credit performance conditions to reduce future risk.

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Construction loans generally have greater credit risk than traditional residential real estate mortgage loans. The repayment of these loans depends upon the availability of permanent financing upon completion of all improvements. In the event the Association makes a loan on property that is not yet approved for the planned development, there is the risk that approvals will not be granted or will be delayed. These events may adversely affect the borrower and the collateral value of the property. Construction loans also expose the Association to the risk that improvements will not be completed on time in accordance with specifications and projected costs.

Other consumer loans are comprised of loans secured by certificate of deposit accounts, which are fully recoverable in the event of non-payment.

The recorded investment and the unpaid principal balance of impaired loans, including those reported as troubled debt restructurings, as of March 31, 2014 and September 30, 2013 are summarized as follows. Balances of recorded investments are net of deferred fees.

	March 31, 2014			September 30, 2013		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Residential non-Home Today	$80,384	$103,894	$—	$86,040	$114,799	$—
Residential Home Today	30,545	62,280	—	33,163	66,366	—
Home equity loans and lines of credit	28,925	41,669	—	27,494	58,267	—
Construction	151	169	—	422	544	—
Other consumer loans	—	—	—	—	—	—
Total	$140,005	$208,012	$—	$147,119	$239,976	$—
With an allowance recorded:						
Residential non-Home Today	$56,436	$57,466	$8,632	$63,062	$64,468	$7,138
Residential Home Today	41,452	42,125	6,195	45,902	46,698	7,677
Home equity loans and lines of credit	6,885	6,934	537	6,893	6,996	1,018
Construction	—	—	—	65	65	5
Other consumer loans	—	—	—	—	—	—
Total	$104,773	$106,525	$15,364	$115,922	$118,227	$15,838
Total impaired loans:						
Residential non-Home Today	$136,820	$161,360	$8,632	$149,102	$179,267	$7,138
Residential Home Today	71,997	104,405	6,195	79,065	113,064	7,677
Home equity loans and lines of credit	35,810	48,603	537	34,387	65,263	1,018
Construction	151	169	—	487	609	5
Other consumer loans	—	—	—	—	—	—
Total	$244,778	$314,537	$15,364	$263,041	$358,203	$15,838

At March 31, 2014 and September 30, 2013, respectively, the recorded investment in impaired loans includes $189,671 and $201,692 of loans modified in troubled debt restructurings of which $26,591 and $30,550 were 90 days or more past due.

For all classes of loans, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal and interest according to the contractual terms of the loan agreement. Factors considered in determining that a loan is impaired may include the deteriorating financial condition of the borrower indicated by missed or delinquent payments, a pending legal action, such as bankruptcy or foreclosure, or the absence of adequate security for the loan.

Charge-offs on residential mortgage loans, home equity loans and lines of credit, and construction loans are recognized when triggering events, such as foreclosure actions, short sales, or deeds accepted in lieu of repayment, result in less than full repayment of the recorded investment in the loans.

Partial or full charge-offs are also recognized for the amount of impairment on loans considered collateral dependent that meet the conditions described below.

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- For residential mortgage loans, payments are greater than 180 days delinquent;
- For home equity lines of credit, equity loans, and residential loans modified in a troubled debt restructuring, payments are greater than 90 days delinquent;
- For all classes of loans, a sheriff sale is scheduled within 60 days to sell the collateral securing the loan;
- For all classes of loans, all borrowers have been discharged of their obligation through a chapter 7 bankruptcy;
- For all classes of loans, a borrower obligated on a loan has filed bankruptcy and the loan is greater than 30 days delinquent;
- For all classes of loans, it becomes evident that a loss is probable.

Collateral dependent residential mortgage loans and construction loans are charged off to the extent the recorded investment in a loan, net of anticipated mortgage insurance claims, exceeds the fair value less costs to dispose of the underlying property. Management can determine the loan is uncollectible for reasons such as foreclosures exceeding a reasonable time frame and recommend a full charge-off. Home equity loans or lines of credit are charged off to the extent the recorded investment in the loan plus the balance of any senior liens exceeds the fair value less costs to dispose of the underlying property or management determines the collateral is not sufficient to satisfy the loan. A loan in any portfolio that is identified as collateral dependent will continue to be reported as impaired until it is no longer considered collateral dependent, is less than 30 days past due and does not have a prior charge-off. A loan in any portfolio that has a partial charge-off consequent to impairment evaluation will continue to be individually evaluated for impairment until, at a minimum, the impairment has been recovered.

The following summarizes the effective dates of charge-off policies that changed or were first implemented during the current and previous four fiscal years and the portfolios to which those policies apply.

Effective Date	Policy	Residential Non-Home Today	Residential Home Today	Home Equity Lines of Credit	Home Equity Loans	Construction
9/30/2012	Pursuant to an OCC directive, a loan is considered collateral dependent and any collateral shortfall is charged off when all borrowers obligated on a loan are discharged through Chapter 7 bankruptcy	X	X	X	X	X
6/30/2012	Loans in any form of bankruptcy greater than 30 days past due are considered collateral dependent and any collateral shortfall is charged off	X	X	X	X	X
12/31/2011	Pursuant to an OCC directive, impairment on collateral dependent loans previously recognized as SVAs were charged off. Charge-offs are recorded to recognize confirmed collateral shortfalls on impaired loans. (1)	X	X	X	X	X
9/30/2010	Timing of impairment evaluation was accelerated to include equity loans greater than 90 days delinquent (2)				X	

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(1)

Prior to 12/31/2011, partial charge-offs were not used, but an SVA was established when the recorded investment in the loan exceeded the fair value of the collateral less costs to dispose. Individual loans were only charged off when a triggering event occurred, such as a foreclosure action was culminated, a short sale was approved, or a deed was accepted in lieu of repayment.

(2) Prior to 9/30/2010, impairment evaluations on equity loans were performed when the loan was greater than 180 days delinquent.

Loans modified in troubled debt restructurings that are not evaluated based on collateral are separately evaluated for impairment on a loan by loan basis at the time of restructuring and at each subsequent reporting date for as long as they are reported as troubled debt restructurings. The impairment evaluation is based on the present value of expected future cash flows discounted at the effective interest rate of the original loan. Expected future cash flows include a discount factor representing a potential for default. Valuation allowances are recorded for the excess of the recorded investments over the result of the cash flow analysis. Loans discharged in Chapter 7 bankruptcy are reported as troubled debt restructurings and also evaluated based

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on the present value of expected future cash flows unless evaluated based on collateral. We evaluate these loans using the expected future cash flows because we expect the borrower, not liquidation of the collateral, to be the source of repayment for the loan. Other consumer loans are not considered for restructuring. A loan modified in a troubled debt restructuring is classified as an impaired loan for a minimum of one year. After one year, a loan is no longer included in the balance of impaired loans if the loan was modified to yield a market rate for loans of similar credit risk at the time of restructuring and the loan is not impaired based on the terms of the restructuring agreement. No troubled debt restructurings were reclassified from impaired loans during the quarters ended or six months ended March 31, 2014 and March 31, 2013.

The average recorded investment in impaired loans and the amount of interest income recognized during the period that the loans were impaired are summarized below.

	For the Three Months Ended March 31,			
	2014		2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Residential non-Home Today	$80,383	$ 294	$92,774	$ 258
Residential Home Today	31,130	66	35,450	18
Home equity loans and lines of credit	28,752	85	27,619	114
Construction	340	1	666	4
Other consumer loans	—	—	—	—
Total	$140,605	$ 446	$156,509	$ 394
With an allowance recorded:				
Residential non-Home Today	$59,000	$ 680	$65,963	$ 803
Residential Home Today	42,427	536	53,691	632
Home equity loans and lines of credit	6,888	59	7,947	64
Construction	—	—	402	4
Other consumer loans	—	—	—	—
Total	$108,315	$ 1,275	$128,003	$ 1,503
Total impaired loans:				
Residential non-Home Today	$139,383	$ 974	$158,737	$ 1,061
Residential Home Today	73,557	602	89,141	650
Home equity loans and lines of credit	35,640	144	35,566	178
Construction	340	1	1,068	8
Other consumer loans	—	—	—	—
Total	$248,920	$ 1,721	$284,512	$ 1,897

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	For the Six Months Ended March 31,			
	2014		2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Residential non-Home Today	$83,212	$ 575	$94,058	$ 657
Residential Home Today	31,854	153	35,572	86
Home equity loans and lines of credit	28,210	177	25,014	296
Construction	287	6	761	8
Other consumer loans	—	—	—	—
Total	$143,563	$ 911	$155,405	$ 1,047
With an allowance recorded:				
Residential non-Home Today	$59,749	$ 1,423	$66,707	$ 1,645
Residential Home Today	43,677	1,089	55,432	1,274
Home equity loans and lines of credit	6,889	119	9,913	138
Construction	33	—	404	8
Other consumer loans	—	—	—	—
Total	$110,348	$ 2,631	$132,456	$ 3,065
Total impaired loans:				
Residential non-Home Today	$142,961	$ 1,998	$160,765	$ 2,302
Residential Home Today	75,531	1,242	91,004	1,360
Home equity loans and lines of credit	35,099	296	34,927	434
Construction	320	6	1,165	16
Other consumer loans	—	—	—	—
Total	$253,911	$ 3,542	$287,861	$ 4,112

The amounts of interest income on impaired loans recognized using a cash-basis method were $285 and $629 for the quarter ended and six months ended March 31, 2014, respectively, and $278 and $877 for the quarter ended and six months ended March 31, 2013, respectively.

The recorded investment in troubled debt restructurings as of March 31, 2014 and September 30, 2013 is shown in the tables below.

March 31, 2014	Reduction in Interest Rates	Payment Extensions	Forbearance or Other Actions	Multiple Concessions	Multiple Modifications	Bankruptcy	Total
Residential non-Home Today	$ 16,099	$ 1,588	$ 11,362	$ 20,541	$ 20,096	$35,055	$104,741
Residential Home Today	13,090	89	7,693	17,209	20,658	5,039	63,778
Home equity loans and lines of credit	78	1,004	599	909	667	17,744	21,001
Construction	—	151	—	—	—	—	151
Total	$ 29,267	$ 2,832	$ 19,654	$ 38,659	$ 41,421	$57,838	$189,671

September 30, 2013	Reduction in Interest Rates	Payment Extensions	Forbearance or Other Actions	Multiple Concessions	Multiple Modifications	Bankruptcy	Total
Residential non-Home Today	$ 17,861	$					