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	98550
(Address of principal executive offices)	(Zip Code)
Registrant's telephone number, including area code:	(360) 533-4747

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

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

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

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

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

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

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

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

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

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

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

As of November 30, 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	

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(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

(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 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 %

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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

Name	Age at September 30, 2013	Position 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:			