

To Our Shareholders:

FISCAL 2008 OVERVIEW

Guaranty Bank (the "Bank") finished its 87th fiscal year on September 30, 2008, concluding a challenging year amid unprecedented market turmoil. During Fiscal 2008, we continued to experience the planned costs associated with our Retail Bank expansion, but we again experienced greater than anticipated credit losses as the nation's housing market continued to decline.

During Fiscal 2008, we slowed the growth in our bank branches, opening just 8 new branches compared to 25 in the previous fiscal year. As noted in prior Annual Reports, bank branch profitability is typically achieved only after several years of operation. The residential mortgage loan business faced further declines in property values and continued deterioration in the credit markets in Fiscal 2008. This led to declines in loan volume and credit losses beyond our projections. We also had to deal with a continued loss of market purchasers for our loans, buyback requests, as well as credit losses in our second mortgage portfolio throughout the year.

Even though the Bank realized a net loss for Fiscal 2008, we continue to be well capitalized as defined by the Bank's regulations. Moreover, the Bank's liquidity position is strong.

RECENT DEVELOPMENTS/HIGHLIGHTS

During the Fiscal Year, the Bank opened 4 new locations in the Atlanta market and 1 new location in the Detroit market (both of which operate under our BestBank trade name). The Bank also opened 1 additional location in the Chicago area during the fiscal year and 2 new locations in Wisconsin. Approximately 8 branches were closed or relocated during the Fiscal Year due to grocery store closings by our grocery store partners or as part of our normal branch assessment and consolidation process. As of September 30, 2008, we had 176 total retail bank locations (66 in southeast Wisconsin, 18 in northern Illinois, 28 in southeast Michigan, 19 in the Minneapolis area and 45 in the Atlanta market). Nevertheless, the retail banking division and the corporate operations of the bank experienced a loss for the Fiscal year.

In Fiscal 2008, our retail mortgage company (Shelter Mortgage) was again able to continue to generate earnings due to its partnership relationships with quality loan sources. Joint ventures were commenced with several new parties that had previously been affiliated with other large lenders who have exited or are scaling back their joint venture operations. Unfortunately, continuing declines in property values and investor charge backs caused GB Mortgage, our wholesale mortgage lending operation, to be faced with credit and fraud losses.

BUSINESS STRATEGIES

The Bank's primary business strategies and focus are as follows:

- Generating core deposits through our retail bank franchise with innovative checking and savings products that are specially designed to provide convenience and value to the working class consumer.
- Originating for sale home mortgage loans through our mortgage banking operations.

- Proactively managing our loan portfolio to minimize losses and maximize returns, by ensuring that loans are properly serviced prior to sale and focusing our loss mitigation efforts on contacting at-risk customers to avoid foreclosures.

In pursuing these goals, we pay close attention to credit and risk management, as well as process improvements and cost reductions.

BUSINESS OVERVIEW

Retail Banking

Consistent with the overall decline in our asset size, as of September 30, 2008, the Bank's total retail deposit base had decreased over 20% to \$1.2 billion compared to the \$1.5 billion deposit base we had a year ago. Demand accounts, such as checking accounts, which generally are the lowest cost of funds for our operations, only declined from \$285 million at September 30, 2007, to \$280 million at September 30, 2008. Money market account balances, however, declined from \$755 million to \$654 million at the same dates, respectively.

Mortgage Lending

The origination of one-to four-family residential mortgage loans through the Bank's subsidiaries continues to be one of our core business strategies.

Due to the turbulence in the residential mortgage market we have seen an increase in demand for our mortgage joint venture services. This increase is attributable to a decline in competition and our reputation for excellent service delivery. Evidence of this growth is the 4.6% increase in first mortgage originations by Shelter Mortgage Company, LLC, Guaranty Bank's subsidiary that is primarily responsible for our retail mortgage lending. This increase occurred despite the decline in Guaranty Bank's overall first mortgage originations for the fiscal year end September 30, 2008 compared to September 30, 2007 of 16.7%, and the unprecedented decline in new home and existing home sales in the United States.

The Bank has exited the auto lending market and has sold most of its auto loans. As of September 30, 2008, the Bank's direct and indirect auto loan portfolio totaled \$56 million. The Bank also does a small amount of consumer and commercial lending as a complement to our banking operations, but this only amounted to \$61 million as of September 30, 2008.

Homeowner Assistance and Other Servicing

As a result of our previous strategy to diversify the balance sheet with high yielding assets, as of September 30, 2008, the Bank had a portfolio of approximately \$842 million in home equity first and second lien mortgage loans. In response to the difficult economy, the Bank has instituted a comprehensive program we call our "Helping Mainstreet Initiative" to proactively identify customers who may need assistance to avoid default and foreclosure before they even appear on our delinquency rolls. In addition to our regular loss mitigation team, the Bank has assigned a special team of key managers to direct and coordinate these intensive efforts to reach out to borrowers we have determined are "at risk" before they default, to place them on solid ground through loan modification or refinance.

In Fiscal 2008, the Bank continued its strategy of selling most of the servicing generated by new first mortgage originations. Thus, most servicing on the Bank's balance sheet results from servicing held on an interim or subservicing basis. Mortgage servicing rights declined by \$6.4 million or 64.9% for the year ended September 30, 2008 compared to the year ended September 30, 2007. The decline in mortgage servicing rights was the result of our decision during fiscal year 2008 to sell mortgage servicing rights with a book value of approximately \$5.5 million.

MANAGEMENT'S ANALYSIS OF RESULTS

Earnings Summary

Along with credit losses in our mortgage business, the continued costs of expansion in the retail bank area resulted in a loss of \$24.1 million or \$12.99 (diluted earnings) per share, for Fiscal 2008. This loss reflects an increased loss of \$600,000 over the loss of \$23.5 million, or \$12.68 (diluted earnings) per share, incurred in Fiscal 2007.

The Bank's regulatory capital ratios continue to exceed required regulatory capital standards and the Bank meets the requirements to be considered "well-capitalized" under applicable regulatory guidelines.

Interest Income. During Fiscal 2008, interest income decreased by \$22.3 million to \$104.9 million compared to \$127.2 million for Fiscal 2007.

Interest Expense. Interest expense decreased to \$42.7 million for Fiscal 2008, from \$63.6 million in Fiscal 2007. The interest paid on deposit accounts decreased to \$33.9 million, down from \$54.5 million in Fiscal 2007. Interest on borrowings decreased to \$8.8 million in Fiscal 2008, from \$9.1 million in Fiscal 2007.

Net Interest Income. The foregoing interest income and expense items resulted in net interest income of \$62.2 million for the Fiscal Year ending September 30, 2008, a decrease of 2.2 % from the \$63.6 million of net interest income earned (before provision for loan losses) for the year ending September 30, 2007.

Provision for Losses on Loans. The Bank's provision for loan losses was \$49.7 million for Fiscal 2008 compared to \$14.1 million (number conformed to Fiscal 2008 presentation) for Fiscal 2007. Provisions for loan losses are based on management's evaluation of the loan portfolio composition, including past loan loss experience, applicable credit insurance availability, market conditions and other relevant factors. In contrast to prior periods, in determining the allowance for losses on loans in Fiscal 2008, management has included an amount for home equity loans and lines of credit in the allowance despite the fact that Guaranty Bank has placed credit loss insurance on approximately \$737 million of the home equity loans and lines of credit held for investment.

Noninterest Income/Expense Analysis

Total Noninterest Income. Total noninterest income for the Bank increased to \$ 130.2 million for Fiscal 2008, from \$121.0 million earned in Fiscal 2007. The discussion below highlights the components of noninterest income.

Retail Banking Income. Fees and service charges generated by our retail banking operation increased from \$56.6 million in Fiscal 2007 to \$62.7 million in Fiscal 2008.

Mortgage Banking Income. Mortgage banking income, which includes gains on sale of servicing, gains on sale of loans and origination fees, increased from \$53.8 million in Fiscal 2007, to \$58.4 million in Fiscal 2008.

Noninterest Expense. Total noninterest expense for Fiscal 2008 decreased to \$199.8 million from \$203.4 million in Fiscal 2007.

Asset Size Analysis

The Bank's asset size decreased from \$1.9 billion at Fiscal Year end 2007 to \$1.6 billion at September 30, 2008. Net loans held for investment at Fiscal Year 2008 end increased to \$1.1 billion compared to \$679 million at the end of Fiscal 2007. The Bank's overall deposit account balances declined to \$1.2 billion. The Bank's borrowings at Fiscal Year end increased by \$53 million to \$133 million, from \$80 million as of the end of Fiscal 2007.

Capital

At the end of Fiscal 2008, the Bank's stockholder's equity (including REIT capital) stood at \$151.2 million, a decrease of 13.5 % from \$174.7 million as of September 30, 2007. As noted earlier, the Bank's regulatory capital ratios continue to exceed required regulatory capital standards and the Bank meets the requirements to be considered "well-capitalized" under applicable regulatory guidelines.

Though we experienced another loss in Fiscal 2008, we believe that significant progress was made towards enhancing our future. Through our long term focus, growth in our retail banking customer base and understanding the cyclical nature of the economy in general and the mortgage banking business in particular, the Bank is optimistic that the Bank can return to a healthy earnings picture in the years to come.

Respectfully submitted,

Gerald J. Levy,
Chairman of the Board

Safe Harbor Provision:

- The Private Securities Litigation Report Act of 1995 provides a "safe harbor" for certain forward-looking statements. This letter to shareholders may contain forward-looking statements that reflect the Company's current views with respect to future events and financial performance. These forward-looking statements are subject to certain risks and uncertainties, including those identified below, which could cause future results to differ materially from historical results or those anticipated. The words "believe," "expect," "anticipate," "intend," "estimate," "goals," "would," "could," "should" and other expressions which indicate future events and trends identify forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their dates, and if no date is provided, then such statements speak only as of today. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. The following factors, as well as those disclosed in the Company's Offering Circular dated January 27, 1993, could cause future results to differ materially from historical results or those anticipated: (1) the level of demand for mortgage credit and ancillary services, which is affected by such external factors as the level of interest rates and home prices; (2) the direction of interest rates; (3) the relationship between mortgage interest rates and the cost of funds; (4) federal and state regulation of banking and mortgage banking; (5) investment in new retail bank branch locations and markets; (6) supermarket operator consolidation and store closing(s); (7) liquidity in the secondary market for first and second mortgage home loans; (8) competition within the banking and mortgage banking industries; (9) availability and pricing for mortgage credit insurance products; (10) legislative or regulatory changes that adversely affect our business, including changes in the interpretation of regulatory capital or other rules; (11) results of examinations by regulatory authorities; (12) inability of key third-party providers to perform their obligations to us; and (13) difficulties in reducing risk associated with home equity loans on our balance sheet.

Guaranty Financial Corp. and Subsidiaries

Consolidated Financial Statements as of and
for the Years Ended September 30, 2008 and 2007,
and Independent Auditors' Report

GUARANTY FINANCIAL CORP. AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Guaranty Financial Corp.:

We have audited the accompanying consolidated statements of financial condition of Guaranty Financial Corp. and Subsidiaries (the "Company") as of September 30, 2008 and 2007, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of September 30, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

December 19, 2008

GUARANTY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION AS OF SEPTEMBER 30, 2008 AND 2007 (In thousands)

	2008	2007
ASSETS:		
CASH AND CASH EQUIVALENTS:		
Cash and due from banks	\$ 66,915	\$ 70,962
Federal funds sold and other short-term investments	<u>2,188</u>	<u>67,980</u>
Total cash and cash equivalents	69,103	138,942
INVESTMENT SECURITIES AVAILABLE-FOR-SALE (Amortized cost of \$16,900 and \$23,640, respectively)	16,916	23,645
INVESTMENT SECURITIES HELD-TO-MATURITY (Fair value of \$3,190 and \$3,539, respectively)	3,191	3,449
LOANS HELD FOR SALE (Net of valuation allowance of \$1,937 and \$6,628, respectively)	144,874	818,748
LOANS HELD FOR INVESTMENT (Less allowance for losses on loans of \$42,329 and \$17,126, respectively)	1,102,308	679,263
FEDERAL HOME LOAN BANK STOCK	27,135	27,135
BANK-OWNED LIFE INSURANCE	65,055	61,665
PREMISES AND EQUIPMENT — Net	32,034	36,890
MORTGAGE SERVICING RIGHTS	3,479	9,904
OTHER ASSETS	<u>97,727</u>	<u>62,331</u>
TOTAL	<u>\$ 1,561,822</u>	<u>\$ 1,861,972</u>
LIABILITIES AND STOCKHOLDERS' EQUITY:		
LIABILITIES:		
Deposits	\$ 1,221,369	\$ 1,533,303
Escrow funds due to investors	16,367	31,433
Borrowings	133,000	80,000
Accrued expenses and other liabilities	35,816	39,462
Minority interest	<u>4,028</u>	<u>3,116</u>
Total liabilities	<u>1,410,580</u>	<u>1,687,314</u>
STOCKHOLDERS' EQUITY:		
Preferred stock, \$0.10 par value — authorized, 5,000,000 shares; none outstanding		
Common stock, \$0.10 par value — authorized, 10,000,000 shares; issued September 30, 2008 and 2007; 1,871,014 and 1,859,014 shares; outstanding September 30, 2008 and 2007; 1,867,431 and 1,855,431 shares	187	186
Additional paid-in capital	12,961	12,267
Preferred stock of subsidiary held by parent	50,099	50,099
Retained earnings	88,235	112,353
Accumulated other comprehensive income	10	3
Treasury common stock — at cost (3,583 shares in 2008 and 2007)	<u>(250)</u>	<u>(250)</u>
Total stockholders' equity	<u>151,242</u>	<u>174,658</u>
TOTAL	<u>\$ 1,561,822</u>	<u>\$ 1,861,972</u>

See notes to consolidated financial statements.

GUARANTY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007 (In thousands)

	2008	2007
INTEREST INCOME:		
Loans	\$ 103,693	\$ 123,994
Investments	<u>1,226</u>	<u>3,192</u>
Total interest income	<u>104,919</u>	<u>127,186</u>
INTEREST EXPENSE:		
Deposits	33,897	54,451
Borrowings	<u>8,779</u>	<u>9,145</u>
Total interest expense	<u>42,676</u>	<u>63,596</u>
NET INTEREST INCOME	62,243	63,590
PROVISION FOR LOSSES ON LOANS	<u>49,681</u>	<u>14,126</u>
NET INTEREST INCOME AFTER PROVISION FOR LOSSES ON LOANS	12,562	49,464
RECOVERIES (EXPENSES) FROM CREDIT INSURANCE — Net of insurance premium	<u>20,891</u>	<u>(1,307)</u>
NET INTEREST INCOME AFTER PROVISION FOR LOSSES ON LOANS AND RECOVERIES (EXPENSES) FROM CREDIT INSURANCE — Net of insurance premium	<u>33,453</u>	<u>48,157</u>
NONINTEREST INCOME:		
Retail banking	62,731	56,607
Loan service fees — net of amortization	4,247	6,080
Gain on sale of loans and mortgage servicing rights — net	58,424	53,773
Other income	<u>4,760</u>	<u>4,532</u>
Total noninterest income	<u>130,162</u>	<u>120,992</u>
NONINTEREST EXPENSE:		
Compensation and employee benefits	104,913	110,300
Advertising and marketing	5,759	7,572
Occupancy and equipment	25,266	26,026
Professional services	14,635	16,252
Data processing	10,586	10,994
Other	<u>38,674</u>	<u>32,293</u>
Total noninterest expense	<u>199,833</u>	<u>203,437</u>
LOSS BEFORE INCOME TAXES AND MINORITY INTEREST	(36,218)	(34,288)
INCOME TAX BENEFIT	<u>(15,807)</u>	<u>(15,226)</u>
LOSS BEFORE MINORITY INTEREST	(20,411)	(19,062)
MINORITY INTEREST IN SUBSIDIARY INCOME	<u>(3,707)</u>	<u>(4,453)</u>
NET LOSS	<u>\$ (24,118)</u>	<u>\$ (23,515)</u>
PER COMMON SHARE:		
Basic earnings	<u>\$ (12.99)</u>	<u>\$ (12.68)</u>
Diluted earnings	<u>\$ (12.99)</u>	<u>\$ (12.68)</u>
Cash dividends declared	<u>\$ -</u>	<u>\$ 2.00</u>

See notes to consolidated financial statements.

GUARANTY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007 (In thousands)

	Comprehensive Income	Common Stock	Additional Paid-in Capital	Preferred Stock of Subsidiary Held by Parent	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
BALANCE — September 30, 2006		\$ 186	\$ 12,267	\$ 50,099	\$ 137,650	\$ 52	\$ (250)	\$200,004
Comprehensive loss:								
Net loss	\$ (23,515)				(23,515)			(23,515)
Unrealized losses on securities:								
Arising during the period — net of income tax benefit of \$4	(6)					(6)		(6)
Reclassification for securities transactions included in net income — net of taxes of \$29	<u>(43)</u>					<u>(43)</u>		<u>(43)</u>
Total unrealized holding losses arising during year	<u>(49)</u>					(49)		(49)
Comprehensive loss	<u>\$ (23,564)</u>							
Dividends					<u>(1,782)</u>			<u>(1,782)</u>
BALANCE — September 30, 2007		186	12,267	50,099	112,353	3	(250)	174,658
Comprehensive loss:								
Net loss	\$ (24,118)				(24,118)			(24,118)
Unrealized gains on securities:								
Arising during the period — net of income taxes of \$4	<u>7</u>					7		7
Comprehensive loss	<u>\$ (24,111)</u>							
Issuance of 12,000 common shares		<u>1</u>	<u>694</u>					<u>695</u>
BALANCE — September 30, 2008		<u>\$ 187</u>	<u>\$ 12,961</u>	<u>\$ 50,099</u>	<u>\$ 88,235</u>	<u>\$ 10</u>	<u>\$ (250)</u>	<u>\$151,242</u>

See notes to consolidated financial statements.

GUARANTY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007 (In thousands)

	2008	2007
OPERATING ACTIVITIES:		
Net loss	\$ (24,118)	\$ (23,515)
Adjustments to reconcile net loss to net cash used in operating activities:		
Provisions for losses on loans	49,681	14,126
Depreciation	6,092	6,729
Deferred tax benefit	(16,033)	(13,907)
Amortization of intangibles	3,191	3,062
Originations and purchases of loans held for sale	(3,400,303)	(4,466,106)
Proceeds from sales of loans held for sale and loan principal repayments	3,436,020	4,469,525
Gain on sale of loans and mortgage servicing rights — net	(65,549)	(53,773)
Loss on disposal of premises and equipment	1,521	1,260
Gain on sale of investment securities available-for-sale		(72)
Increase in bank-owned life insurance	(3,390)	(3,331)
Increase in other assets	(28,074)	(5,614)
Decrease in other liabilities	(3,646)	(3,864)
Increase (decrease) in minority interest	912	(377)
Net cash used in operating activities	<u>(43,696)</u>	<u>(75,857)</u>
INVESTING ACTIVITIES:		
Purchases of investment securities available-for-sale	(12,484)	(25,836)
Proceeds from maturities of investment securities available-for-sale	19,224	7,037
Proceeds from maturities of investment securities held-to-maturity	258	216
Proceeds from sales of investment securities available-for-sale		73
Proceeds from sales of mortgage servicing rights	12,604	
Net decrease in loans held for investment	231,961	6,134
Redemptions in FHLB stock		6,400
Purchases of premises and equipment — net of disposals	(4,401)	(9,040)
Net cash provided by (used in) investing activities	<u>247,162</u>	<u>(15,016)</u>
FINANCING ACTIVITIES:		
Net (decrease) increase in deposits and escrow funds due to investors	(327,000)	90,593
Issuance of new borrowings	53,000	80,000
Payment of borrowings		(50,000)
Issuance of common stock	695	
Cash dividends paid		(1,782)
Net cash (used in) provided by financing activities	<u>(273,305)</u>	<u>118,811</u>
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(69,839)	27,938
CASH AND CASH EQUIVALENTS:		
Beginning of year	<u>138,942</u>	<u>111,004</u>
End of year	<u>\$ 69,103</u>	<u>\$ 138,942</u>
SUPPLEMENTAL INFORMATION — Cash paid during the year for:		
Interest on deposits and borrowings	<u>\$ 44,623</u>	<u>\$ 64,681</u>
Income taxes	<u>\$ 211</u>	<u>\$ 379</u>
SIGNIFICANT NONCASH TRANSACTIONS:		
Real estate acquired through foreclosure	<u>\$ 22,268</u>	<u>\$ 10,966</u>
Transfer of loans from held for sale to held for investment	<u>\$ 695,980</u>	<u>\$ 110,596</u>

See notes to consolidated financial statements.

GUARANTY FINANCIAL CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation — The consolidated financial statements include only the accounts and operations of Guaranty Financial Corp. (the “Company” or GFC) (a majority owned subsidiary of Guaranty Financial, MHC (the “Corporation”)) and its wholly owned subsidiary, Guaranty Bank (“Guaranty Bank”). Guaranty Bank includes its wholly owned subsidiaries, GB Mortgage, LLC; Shelter Mortgage Company, LLC; GB Home Equity, LLC; Guaranty Investment Corporation; GB REIT Holding Corporation (and its subsidiary GB REIT Corporation); and Guaranty Financial Services, Ltd., which are collectively referred to as the “Bank.” Guaranty Bank maintains a 50.1% or greater ownership interest in a group of mortgage origination entities. All significant intercompany accounts and transactions have been eliminated in consolidation.

Business — The Company is a consumer oriented financial institution that emphasizes single family residential and home equity lending through a nationwide correspondent network, consumer lending, retail deposit activities, mortgage banking, and other retail financial services.

Use of Estimates — In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statements of financial condition and revenues and expenses for the related periods. Actual results could differ from those estimates, and such differences may be material to the financial statements. Estimates that are particularly susceptible to change in the near term relate to the determination of the allowance for loan losses, the credit insurance recoverable asset, the valuation allowance on loans held for sale, the determination of reserves for repurchase of loans previously sold, and the reserve to estimate the liability for credit insurance with retrospective premiums.

Cash and Cash Equivalents — For the purpose of reporting cash flows, cash and cash equivalents include cash, amounts due from banks, federal funds sold, and other short-term investments with an original maturity of three months or less.

Securities — Debt securities that the Company has the positive intent and ability to hold until maturity are classified as held-to-maturity and are stated at amortized cost. Debt and equity securities that are bought and held principally for the purpose of selling them in the near future are classified as trading securities and are reported at fair value. As of September 30, 2008 and 2007, the Company did not hold trading securities. Debt and equity securities not classified as held-to-maturity, or trading securities, are classified as available-for-sale and are carried at fair value with unrealized gains and losses, net of deferred tax, recorded as other comprehensive income.

Premiums and discounts are amortized over the life of the related security on the level yield method. Gains or losses on sales of securities are computed on the basis of specific identification of the adjusted cost of each security on a trade-date basis.

Loans — The majority of loans held for sale are designated as a hedged item and are carried at fair value; nonhedged loans held for sale are carried at the lower of cost or fair value. Fair value is determined by outstanding commitments from investors or current investor yield requirements.

Loans that management has the intent to hold for the foreseeable future or until maturity are recorded at cost less, deferred loan fees and costs, and the allowance for losses on loans.

Loan Fees and Costs — Loan origination and commitment fees and certain direct loan origination costs are deferred. The net amounts relative to loans held for investment are amortized as an adjustment to the related loan's yield using the level-yield method over the contractual life of the related loans.

Allowance for Losses on Loans — The allowance for losses on loans is maintained at levels believed adequate by management to absorb estimated losses in the loan portfolio. Additions to the allowance are charged to operations and actual losses and recoveries of losses are charged or credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The Company's portfolio consists primarily of large groups of smaller balance homogeneous loans and are collectively evaluated for impairment. The Company segments the loans by type based on similar characteristics and, using historical loss information, estimates a loss reserve for each type of loan. To appropriately manage the risk of credit loss associated with home equity loans and lines of credit, the Company has placed credit loss insurance on a substantial amount of the home equity loans and lines of credit held for sale and investment with third party insurance carriers. Home equity loans and lines of credit, held for investment and sale, for which the Company has placed insurance to protect against credit losses were approximately \$737 million and \$872 million as of September 30, 2008 and 2007, respectively.

Default by one of the insurance carriers with which we have placed the credit loss insurance could potentially expose the Company to loss. Management continuously monitors the financial conditions of the carriers from which this insurance was purchased and as of September 30, 2008 estimates the risk of loss due to default as remote.

In determining the allowance for losses on loans and provision for losses on loans presented in the consolidated financial statements, management estimates the amount of expected losses on the home equity loan and lines of credit categories for insured loans and records the estimate in the allowance for loan losses with a similar amount as a credit insurance recoverable asset.

The Company generally submits claims for insurance losses to the carrier when the loan has been delinquent for a minimum of 90 days and not more than 180 days. Payments are generally received from the carrier within 90 to 180 days from the date of submission.

The Company recognizes the credit insurance recoverable, which is included in other assets, as the recovery from the carrier is reasonably assured. The credit insurance recoverable is monitored regularly by management for collectibility and the valuation of the credit insurance recoverable estimate is determined by management based on the carrier's actuarial projections of loss and subsequent recoveries.

Derivatives — Derivatives are recognized as either assets or liabilities in the consolidated statements of financial condition and measured at fair value. If certain conditions are met, a derivative may be specifically designated as a hedge. For a derivative designated as hedging, the exposure to changes in

fair value of an asset or liability (referred to as a fair value hedge), or any gain or loss associated with the derivative is reported in earnings along with the change in fair value of the asset or liability being hedged. For a derivative not designated as a hedging instrument, the gain or loss is recognized in earnings in the period of change. For purposes of measuring fair value and the resulting gain or loss on derivatives and hedged items, when applicable, the Company uses various methods depending on the nature of the derivative or hedged item, such as quotes obtained from independent pricing services, valuation models of independent pricing services with known factors put into the model, or software models utilizing assumptions, or data obtained from independent sources. Changes in market conditions and actual liquidation experience may result in additional valuation adjustments that could impact earnings in future periods.

Premises and Equipment — Premises and equipment are recorded at cost and include expenditures for new facilities and items that substantially increase the useful lives of existing buildings and equipment. Expenditures for normal repairs and maintenance are charged to operations as incurred. When premises and equipment are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the respective accounts and the resulting gain or loss is recorded in income.

The cost of premises and equipment is being depreciated principally by the straight-line method over the estimated useful lives of the assets. The cost of leasehold improvements is being amortized by the straight-line method over the lesser of the term of the respective lease or estimated economic life of the improvement.

Mortgage Servicing Rights (MSRs) — The Company recognizes, as separate assets, the rights to service mortgage loans which have been sold to investors. Upon sale of loans with the servicing rights retained, total costs incurred are allocated between the loan and the servicing rights retained based on their relative fair values. Capitalized servicing rights are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Projected net servicing income is, in turn, determined on the basis of the estimated future balance of the underlying mortgage loan portfolio, which declines over time from prepayments and scheduled loan amortization. The Company estimates future prepayment rates based on consensus prepayment rates reported by independent reporting services, current interest rate levels, other economic conditions and market forecasts, as well as relevant characteristics of the servicing portfolio, which include loan type and interest rate stratification. MSRs are periodically assessed for impairment. Impairment is recognized through a valuation allowance which is included in loan service fees during the period in which the carrying amount of servicing assets for a stratum exceed fair value as an adjustment to a valuation allowance.

Real Estate Acquired Through Foreclosure — Foreclosed properties are recorded at the lower of cost or fair value. Costs relating to the development and improvement of the property are capitalized; holding period costs and fair value adjustments are charged to expense. Real estate acquired through foreclosure was \$9.1 million and \$8.6 million as of September 30, 2008 and 2007, respectively, and is included in other assets.

Loan Repurchase Reserve — In the ordinary course of business, the Company sells first mortgage and home equity loans to investors. Upon sale, the risk of credit loss is passed to the investor; however, the Company provides certain representations and warranties in connection with these sales. The Company does retain the risk of loss should a loan previously sold go into default and it is determined that such loan was not within the agreed-upon underwriting guidelines due to negligence on the part of the Company or fraud on the part of the borrower. Such risk is standard within the mortgage banking industry. Based on historical activity, the Company establishes a reserve for estimated exposure pertaining to the representations and warranties made in connection with loan sales which is included in

accrued expenses and other liabilities in the statement of financial condition. It is not possible to reliably determine the maximum potential amount of exposure related to these representations and warranties since the amount of loans previously sold, which are serviced by third parties and which have paid-off, is unknown.

Interest Income — Interest income is accrued as earned. Loans are placed on nonaccrual status when any portion of principal or interest is 90 days past due or earlier when concerns exist as to the ultimate collectibility of principal or interest. Loans return to accrual status when principal and interest become current and are anticipated to be fully collectible.

Service Fees — Net of Amortization — Loan servicing income consists of fees earned for servicing residential first and second mortgage loans for investors and related ancillary income. Fees earned for servicing loans sold to other investors are recorded as income as the related loan payments are received from homeowners. Included in service fees is amortization expense of mortgage servicing rights.

Gain on Sale of Loans — Gains on sales of first and second mortgages and the sale of mortgage servicing rights are recorded when the loans and servicing rights are sold and substantially all risks and rewards of ownership have passed to the buyer.

Income Taxes — GFC and its subsidiaries file a consolidated federal income tax return and either combined or separate state income tax returns, while the Corporation files separate federal and state income tax returns. Federal income tax is allocated to the Corporation as if the Corporation were a separate tax paying entity. Deferred income taxes are computed on the liability method. Under the liability method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. A valuation allowance is established for deferred tax assets when, as determined by management, it is more likely than not that the tax benefit will not be realized.

Earnings Per Share — Earnings per share is based on average shares outstanding and there are no potentially dilutive securities.

Dividend — The Corporation, the parent of GFC began waiving its right to regular quarterly dividends beginning with the second quarter dividend in 2007. The effect of these dividends waived was a reduction in equity of \$1.7 million in 2007.

Recent Accounting Pronouncements — In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 157, *Fair Value Measurements*. SFAS 157 provides enhanced guidance for using fair value to measure assets and liabilities. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances.

Under the standard, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity is engaged. SFAS 157 will be effective for the GFC on October 1, 2008. Management is currently evaluating the financial statement impact, of adopting SFAS 157.

In February 2007, the FASB issued Statement of Financial Accounting Standard No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of FASB Statement No. 115*. SFAS 159 permits entities to choose to measure many financial instruments and certain other items generally on an instrument-by-instrument basis at fair value that are not currently

required to be measured at fair value. SFAS 159 is intended to provide entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 does not change requirements for recognizing and measuring dividend income, interest income, or interest expense. SFAS 159 is effective for GFC on October 1, 2008. Management continues to assess the impact SFAS 159 will have on GFC.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interest in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51*. SFAS 160 establishes accounting and reporting standards that require noncontrolling interests to be reported as a component of equity, changes in parent's ownership interest while the parent retains its controlling interest be accounted for as equity transactions, and any retained noncontrolling equity investment upon the deconsolidation of a subsidiary be initially measured at fair value. SFAS 160 is effective for GFC on October 1, 2009, and is to be applied prospectively, except for the presentation and disclosure requirements which are to be applied retrospectively. Early adoption is not permitted. Management continues to assess the impact SFAS 160 will have on GFC.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*. SFAS 161 amends and expands the disclosure requirements of SFAS No. 133, *Accounting for Derivatives Instruments and Hedging Activities*, with the intent to provide users of financial statements with an enhanced understanding of how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS 133, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS 161 is effective for GFC on October 1, 2009. Management continues to assess the impact SFAS 161 will have on GFC.

Reclassification — During fiscal 2008, the Company modified its presentation of the allowance for loan losses on the consolidated statements of financial condition to exclude probable insurance recoveries and reflect those probable insurance recoveries as a credit insurance recoverable asset on the balance sheet, which is included as a component of other assets. The Company also modified its presentation of the net recoveries from credit insurance on the consolidated statements of operations. Recoveries, net of insurance premiums, related to credit insurance are presented as a separate line item in the statements of operations. Prior year amounts were reclassified to conform to the 2008 presentation. Such amounts were \$13.1 million related to the reclassification between the allowance for loan losses and other assets on the statement of financial condition, and \$1.3 million related to the reclassification on the statement of operations.

2. RESTRICTIONS ON CASH AND DUE FROM BANKS

The Company is required to maintain certain vault cash and reserve balances with the Federal Reserve Bank to meet specific reserve requirements. These requirements approximate \$7 million and \$8 million as of September 30, 2008 and 2007, respectively.

3. INVESTMENT SECURITIES

The amortized cost and approximate fair values of securities available-for-sale as of September 30, 2008 and 2007, are as follows (in thousands):

	2008			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. and other government obligations	\$ 12,484	\$ 318	\$ -	\$ 12,802
Other equity securities	<u>4,416</u>	<u> </u>	<u>302</u>	<u>4,114</u>
Total	<u>\$ 16,900</u>	<u>\$ 318</u>	<u>\$ 302</u>	<u>\$ 16,916</u>

	2007			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. and other government obligations	\$ 19,000	\$ -	\$ -	\$ 19,000
Other equity securities	<u>4,640</u>	<u>70</u>	<u>65</u>	<u>4,645</u>
Total	<u>\$ 23,640</u>	<u>\$ 70</u>	<u>\$ 65</u>	<u>\$ 23,645</u>

Investment securities held-to-maturity as of September 30, 2008 and 2007, are as follows (in thousands):

	2008			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. and other government obligations	\$ 1,000	\$ 3	\$ -	\$ 1,003
Mortgage-backed securities	<u>2,191</u>	<u>1</u>	<u>5</u>	<u>2,187</u>
Total	<u>\$ 3,191</u>	<u>\$ 4</u>	<u>\$ 5</u>	<u>\$ 3,190</u>

	2007			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. and other government obligations	\$ 1,000	\$ -	\$ 31	\$ 969
Mortgage-backed securities	<u>2,449</u>	<u> </u>	<u>59</u>	<u>2,390</u>
Total	<u>\$ 3,449</u>	<u>\$ -</u>	<u>\$ 90</u>	<u>\$ 3,359</u>

The amortized cost and approximate fair value of U.S. and other government obligations available-for-sale by contractual maturity as of September 30, 2008, are shown below (in thousands). Expected maturities may differ from contractual maturities because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>Available-for-Sale</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>
Due after 10 years	<u>\$ 12,484</u>	<u>\$ 12,802</u>

As of September 30, 2008, the gross unrealized losses and fair market values for securities by length of time they have been in a continuous unrealized loss position are as follows (in thousands):

	<u>Less than 12 Months</u>		<u>12 Months or More</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
Other equity securities	\$ 2	\$ 1	\$ 1,875	\$ 301
Mortgage-backed securities	<u>1,486</u>	<u>5</u>	<u> </u>	<u> </u>
Total	<u>\$ 1,488</u>	<u>\$ 6</u>	<u>\$ 1,875</u>	<u>\$ 301</u>

There were no sales of investment securities available-for-sale during 2008. Gross investment securities gains and losses on securities available-for-sale were immaterial in 2008 and 2007.

4. LOANS

Loans held for sale as of September 30, 2008 and 2007, consist of the following (in thousands):

	2008	2007
One-to-four family mortgage loans	\$ 126,867	\$ 211,836
Home equity loans — fixed rate	3,897	225,461
Home equity lines of credit	12,627	295,223
Home equity loans — fixed rate 1st liens		2,111
Home equity lines of credit 1st liens	4,179	83,897
Deferred costs (fees)	(759)	6,848
Less valuation allowance	<u>(1,937)</u>	<u>(6,628)</u>
Total	<u>\$ 144,874</u>	<u>\$ 818,748</u>

Loans held for investment as of September 30, 2008 and 2007, consist of the following (in thousands):

	2008	2007
Mortgage loans:		
One-to-four family	\$ 126,905	\$ 99,382
Construction loans	<u>74,532</u>	<u>47,067</u>
Total mortgage real estate loans	201,437	146,449
Consumer and other loans:		
Home equity loans — fixed rate	430,236	333,427
Home equity loans lines of credit	301,433	13,142
Home equity loans — fixed rate 1st liens	5,503	4,515
Home equity loans lines of credit 1st liens	83,104	14,836
Auto loans	55,277	135,266
Student Loans	29,453	22,913
Commercial	18,030	11,536
Other consumer	<u>13,341</u>	<u>10,589</u>
Total consumer and other loans	<u>936,377</u>	<u>546,224</u>
Total loans receivable	1,137,814	692,673
Deferred costs	6,823	3,716
Less allowance for loan losses	<u>(42,329)</u>	<u>(17,126)</u>
Total	<u>\$ 1,102,308</u>	<u>\$ 679,263</u>

Nonperforming loans and renegotiated loans as of September 30, 2008 and 2007, aggregated \$52.5 million and \$23.7 million, respectively. The Company has a significant geographic concentration of loans in Wisconsin, Florida, Arizona, Georgia, California and Illinois. Accordingly, the ultimate collection of a substantial portion of the loan portfolio is susceptible to changes in market condition in that area.

During the year ended September 30, 2008, the Company's wholly owned subsidiary, GB Mortgage, LLC originated 1,531 FHA and VA insured mortgage loans with proceeds of approximately \$289 million. The Company's wholly owned subsidiary, Shelter Mortgage Company, LLC originated 2,133 FHA and VA insured mortgage loans with proceeds of approximately \$346 million.

A summary of the activity in the allowance for losses on loans as of September 30, 2008 and 2007, are as follows (in thousands):

	2008	2007
Balance — beginning of year	<u>\$ 17,126</u>	<u>\$ 15,145</u>
Provision charged to income	49,681	14,126
Charge-offs on uninsured loans	(14,730)	(4,637)
Charge-offs on insured loans	(10,775)	(8,438)
Recoveries on uninsured loans	<u>1,027</u>	<u>930</u>
Net charge-offs	<u>(24,478)</u>	<u>(12,145)</u>
Balance — end of year	<u>\$ 42,329</u>	<u>\$ 17,126</u>

The Company maintains insurance contracts with third parties, which passes the risk of credit loss to the third party on the majority of home equity loans held both for sale and investment. Premiums are charged evenly throughout the life of the loans based on outstanding balances. As of September 30, 2008 and 2007, approximately \$737 million and \$872 million, respectively, of home equity loans held for sale and held for investment and \$13 million of loans serviced for others are covered by the insurance policies. The Company provides an allowance for loans covered under these insurance contracts, which was \$33.2 million and \$13.1 million at September 30, 2008 and 2007, respectively. Such amount is also reflected as a credit insurance recoverable asset, which is a component of other assets. Included in the provision for losses on loans for the years ended September 30, 2008 and 2007 is insured charge-offs on insured loans and probable insurance recoveries of approximately \$31.0 million and \$10.3 million, respectively. These amounts are also reflected in the recoveries (expense) from credit insurance - net, on the statements of operations off-set by insurance premiums of \$10.1 million and \$11.6 million for the years ended September 30, 2008 and 2007, respectively.

5. PREMISES AND EQUIPMENT

Premises and equipment as of September 30, 2008 and 2007, are summarized as follows (in thousands):

	2008	2007
Cost:		
Land and land improvements	\$ 1,493	\$ 1,493
Office buildings	6,908	6,908
Furniture and equipment	37,328	39,696
Leasehold improvements	<u>27,482</u>	<u>25,837</u>
	73,211	73,934
Less — accumulated depreciation	<u>(41,177)</u>	<u>(37,044)</u>
Total	<u>\$ 32,034</u>	<u>\$ 36,890</u>

The Company's future minimum rental commitments under operating leases for leased premises as of September 30, 2008, are as follows (in thousands):

Years Ending September 30	Amount
2009	\$ 7,934
2010	6,460
2011	4,931
2012	3,331
2013	1,893
Thereafter	<u>5,346</u>
Total	<u>\$ 29,895</u>

The leases, which are all operating leases, provide for payment of certain operating expenses applicable to the leased premises and contain certain escalation clauses and extension provisions. Rent expense was approximately \$8,440,000 and \$8,449,000 for the years ended September 30, 2008 and 2007, respectively.

6. MORTGAGE SERVICING RIGHTS

An analysis of activity in the Company's first and second mortgage servicing rights as of September 30, 2008 and 2007, is as follows (in thousands):

	Cost of Servicing Rights	Valuation Allowance	Mortgage Servicing Rights
Balance — September 30, 2006	\$ 10,982	\$ (167)	\$ 10,815
New MSRs capitalized	1,116		1,116
Amortization	(2,061)		(2,061)
Impairment	<u> </u>	<u>34</u>	<u>34</u>
Balance — September 30, 2007	10,037	(133)	9,904
New MSRs capitalized	601		601
Sale of servicing	(5,670)	218	(5,452)
Amortization	(1,356)	43	(1,313)
Impairment	<u> </u>	<u>(261)</u>	<u>(261)</u>
Balance — September 30, 2008	<u>\$ 3,612</u>	<u>\$ (133)</u>	<u>\$ 3,479</u>

The fair value of servicing rights as of September 30, 2008, approximated \$3.8 million and was determined using a discount rate of 9.87% and prepayment speeds ranging from 8.0% to 48.1%, depending upon the stratification of the specific right. The fair value of servicing rights as of September 30, 2007, approximated \$12.5 million and was determined using a discount rate of 9.9% and prepayment speeds ranging from 11.2% to 54.9%, depending upon the stratification of the specific right. The valuation allowance pertains to specific stratum where the estimated fair value is less than the carrying amount for those strata.

Information regarding loans serviced for investors for the years ended September 30, 2008 and 2007, is as follows (in thousands):

	2008	2007
Total principal balance of loans serviced:		
First mortgage loans	\$ 745,088	\$ 1,707,041
First mortgage loans — subserviced	90,864	104,822
Home equity loans	<u>13,453</u>	<u>18,528</u>
Total	<u>\$ 849,405</u>	<u>\$ 1,830,391</u>
Number of loans serviced:		
First mortgage loans	6,539	13,502
First mortgage loans — subserviced	554	586
Home equity loans	<u>606</u>	<u>780</u>
Total	<u>7,699</u>	<u>14,868</u>
Funds held at Guaranty Bank for investors	<u>\$ 16,367</u>	<u>\$ 31,433</u>

Funds held for investors represent amounts collected from borrowers primarily for the payment of principal and interest, and tax and insurance escrows applicable to mortgage loans being serviced.

7. DEPOSITS

Deposits for the years ended September 30, 2008 and 2007, are summarized as follows (in thousands):

	2008	2007
Non-interest bearing demand accounts	\$ 190,520	\$ 198,747
Interest-bearing demand accounts	89,913	85,984
Money market accounts	654,466	755,033
Savings passbook accounts	65,657	57,705
Certificates of deposit	<u>220,813</u>	<u>435,834</u>
Total	<u>\$ 1,221,369</u>	<u>\$ 1,533,303</u>

There were no brokered deposits included in certificates of deposit for 2008 and 2007. As of September 30, 2008 and 2007, deposits (excluding non-interest bearing custodial accounts) with balances greater than or equal to \$100,000 amounted to \$166 million and \$251 million, respectively.

Certificates of deposit accounts as of September 30, 2008, mature during the fiscal year indicated as follows (in thousands):

Years Ending September 30	Amount
2009	\$ 206,761
2010	5,872
2011	2,658
2012	1,270
2013	<u>4,252</u>
Total	<u>\$ 220,813</u>

8. BORROWINGS

Borrowings as of September 30, 2008 and 2007, are summarized as follows (dollars in thousands):

Description	Maturity Date	Interest Rate at the Year-End		2008	2007
		2008	2007		
Note payable to Federal Home Loan Bank	5/26/2009	5.13 %	5.13 %	\$ 25,000	\$ 25,000
Note payable to Federal Home Loan Bank	8/3/2009	4.98	4.98	30,000	30,000
Note payable to Federal Home Loan Bank	8/23/2010	4.34	4.34	25,000	25,000
Note payable to Federal Home Loan Bank	10/1/2008	1.33		50,000	
Note payable to Federal Home Loan Bank	10/1/2008	2.46		<u>3,000</u>	<u> </u>
Total				<u>\$ 133,000</u>	<u>\$ 80,000</u>

The \$25 million 4.34% note payable to the Federal Home Loan Bank (FHLB) maturing August 23, 2010, is a callable advance which is callable by the FHLB on a quarterly basis. The \$53 million of notes payable to the FHLB maturing October 1, 2008 were short-term borrowings which were subsequently refinanced with overnight FHLB borrowings under similar terms.

The Company is required to maintain unencumbered loans and mortgage-backed securities aggregating at least 134% and 200% of the amount of outstanding advances from the FHLB as collateral for the borrowings therefrom for first mortgages and second mortgages, respectively. In addition, these notes are collateralized by FHLB stock.

9. REGULATORY CAPITAL AND PREFERRED STOCK OF SUBSIDIARY

Preferred Stock of Subsidiary Held by Parent — The preferred stock of GB REIT Corporation is held primarily by Guaranty Financial, MHC. The preferred stock pays noncumulative cash distributions quarterly at an adjustable rate (5.05% and 7.61% as of September 30, 2008 and 2007, respectively). The preferred stock is redeemable at the option of GB REIT Corporation, subject to regulatory approval, in whole or in part, at any time, at a redemption price of \$1,000 per share (50,099 shares outstanding as of

September 30, 2008 and 2007). The proceeds of the preferred stock have been invested by GB REIT Corporation in participating interests of pools of loans purchased from the Company. The preferred stock qualifies as Tier 1 capital of the Company for regulatory capital purposes.

Regulatory Capital Requirements — The Bank is subject to various regulatory capital requirements administered by the Office of Thrift Supervision (OTS). Failure to meet minimum capital requirements can initiate certain mandatory, and possible additional discretionary actions by regulators, that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of September 30, 2008 and 2007, that the Bank met all capital adequacy requirements to which they are subject.

As of September 30, 2008, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category.

As of September 30, 2008 and 2007, the Bank's regulatory capital levels and ratios relative to its minimum capital requirements are as follows (dollars in thousands):

	Actual Capital		Required Capital	
	Amount	Ratio	Amount	Ratio
As of September 30, 2008 — OTS capital adequacy:				
Tangible capital	\$ 95,648	6.26 %	\$ 22,928	1.50 %
Core capital	95,648	6.26	61,142	4.00
Risk-based capital	137,655	10.88	101,203	8.00
FDICIA regulations to be well capitalized:				
Tier 1 leverage ratio	\$ 95,648	6.26 %	\$ 76,427	5.00 %
Tier 1 risk-based ratio	95,648	7.56	75,902	6.00
Total risk-based ratio	137,655	10.88	126,503	10.00
As of September 30, 2007 — OTS capital adequacy:				
Tangible capital	\$ 165,713	8.86 %	\$ 28,070	1.50 %
Core capital	165,713	8.86	74,853	4.00
Risk-based capital	178,432	11.22	127,237	8.00
FDICIA regulations to be well capitalized:				
Tier 1 leverage ratio	\$ 165,713	8.86 %	\$ 93,566	5.00 %
Tier 1 risk-based ratio	165,713	10.42	95,427	6.00
Total risk-based ratio	178,432	11.22	159,046	10.00

Dividend Restrictions — As a well capitalized bank before and after a dividend, the Bank could, after prior notice to the OTS, declare dividends during a year up to earnings for the year plus the two preceding years, less capital distributions paid over that time period. No amounts were available for dividend distribution as of September 30, 2008 and 2007.

10. EMPLOYEE BENEFIT PLANS

The Bank has a participatory 401(k) plan which covers substantially all employees. Employees must have more than 90 days of service and be at least 21 years of age to participate. Participating employees may contribute up to 50% of their pretax compensation plus an additional 10% of their after tax compensation, subject to Internal Revenue Code (IRC) limitations. The Bank contributes 25% of the amount contributed by each employee up to the first 6% of compensation (1.5%), all of which is immediately vested. A variable match of up to an additional 75% of the first 6% employee contribution is based on a formula based on the Bank's return on equity. The variable match is subject to a three year vesting schedule. The Bank's expense for this plan amounted to \$778,000 and \$414,000 for the years ended September 30, 2008 and 2007, respectively.

During fiscal 2008, the Bank adopted a phantom stock plan for key employees. Under this plan, the Company may grant phantom shares to key employees as a performance incentive that is ultimately payable in cash in the two years following the three year vesting period. The Bank calculates the value based on the fair value of the Bank's stock at the grant date. Expense related to this plan totaled approximately \$645,000 in fiscal 2008 for the 43,700 phantom shares granted. As of September 30, 2008, unrecognized compensation cost related to the phantom shares was approximately \$1.3 million.

11. INCOME TAXES

The provision for income taxes for the years ended September 30, 2008 and 2007, consists of the following (in thousands):

	2008	2007
Current:		
Federal	\$ -	\$ (1,909)
State	<u>226</u>	<u>590</u>
Total current tax expense (benefit)	<u>226</u>	<u>(1,319)</u>
Deferred:		
Federal	(14,788)	(12,341)
State	<u>(1,245)</u>	<u>(1,566)</u>
Total deferred tax benefit	<u>(16,033)</u>	<u>(13,907)</u>
Total income tax benefit	<u>\$ (15,807)</u>	<u>\$ (15,226)</u>

The income tax benefit differs from that computed at the federal statutory tax rate for the years ended September 30, 2008 and 2007, as follows (in thousands):

	2008	2007
Income before income taxes and minority interest	<u>\$ (36,218)</u>	<u>\$ (34,288)</u>
Tax at federal statutory rates	\$ (12,676)	\$ (12,001)
(Deduct) add effect of:		
Income allocated to members of LLC subsidiaries (minority interest)	(1,297)	(1,559)
State income taxes	(1,019)	(976)
Bank-owned life insurance	(1,305)	(1,166)
Other	<u>490</u>	<u>476</u>
Total	<u>\$ (15,807)</u>	<u>\$ (15,226)</u>

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and for income tax purposes. The significant components of the Company's net deferred tax assets (liabilities) as of September 30, 2008 and 2007, are as follows (in thousands):

	2008	2007
Deferred tax assets:		
Allowance for losses on loans	\$ 16,211	\$ 6,597
Accrued payroll and pension	2,199	1,849
Prepayment and other reserves	4,176	4,247
Loans at cost marked-to-market for tax purposes	5,141	7,386
State loss carryforwards	5,454	3,374
Federal loss carryforwards	19,607	7,666
AMT credit carryforward	177	
Other	<u>3,817</u>	<u>1,825</u>
Total deferred tax assets	<u>56,782</u>	<u>32,944</u>
Deferred tax liabilities:		
Deferred loan costs	1,801	2,254
FHLB dividend paid in stock	2,740	2,759
Fixed assets	599	473
Mortgage servicing rights	1,255	2,464
Credit insurance recoverable	12,746	5,036
Net unrealized gains on securities available-for-sale	6	2
Other	<u>714</u>	<u>928</u>
Total deferred tax liabilities	<u>19,861</u>	<u>13,916</u>
Total net deferred tax assets before valuation allowance	36,921	19,028
Valuation allowance	<u>(2,707)</u>	<u>(1,858)</u>
Total net deferred tax assets	<u>\$ 34,214</u>	<u>\$ 17,170</u>

Changes in the valuation allowance for the years ended September 30, 2008 and 2007, were as follows:

Balance — September 30, 2006	\$ 1,816
Adjustments to the valuation allowance — creation of state net operating loss in fiscal 2007	<u>42</u>
Balance — September 30, 2007	1,858
Adjustments to the valuation allowance — creation of state net operating loss in fiscal 2008	<u>849</u>
Balance — September 30, 2008	<u>\$ 2,707</u>

The Company records net deferred tax assets to the extent the Company believes these assets will more likely than not be realized. In making such determination, the Company considers all available positive and negative evidence, including scheduled reversal of deferred tax assets and liabilities, projected future taxable income, tax planning strategies and recent financial performance. The Company has concluded, based on its historical earnings and projected earnings, that it will more likely than not be able to realize the full effect of the deferred tax assets with no valuation allowance, except for certain net operating losses discussed below.

Prior to fiscal 2003, the Company generated significant state tax net operating losses due to the use of certain tax savings strategies. The Company recorded a valuation allowance against the net operating loss generated in fiscal 2002 and prior years because Company management believed it was more likely than not that the benefit of this deferred tax asset would not be realized. Company management continues to believe it is more likely than not that the benefit of the remaining deferred tax asset will not be realized. In addition, the Company has other state net operating loss carryforwards management believes likely will not be fully realized because of reduced operations in those states and thus has recorded a valuation allowance against such net operating losses. The total state net operating loss carryforwards of \$112.4 million, if unused, will expire beginning in fiscal 2014.

The Company also has a federal net operation loss carryforward of \$56.8 million that, if unused, will expire beginning in fiscal 2027.

Under the Internal Revenue Code and Wisconsin Statutes, bad debt reserves established before October 1, 1987 (the base year) are effectively frozen and recaptured into income only in the event of certain conditions. A deferred tax liability has not been recognized for these bad debt reserves of the Company created in the tax years which began prior to October 1, 1987. As of September 30, 2008, these reserves totaled approximately \$6.3 million with an unrecognized deferred tax liability approximating \$2.5 million. This unrecognized deferred tax liability could be recognized in the future, in whole or in part, if there is a change in federal tax law, the Company fails to meet certain definitional tests and other conditions in the federal tax law, or the bad debt reserves are used for any purpose other than absorbing bad debt losses.

On October 1, 2007, the Company adopted the provision of FASB Interpretation (FIN) No. 48, and there was no impact on the financial statements at adoption. FIN 48 prescribes the manner in which the Company reports a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax expense.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

Balance — October 1, 2007	\$ 1,409
Increases for tax positions related to the current year	88
Increases for tax positions related to prior years	50
Decreases for positions related to prior years	<u>(51)</u>
Balance — September 30, 2008	<u>\$ 1,496</u>

Tax years that remain subject to examination by major tax jurisdictions include fiscal 2004 through fiscal 2008. The Company anticipates it is reasonably possible within 12 months of September 30, 2008, that unrecognized tax benefits of up to \$0.2 million could be realized. The realization would primarily result from lapse of statute of limitations with taxing authorities.

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is \$1.5 million. The total amount of interest and penalties included in the income statement as it pertains to the unrecognized tax benefits for fiscal 2008 is \$0.2 million, included in the total liability for unrecognized tax benefits as of September 30, 2008, and the date of adoption is interest of \$0.7 million and \$0.5 million, respectively. No penalties are included in the total liability for unrecognized tax benefits as of September 30, 2008, or the date of adoption.

Guaranty Investment Corporation (GIC), a Nevada company and wholly owned subsidiary of the Company, has not been subject to taxation in Wisconsin since its formation in fiscal 2000. Likewise, another wholly owned subsidiary of the Company, GB REIT Holding Company, a Delaware corporation (“REIT Holding”) also has taken advantage of certain tax rules applicable to out-of-state subsidiaries. Management believes that the Company, REIT Holding, and GIC have complied with the tax rules relating to the income of out-of-state subsidiaries. However, management also believes that the Wisconsin Department of Revenue (WDR) may take the position that the income of GIC and REIT Holding is taxable in Wisconsin since the WDR has contacted the Company (and virtually all other Wisconsin banks) to obtain additional information related to such out-of-state subsidiaries. WDR has settled similar tax claims with many Wisconsin banks, and the Company intends to engage in settlement discussions with WDR about these issues.

12. DERIVATIVES AND FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

In the normal course of business, the Company is party to financial instruments with off-balance-sheet risk. Those financial instruments consist of commitments to extend credit, forward commitments to sell mortgage loans, and option contracts. These instruments involve, to varying degrees, elements of credit, liquidity, and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition. The contract amounts reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company’s maximum exposure to credit loss for commitments to extend credit is represented by the contract amount of those instruments. Forward commitments to sell loans and option contracts do not represent exposure to credit loss.

Financial instruments whose contract amounts represent credit and interest rate risk as of September 30, 2008 and 2007, are as follows (in thousands):

	2008	2007
Commitments to extend credit	\$ 358,642	\$ 156,767
Unused lines of credit	169,374	244,707
Forward commitments to sell loans	334,350	228,968
Option contracts (notional amount)	42,000	

Commitments to extend credit are agreements to lend to residential first mortgage customers as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and generally require payment of a fee. As some commitments expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates the creditworthiness of each customer on a case by case basis. The Company generally extends credit only on a secured basis.

The portion of these commitments that have interest rate locks on single family mortgages are accounted for as derivatives and are recorded at fair value. The fair value of these derivatives was \$1,653,000 and \$762,000 as of September 30, 2008 and 2007, respectively, and are included in other liabilities in 2008 and 2007. Commitments to extend credit for other loans are not considered derivatives under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and related interpretations.

Forward commitments to sell mortgage loans represent commitments obtained by the Company, primarily from secondary market agencies, to purchase mortgages from the Company and place them in mortgage-backed security pools with defined yields. The Company also purchases options on mortgage-backed and treasury securities as an additional means of hedging interest rate risks relative to loans originated for sale. These contracts represent options to buy or sell securities at a future date and at a specified price. The commitments and options are derivatives and recorded at fair value of \$539,000 and \$201,000 as of September 30, 2008 and 2007, respectively, and are included in other assets in 2008 and other liabilities in 2007. Commitments and options expose the Company to market risk if rates of interest decrease during the commitment period. Commitments to sell loans are made to mitigate interest rate risk on commitments to originate loans and loans held for sale.

The Company sells first mortgage and home equity loans to investors and may or may not retain servicing responsibilities. Upon sale, the risk of credit loss is passed to the investor. The Company does retain the risk of loss should a loan that has been previously sold go into default and it is determined that such loan was not within the agreed-upon underwriting guidelines due to negligence on the part of the Company or fraud on the part of the borrower. Such risk retention is standard within the mortgage banking industry. The Company's reserve for exposure relating to these representations and warranties was approximately \$4.1 million and \$3.8 million as of September 30, 2008 and 2007, respectively.

13. FAIR VALUES OF FINANCIAL INSTRUMENTS

Following is a disclosure of fair value information about financial instruments, whether or not recognized in the consolidated statements of financial condition, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many

cases, could not be realized in immediate settlement of the instrument. The aggregate fair value amounts presented do not represent the underlying value of the Company.

It is not the intent of the Company to liquidate and, therefore, realize the difference between market value and carrying value of all financial instruments and, even if it were, there is no assurance that the estimated market values could be realized. Thus, the information presented is not relevant to predicting the Company's future earnings or cash flows.

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash and Cash Equivalents — The carrying amount reported in the consolidated statements of financial condition for this asset approximates its fair value.

Securities — Fair values for securities are based on quoted market prices.

Loans Held for Sale and Purchase and Sale Commitments — The fair value of mortgage loans held for sale to investors and that portion of commitments to originate loans that are estimated to result in mortgage loans which are committed for sale, is based on prices established by the Company's commitments to sell the related mortgage loans. For mortgage loans held for sale and that portion of commitments to originate loans that are estimated to result in mortgage loans which are not committed for sale, fair values are based on quoted market prices for mortgage-backed securities with similar terms. Mandatory commitments to sell mortgage loans are valued at the cost to repurchase the commitment.

Loans Held for Investment — The Company's loans held for investment consist primarily of adjustable rate mortgage loans with varying terms, loans repurchased from investors, construction loans, participation loans, home equity loans, and consumer loans with variable and fixed rates. For variable rate first mortgage loans and construction loans, management believes, based on general review of the loan terms that the fair value of these loans approximates their carrying value. For repurchased loans, home equity loans, and the other consumer loans, fair values were calculated by discounting cash flows using an estimated discount rate that reflects current market rates and the type of loan. In addition, when computing the estimated fair value for all loans, allowances for loan losses were subtracted from the calculated fair value for consideration of potential credit issues.

FHLB Stock — FHLB stock is carried at cost which is its redeemable (fair) value since the market for this stock is restricted.

Deposits — The fair values disclosed for interest and non-interest bearing negotiable order of withdrawal accounts, passbook accounts, money market, and variable rate accounts are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities of the outstanding certificates of deposit.

Borrowings — The fair values for borrowings are estimated using a discounted cash flow calculation that applies interest rates currently charged on similar borrowings to a schedule of payments due under the existing borrowing agreements.

The carrying amounts and fair values of the Company's financial instruments as of September 30, 2008 and 2007, consist of the following (in thousands):

	2008	
	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 69,103	\$ 69,103
Securities available-for-sale	16,916	16,916
Securities held-to-maturity	3,191	3,190
Loans held for sale	144,874	144,874
Commitments for first mortgage loans	(1,653)	(1,653)
Forward commitments and options	539	539
Loans held for investment — net	1,102,308	1,102,948
Federal Home Loan Bank stock	27,135	27,135
Deposits	(1,221,369)	(1,181,165)
Borrowings	(133,000)	(134,352)
	2007	
	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 138,942	\$ 138,942
Securities available-for-sale	23,645	23,645
Securities held-to-maturity	3,449	3,390
Loans held for sale	818,748	818,748
Commitments for first mortgage loans	(762)	(762)
Forward commitments and options	(201)	(201)
Loans held for investment — net	679,263	682,200
Federal Home Loan Bank stock	27,135	27,135
Deposits	(1,533,303)	(1,534,531)
Borrowings	(80,000)	(80,000)

14. SUBSEQUENT EVENTS

FDIC Temporary Liquidity Guarantee Program

On October 14, 2008, the FDIC established a Temporary Liquidity Guarantee Program (TLGP). The FDIC issued an interim rule governing the Program on October 23, 2008 ("Interim Rule"). The TLGP is intended to preserve confidence and encourage liquidity in the banking system in order to ease lending to creditworthy businesses and consumers. The TLGP is a voluntary and time-limited program that will be funded through special fees charged to participating bank and financial holding companies and FDIC-insured depository institutions. The program consists of two components: a temporary guarantee of newly-issued senior unsecured debt (the Debt Guarantee Program or DGP) and a temporary unlimited guarantee of funds in non-interest bearing transaction accounts at FDIC-insured institutions (the Transaction Account Guarantee Program or TAGP). The Company is eligible to participate in either or both components of the TLGP to the degree specified in the Interim Rule. As more fully detailed in the Interim Rule, the DGP specifies that the FDIC will temporarily guarantee (through June 30, 2012) all new senior unsecured debt up to prescribed limits issued by participating holding companies and insured financial institutions from October 14, 2008 through June 30, 2009. Under the TAGP, the FDIC will provide an unlimited guarantee for non-interest bearing transaction accounts in excess of the existing deposit insurance limit of \$250,000 per account. This coverage is effective on October 14, 2008, and will continue through December 31, 2009.

The TLGP became effective on October 14, 2008. For the first 30 days of the program, the guarantees provided by the program have been offered at no cost to the Company. Unless the Company opts out of either or both of the TLGP programs described in the previous paragraph on or before December 5, 2008, the Company will be assessed fees for its participation in either or both of the programs. Beginning on December 5, 2008, FDIC-insured institutions that have not opted out of the TAGP will be assessed on a quarterly basis an annualized amount equal to 10 basis points on balances in non-interest bearing transaction accounts that exceed the existing deposit insurance limit of \$250,000. Management has elected to continue participation in the TAGP. Management does not believe any assessments under the TAGP will be material to future operating results.

Beginning on December 5, 2008, any financial institution such as the Company that have not chosen to opt out of the DGP generally will be assessed an annualized fee equal to 75 basis points multiplied by the amount of new debt issued under the program and the remaining term (in years) to maturity or June 30, 2012, whichever is earlier. Management has elected to not continue participation in the DGP.

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