

GuarantyFinancialCorp.

Consolidated Financial Statements

*Years ended
September 30, 2011 and 2010*

GuarantyFinancialCorp.

To Our Shareholders:

FISCAL 2011 OVERVIEW

Guaranty Bank finished its 88th fiscal year on September 30, 2011, concluding another year of regulatory and market-driven change. The primary drivers of our financial results in Fiscal 2011 included: 1) continued profitability in our Retail Bank and our retail mortgage lending operations; and 2) credit losses and insurance expense associated with our second mortgage portfolio.

Both the Retail Bank and our residential mortgage lending business generated positive income contributions in Fiscal 2011. Moreover, we experienced continued stabilization of delinquency rates below industry averages.

Though the Bank realized a net loss for Fiscal 2011, we experienced year-over-year improvement and made progress in increasing revenue, decreasing costs and mitigating risk. Moreover, the Bank's liquidity position remains solid.

At Fiscal Year end, the Bank reported capital levels at 5.37% Tier 1 Core Capital ratio and 8.92% Total Risk Based Capital ratio.

Our non-performing assets to total assets ratio remained relatively unchanged at 3.34% in Fiscal 2011 compared to 3.32% in Fiscal 2010.

BUSINESS STRATEGIES

During Fiscal 2011, our company strategy was centered on the following:

- Growing core earnings from the Retail Bank and our mortgage lending operations.
- Maintaining our net investment income.
- Maintaining a strong focus on cost containment, reducing our credit losses, and mitigating risk.

In pursuing these goals, we continue to pay close attention to credit risk management, capital levels, process improvements, expense management and revenue generation.

BUSINESS OVERVIEW

Retail Banking

As of September 30, 2011, the Bank's total retail deposit base remained stable compared to last year at approximately \$1.1 billion. Demand accounts, such as checking accounts, which generally are the lowest cost of funds for our operations, increased from \$290 million at

September 30, 2010, to \$340 million at September 30, 2011. Money market account balances, however, declined from \$578 million to \$551 million at the same dates, respectively.

Mortgage Lending & Servicing

The origination of one-to four-family residential mortgage loans through the Bank's subsidiaries continues to be one of our core business strategies. The Bank originates high quality home mortgage loans throughout the country. First mortgage loans, primarily conventional one-to-four family FNMA/FHLMC and FHA government insured loans, are originated for sale to the secondary market.

The Bank's retail mortgage lending subsidiary, Shelter Mortgage Company, LLC, generated \$1.2 billion in new loan originations throughout Fiscal 2011 compared to \$1.3 billion in Fiscal 2010, while still generating positive return.

Throughout the year, the Bank may choose to sell or retain loan servicing rights in accordance with changes in the market. Our servicing rights in Fiscal 2011 decreased, with \$11.3 million for the year ended September 30, 2011 compared to \$12.6 million for the year ended September 30, 2010.

Other Lending

The Bank's held for investment loan portfolio is \$687 million as of September 30, 2011. This represents a deliberate reduction of \$83 million in the size of our second mortgage portfolio in order to minimize our future loss exposure. The Bank's second mortgage portfolio stood at \$439 million at Fiscal Year-end.

This held for investment loan portfolio consists primarily of second lien home equity mortgage loans. The portfolio also includes \$213 million of first mortgage loans, \$3 million of construction loans, \$6 million of land loans, \$3 million of auto loans, \$19 million of student loans, \$24 million of small business commercial and nonresidential loans and \$16 million of other consumer loans. During the Fiscal Year, the bank did not offer second mortgage home equity loans.

Homeowner Assistance

In response to the difficult economy, the Bank instituted a comprehensive program in 2009 called "Helping Main Street." This initiative proactively identifies customers who may need assistance to avoid default and foreclosure before they appear on our delinquency rolls.

During Fiscal 2011, our team of loss mitigation experts assisted 899 homeowners through loan modification or refinancing, in an effort to reduce the risk of homeownership default. The number of real estate or bank owned properties decreased to 16 from 25 a year ago. The value of those properties also decreased to \$1.6 million in Fiscal 2011 compared to \$7.1 million in Fiscal 2010. While nationally the redelinquency rate on loans that have been modified averages between 40-50%, our redefault rate has averaged between 10-15%.

MANAGEMENT'S ANALYSIS OF RESULTS

Earnings and Capital Summary

The Bank reported a loss of \$13.9 million, or \$7.44 (diluted earnings) per share, for Fiscal 2011. This loss reflects an improvement of \$10.1 million over the loss of \$24.0 million, or \$12.86 (diluted earnings) per share, incurred in Fiscal 2010.

The reduction of losses in Fiscal 2011 was influenced by positive income contributions from the Retail Bank and our Shelter Mortgage division. A decline of \$14.1 million in credit losses and credit related expenses also contributed to the year-over-year improvement. Net interest income declined by \$2.1 million compared to the prior year, due in part to a deliberate reduction in the size of our second mortgage portfolio.

The Bank's stockholder's equity stood at \$62.0 million as of September 30, 2011.

Net Interest Income. The interest income and expense items resulted in net interest income of \$38.2 million for the Fiscal Year ended September 30, 2011, a decrease of 5.2% from the \$40.3 million of net interest income earned (before provision for loan losses) for the year ended September 30, 2010. Interest expense decreased to \$4.3 million for Fiscal 2011, from \$9.6 million in Fiscal 2010. The interest paid on deposit accounts decreased to \$4.3 million, down from \$8.6 million in Fiscal 2010. Interest on borrowings was insignificant compared to \$1.0 million in Fiscal 2010.

Provision for Losses on Loans. The Bank's provision for loan losses was \$28.4 million for Fiscal 2011 compared to \$54.9 million for Fiscal 2010. 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 determining the allowance for losses on loans in Fiscal 2011 and Fiscal 2010, management has included an amount for home equity loans and lines of credit in the allowance despite the fact that Guaranty Bank has credit loss insurance on these loans. The insured balances were \$443 million at September 30, 2011 compared to \$521 million at September 30, 2010.

Noninterest Income/Expense Analysis

Total Noninterest Income. Total noninterest income for the Bank decreased to \$131.3 million for Fiscal 2011, from \$135.1 million earned in Fiscal 2010. The discussion below highlights the components of noninterest income.

Retail Banking Income. Fees and service charges generated by our retail banking operation were \$80.0 million in Fiscal 2010 compared to \$80.2 million in Fiscal 2011.

Mortgage Banking Income. Mortgage banking income, which includes gains on sale of servicing and gains on sale of loans and origination fees, was \$48.5 million in Fiscal 2010, compared to \$45.6 million in Fiscal 2011.

Noninterest Expense. Total noninterest expense for Fiscal 2011 decreased to \$156.9 million from \$162.2 million in Fiscal 2010.

Asset Size and Liquidity

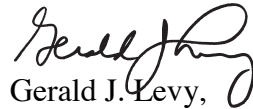
The Bank's asset size declined to \$1.2 billion at Fiscal Year-end 2011 compared to \$1.3 billion at Fiscal Year-end 2010. Net loans held for investment at Fiscal Year-end 2011 decreased to \$687 million compared to \$768 million at the end of Fiscal 2010. The Bank's overall deposit account balances remained constant at \$1.1 billion. The Bank had no borrowings at Fiscal Year-end 2011, compared to \$45 million as of the end of Fiscal 2010.

As of September 30, 2011, the bank's liquidity is strong as evidenced by the cash, short term and marketable assets to deposits and liabilities ratio of 27.7%, more than the September 30, 2010 measurement of 26.3%. Additionally, the bank's cash and due from banks position at September 30, 2011 was \$124.0 million or 11.1% of deposits and short term liabilities, which is a decrease from the September 30, 2010 ratio of 14.3%.

CONCLUSION

Though we experienced a loss in Fiscal 2011, we believe we continued our progress toward a return to profitability. We have focused our business plan on generating income contributions from our retail and mortgage banking businesses, maintaining a careful balance of our investments, and mitigating our risk in the area of credit losses. We are optimistic that this focus will lead us to profitability in the future.

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; (13) difficulties in raising capital; (14) lawsuits; and (15) difficulties in reducing risk associated with home equity loans on our balance sheet.

GUARANTY FINANCIAL CORP. AND SUBSIDIARIES

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1
CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010:	
Statements of Financial Condition	2
Statements of Operations	3
Statements of Stockholders' Equity	4
Statements of Cash Flows	5
Notes to Consolidated Financial Statements	6-31

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Guaranty Financial Corp. and Subsidiaries:

We have audited the accompanying consolidated statements of financial condition of Guaranty Financial Corp. and subsidiaries (the "Company") as of September 30, 2011 and 2010, 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.

As discussed in Note 10 to the consolidated financial statements, Guaranty Bank, a wholly owned subsidiary of the Company, has entered into a cease and desist order with the Office of the Comptroller of the Currency, which requires, among other things, that Guaranty Bank meet prescribed capital requirements. As of September 30, 2011, Guaranty Bank was not in compliance with such capital requirements. Failure to meet minimum capital requirements can initiate certain mandatory, and possible additional discretionary actions by Guaranty Bank's regulators, including actions that could have a direct material effect on Guaranty Bank's financial statements.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of September 30, 2011 and 2010, 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 29, 2011

GUARANTY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

AS OF SEPTEMBER 30, 2011 AND 2010

(In thousands, except share amounts)

	2011	2010
ASSETS		
CASH AND CASH EQUIVALENTS:		
Cash and due from banks	\$ 123,945	\$ 164,824
Federal funds sold and other short-term investments	<u>125</u>	<u>221</u>
Total cash and cash equivalents	124,070	165,045
INVESTMENT SECURITIES AVAILABLE-FOR-SALE (Amortized cost of \$7,102 and \$14,063 in 2011 and 2010, respectively)	7,193	14,305
INVESTMENT SECURITIES HELD-TO-MATURITY (Fair value of \$34,002 and \$2,470 in 2011 and 2010, respectively)	33,022	2,345
LOANS HELD FOR SALE (Net of valuation allowance of \$0 in 2011 and 2010)	155,822	157,734
LOANS HELD FOR INVESTMENT (Less allowance for losses on loans of \$39,560 and \$50,273 in 2011 and 2010, respectively)	686,709	768,205
FEDERAL HOME LOAN BANK STOCK	27,135	27,135
BANK-OWNED LIFE INSURANCE	75,162	71,787
PREMISES AND EQUIPMENT — Net	21,429	24,239
MORTGAGE SERVICING RIGHTS	11,283	12,589
OTHER ASSETS	<u>63,497</u>	<u>76,140</u>
TOTAL	<u>\$1,205,322</u>	<u>\$1,319,524</u>
LIABILITIES AND EQUITY		
LIABILITIES:		
Deposits	\$1,101,228	\$1,109,674
Escrow funds due to investors	16,787	56,666
Borrowings	—	45,000
Accrued expenses and other liabilities	<u>22,356</u>	<u>28,864</u>
Total liabilities	<u>1,140,371</u>	<u>1,240,204</u>
EQUITY:		
Guaranty Financial 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, 1,871,014 shares; outstanding, 1,867,431 shares	187	187
Additional paid-in capital	12,961	12,961
Preferred stock of subsidiary held by parent	50,099	50,099
Retained earnings (accumulated deficit)	(945)	12,942
Accumulated other comprehensive income (loss)	(27)	123
Treasury common stock — at cost (3,583 shares in 2011 and 2010)	<u>(250)</u>	<u>(250)</u>
Total Guaranty Financial stockholders' equity	62,025	76,062
Noncontrolling interest in subsidiaries	<u>2,926</u>	<u>3,258</u>
Total equity	<u>64,951</u>	<u>79,320</u>
TOTAL	<u>\$1,205,322</u>	<u>\$1,319,524</u>

See notes to consolidated financial statements.

GUARANTY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010 (In thousands, except share amounts)

	2011	2010
INTEREST INCOME:		
Loans	\$ 41,483	\$ 49,080
Investments	<u>1,081</u>	<u>825</u>
Total interest income	<u>42,564</u>	<u>49,905</u>
INTEREST EXPENSE:		
Deposits	4,344	8,594
Borrowings	<u>2</u>	<u>1,004</u>
Total interest expense	<u>4,346</u>	<u>9,598</u>
NET INTEREST INCOME	38,218	40,307
PROVISION FOR LOSSES ON LOANS	<u>28,357</u>	<u>54,933</u>
NET INTEREST INCOME (LOSS) AFTER PROVISION FOR LOSSES ON LOANS	9,861	(14,626)
RECOVERIES FROM CREDIT INSURANCE — Net of insurance premium	<u>4,760</u>	<u>21,518</u>
NET INTEREST INCOME AFTER PROVISION FOR LOSSES ON LOANS AND RECOVERIES FROM CREDIT INSURANCE — Net of insurance premium	<u>14,621</u>	<u>6,892</u>
NONINTEREST INCOME:		
Retail banking	80,162	80,010
Loan service fees — net of amortization	1,028	2,419
Gain on sale of loans and mortgage servicing rights — net	45,644	48,461
Other income	<u>4,496</u>	<u>4,251</u>
Total noninterest income	<u>131,330</u>	<u>135,141</u>
NONINTEREST EXPENSE:		
Compensation and employee benefits	82,247	81,945
Advertising and marketing	5,873	3,865
Occupancy and equipment	19,826	20,551
Professional services	11,535	12,376
Data processing	11,163	9,984
Other	<u>26,246</u>	<u>33,453</u>
Total noninterest expense	<u>156,890</u>	<u>162,174</u>
LOSS BEFORE INCOME TAXES	(10,939)	(20,141)
INCOME TAX EXPENSE (BENEFIT)	<u>(595)</u>	<u>15</u>
NET LOSS	(10,344)	(20,156)
LESS: NET INCOME ATTRIBUTABLE TO NONCONTROLLING INTEREST	<u>(3,543)</u>	<u>(3,864)</u>
NET LOSS ATTRIBUTABLE TO GUARANTY FINANCIAL COMMON STOCKHOLDERS	<u>\$ (13,887)</u>	<u>\$ (24,020)</u>
PER COMMON SHARE:		
Basic earnings	<u>(7.44)</u>	<u>(12.86)</u>
Diluted earnings	<u>(7.44)</u>	<u>(12.86)</u>
Cash dividends declared	<u>\$ -</u>	<u>\$ -</u>

See notes to consolidated financial statements.

GUARANTY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010 (In thousands)

	Comprehensive Income/(Loss)	Common Stock	Additional Paid-in Capital	Preferred Stock of Subsidiary Held by Parent	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income/(Loss)	Treasury Stock	Total Guaranty Financial Stockholder's Equity	Noncontrolling Interest in Subsidiaries	Total Equity
BALANCE — October 1, 2009	\$187	\$12,961	\$50,099	\$36,962	\$179	\$(250)	\$100,138	\$4,098	\$104,236	
Comprehensive income (loss):										
Net income (loss)	\$(24,020)									
Unrealized gain (loss) on securities — arising during the period — net of income taxes of \$30	(56)				(56)					
Comprehensive income (loss)	\$(24,076)									
Distributions to noncontrolling interests								(4,296)	(4,296)	
Redemptions or purchases of noncontrolling interests								(408)	(408)	
BALANCE — September 30, 2010	187	12,961	50,099	12,942	123	(250)	76,062	3,258	79,320	
Comprehensive income (loss):										
Net income (loss)	\$(13,887)									
Unrealized gain (loss) on securities — arising during the period — net of income taxes of \$81	(150)				(150)					
Comprehensive income (loss)	\$(14,037)									
Distributions to noncontrolling interests								(4,303)	(4,303)	
Redemptions or purchases of noncontrolling interests								428	428	
BALANCE — September 30, 2011	187	12,961	50,099	(945)	(27)	(250)	62,025	2,926	64,951	

See notes to consolidated financial statements.

GUARANTY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010 (In thousands)

	2011	2010
OPERATING ACTIVITIES:		
Net loss	\$ (10,344)	\$ (20,156)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provisions for losses on loans	28,357	54,933
Depreciation	4,155	4,998
Deferred tax expense		17,967
Amortization of intangibles	3,804	4,862
Impairment on investment security	100	42
Originations and purchases of loans held for sale	(1,228,656)	(1,291,748)
Proceeds from sales of loans held for sale and loan principal repayments	1,272,258	1,264,606
Gain on sale of loans and mortgage servicing rights — net	(43,903)	(49,133)
Loss on disposal of premises and equipment	39	246
Increase in bank-owned life insurance	(3,375)	(3,335)
Decrease in other assets	24,576	18,939
Decrease in other liabilities	(6,508)	(452)
	<u>40,503</u>	<u>1,769</u>
Net cash provided by operating activities		
INVESTING ACTIVITIES:		
Purchases of investment securities available-for-sale	(1,100)	(4,919)
Purchases of investment securities held-to-maturity	(32,046)	(581)
Proceeds from sale of investment securities available-for-sale	8,256	3,768
Proceeds from maturities of investment securities held-to-maturity	1,369	1,061
Proceeds from sales of mortgage servicing rights	3,121	4,827
Net decrease in loans held for investment	38,922	83,286
Purchases of premises and equipment — net of disposals	(2,790)	(2,023)
	<u>15,732</u>	<u>85,419</u>
Net cash provided by investing activities		
FINANCING ACTIVITIES:		
Net increase (decrease) in deposits and escrow funds due to investors	(48,335)	21,107
Issuance of new borrowings		45,000
Payment of borrowings	(45,000)	(57,000)
Distributions to noncontrolling interests	(4,303)	(4,296)
Redemptions or purchases of noncontrolling interests	428	(408)
	<u>(97,210)</u>	<u>4,403</u>
Net cash provided by (used in) financing activities		
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(40,975)	91,591
CASH AND CASH EQUIVALENTS:		
Beginning of year	<u>165,045</u>	<u>73,454</u>
End of year	<u>\$ 124,070</u>	<u>\$ 165,045</u>
SUPPLEMENTAL INFORMATION — Cash paid (received) during the year for:		
Interest on deposits and borrowings	<u>\$ 4,504</u>	<u>\$ 9,981</u>
Income taxes	<u>\$ (1,757)</u>	<u>\$ 128</u>
SIGNIFICANT NONCASH TRANSACTIONS:		
Real estate acquired through foreclosure	<u>\$ 5,745</u>	<u>\$ 9,913</u>
Transfer of loans from held for sale to held for investment	<u>\$ 1,121</u>	<u>\$ 4,274</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, 2011 AND 2010

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, Shelter Mortgage Company, LLC; Guaranty Mortgage Services LLC; 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 intercompany accounts and transactions have been eliminated in consolidation.

Business — The Company is a consumer-oriented financial institution that emphasizes single family residential lending through a nationwide correspondent network, consumer lending, retail deposit activities, mortgage banking, and other retail financial services in Wisconsin, Illinois, Michigan, Minnesota, and Georgia. The Company serves borrowers through its retail operations in Shelter Mortgage Company, LLC, Guaranty Mortgage Services LLC, and the Guaranty Bank Home Owners Assistance Program.

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 consolidated 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 consolidated 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 valuation allowance on deferred tax assets, the determination of reserves for repurchase of loans previously sold, the reserve to estimate the liability for credit insurance with retrospective premiums, the valuation of derivatives, and the valuation of mortgage servicing rights (MSRs).

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, 2011 and 2010, 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 unamortized discounts and premiums, 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 including loans that have been impaired. For nonaccrual loans greater than an established threshold, nonhomogeneous classified loans, and all renegotiated loans, impairment is measured using one of three alternatives: (1) the present value of expected future cash flows discounted at the loan's effective interest rate; (2) the loan's observable market price, if available; or (3) the fair value of the collateral for collateral-dependent loans and loans for which foreclosure is deemed to be probable. Loans below the established thresholds are evaluated as homogenous pools. Management's determination of the adequacy of the allowance is based on a continual review of the loan portfolio, loan loss experience, economic conditions, growth and composition of the portfolio, and other relevant qualitative factors. Additions to the allowance are charged to operations and actual losses and recoveries of losses are charged or credited to the allowance.

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 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 \$443 million and \$521 million as of September 30, 2011 and 2010, respectively.

Default by one of the insurance carriers with which the Company has 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, 2011, estimates the risk of material 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 30 to 60 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 probable. The credit insurance recoverable is monitored regularly by management for collectibility and the valuation of the credit insurance recoverable estimate is determined by management.

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 a hedge, 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 hedge 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.

Bank-Owned Life Insurance (BOLI) — The Company purchased life insurance policies on the lives of certain officers and employees and is the owner and beneficiary of these policies. An additional death benefit is available to the families for employees still employed at the time of their death. The Company records these BOLI policies at each policy's respective cash surrender value, with changes recorded in other income in the consolidated statements of operations.

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.

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 \$1.6 million and \$7.1 million as of September 30, 2011 and 2010, respectively, and is included in other assets.

Loan Repurchase Reserve — In the ordinary course of business, the Company sells first mortgage loans and previously sold 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 requests received to repurchase loans from individual investors, current production and proposed settlements, 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 consolidated statements 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 are 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 after a reasonable period of payment history has been established.

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 MSRs.

Gain on Sale of Loans — Gains on sales of loans 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 separate federal income tax returns and either combined or separate state income tax returns. 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 GFC will not realize the benefit of these deferred tax assets.

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.

Recent Accounting Pronouncements — In June 2009, the Financial Accounting Standards Board (the “FASB”) issued guidance related to the Transfers and Servicing Topic and the Consolidations Topic. Changes to the Transfers and Servicing Topic eliminate the concept of a QSPE, change the requirements for derecognizing financial assets, and require additional disclosures regarding an entity’s continuing involvement in and exposure to risks related to transferred financial assets. The changes to the Consolidations Topic replace the quantitative approach previously required for determining which enterprise should consolidate a variable interest entity with a consolidation approach focused on which enterprise has the power to direct the activities of a variable interest entity and the obligation to absorb

losses of the entity or the right to receive benefits from the entity. The updated Consolidations Topic also requires ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity, and eliminates an exception indicating that a troubled debt restructuring, as defined by the Debt Topic of the Codification, is not an event that required reconsideration of whether an entity is a variable interest entity and whether an enterprise is the primary beneficiary of a variable interest entity. The changes to the Transfers and Servicing Topic and the Consolidations Topic are effective for the Company on October 1, 2011.

In February 2010, the FASB issued an amendment to the Consolidation Topic that would defer the effective date for certain entities and provide for other amendments to the Consolidation Topic.

The adoption of this guidance, including its amendment, is not expected to have a material impact on the consolidated financial statements and related disclosures.

In January 2010, the FASB updated the disclosure guidance in the Fair Value Measurements and Disclosures Topic. This update clarifies certain existing disclosure requirements and requires separate disclosures of significant transfers in and out of Level 1 and Level 2 of the fair value hierarchy along with descriptions of the reasons for the transfers. In addition, information about purchases, sales, issuances, and settlements should be presented separately for Level 3 disclosures. The updated guidance was effective beginning on October 1, 2010, except for the disclosures about purchases, sales, issuances, and settlements of Level 3 fair value measurements. Those disclosures are effective beginning on October 1, 2011. See disclosures related to significant transfers in and out of Level 1 and Level 2 along with descriptions of the reasons for the transfers in Note 3 — “Fair Value Measurements”.

In July 2010, the FASB issued new accounting guidance that will require additional disclosures in the notes to the consolidated financial statements regarding the nature of credit risk inherent in the loan and lease portfolio, how that credit risk is analyzed and assessed in arriving at the allowance for credit losses, information regarding loan modifications that meet the definition of a troubled debt restructuring (“TDR”) and changes in the loan portfolio and the allowance for credit losses. In January 2011, the FASB elected to temporarily defer the effective date of the updated disclosures about TDR’s until the FASB clarifies guidance for determining what constitutes a TDR. In April 2011, the FASB issued new guidance to clarify the accounting principles applied to loan modifications. The additional guidance clarifies when the restructuring of a receivable should be considered a TDR, which the Company refers to as “Renegotiated Loans,” and ends the deferral of activity-based disclosures about TDRs that are part of the new credit quality disclosure requirements. The clarifications regarding which modifications constitute a TDR are effective for periods beginning on or after June 15, 2011, and are to be applied retroactively to the beginning of the annual period of adoption and the additional disclosures are effective for the Company as of October 1, 2011. The Company is in the process of evaluating the impact of the additional disclosure requirements.

In June 2011, the FASB amended the general accounting principles for the Comprehensive Income Topic as it relates to the presentation of comprehensive income. This amendment requires entities to present the total of comprehensive income, the components of net income, and the components of other comprehensive income in either a continuous statement of comprehensive income or in two separate but consecutive statements. The amendment does not change the items that must be reported in other comprehensive income. The amendment is effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. The Company is currently evaluating the impact of this amendment on its consolidated financial statements.

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 \$6 million and \$7 million as of September 30, 2011 and 2010, respectively.

3. FAIR VALUE MEASUREMENTS

The Fair Value Measurements and Disclosures Topic of the Codification generally applies whenever other standards require or permit assets or liabilities to be measured at fair value. Under the guidance, fair value refers to the price at the measurement date that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in which the reporting entity is engaged. The guidance does not expand the use of fair value in any new circumstances.

The accounting guidance establishes a three-tier hierarchy for fair value measurements based upon the transparency of the inputs to the valuation of an asset or liability and expands the disclosures about instruments measured at fair value. A financial instrument is categorized in its entirety and its categorization within the hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels are described below.

Fair Value Hierarchy:

Level 1 — Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 — Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Fair values for these instruments are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows.

Level 3 — Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Fair values are initially valued based upon transaction price and are adjusted to reflect exit values as evidenced by financing and sale transactions with third parties.

Determination of Fair Value — Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Investment Securities — When available, the Company used quoted market prices to determine the fair value of investment securities; such items are classified in Level 1 of the fair value hierarchy.

For the Company's investments in securities where quoted prices are not available for identical securities in an active market, the Company determines fair value utilizing vendors who apply matrix pricing for similar bonds where no price is observable or may compile prices from various sources. These models are primarily industry-standard models that consider various assumptions, including time value, yield curve, volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace and can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Fair values from these models are verified, where possible, to quoted prices for recent trading activity of assets with similar characteristics to the security being valued. Such methods are

Level 3 Gains and Losses — The table presented below summarizes the change in balance sheet carrying values associated with financial instruments measured using significant unobservable inputs (Level 3) during the twelve months ended September 30, 2011 and 2010, (in thousands):

	Other Equity Securities
Balance — October 1, 2009	\$ 2,147
Net payments, purchases, sales	<u>(249)</u>
Balance — September 30, 2010	1,898
Net payments, purchases, sales	<u>550</u>
Balance — September 30, 2011	<u><u>\$ 2,448</u></u>

The increase in Level 3 investment securities at September 30, 2011, was primarily due to purchases of securities to replace securities that had paid-down. The decrease in Level 3 investment securities at September 30, 2010, was primarily due to the pay-down of securities.

The Company's policy is to recognize transfers into and out of levels within the fair value hierarchy at the beginning of the quarter in which the actual event or change in circumstances that caused the transfer occurs. Transfers into Level 3 are due to a lack of observable market data for these securities or, in accordance with Company policy, when the ratings of certain asset classes fall below investment grade. Transfers out of Level 3 are due to an increase in observable market data or when the underlying inputs are evaluated and determined to be market observable. There were no transfers between levels in the current year.

Loans held for sale, which are designated as a hedged item, are reported at fair value. Nonhedged loans held for sale are recorded at the lower of cost or market and therefore are reported at fair value on a nonrecurring basis. Such fair values are generally based on bids and are considered Level 2 fair values. For nonaccrual loans greater than an established threshold individually evaluated for impairment, nonhomogeneous classified loans, and all renegotiated loans, impairment is measured using one of three alternatives: (1) the present value of expected future cash flows discounted at the loan's effective interest rate; (2) the loan's observable market price, if available; or (3) the fair value of the collateral for collateral-dependent loans and loans for which foreclosure is deemed to be probable. A valuation allowance is recorded for the excess of the loan's recorded investment over the amount determined by the above methods. This valuation allowance is a component of the allowance for losses on loans. The discounted cash flow is not a fair value measure. For the collateral value method, the Company generally obtains appraisals to support the fair value of collateral underlying loans. Appraisals incorporate measures such as recent sales prices for comparable properties and costs of construction. The Company considers these fair values as Level 3. For those loans individually evaluated for impairment using the collateral value method, a valuation allowance of \$0.7 million was recorded for loans with a recorded investment of \$10.5 million at September 30, 2011. See Note 5 — "Loans" for more information.

4. INVESTMENT SECURITIES

The amortized cost and approximate fair values of securities available-for-sale as of September 30, 2011 and 2010, are as follows (in thousands):

	2011			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. and other government obligations	\$ 2,827	\$ 47	\$ -	\$ 2,874
Other equity securities	<u>4,275</u>	<u>52</u>	<u>8</u>	<u>4,319</u>
Total	<u>\$ 7,102</u>	<u>\$ 99</u>	<u>\$ 8</u>	<u>\$ 7,193</u>

	2010			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
U.S. and other government obligations	\$ 10,379	\$ 223	\$ 13	\$ 10,589
Other equity securities	<u>3,684</u>	<u>34</u>	<u>2</u>	<u>3,716</u>
Total	<u>\$ 14,063</u>	<u>\$ 257</u>	<u>\$ 15</u>	<u>\$ 14,305</u>

Investment securities held-to-maturity as of September 30, 2011 and 2010, are as follows (in thousands):

	2011			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Mortgage-backed securities	\$ 33,022	\$ 980	\$ -	\$ 34,002
Total	<u>\$ 33,022</u>	<u>\$ 980</u>	<u>\$ -</u>	<u>\$ 34,002</u>

	2010			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Mortgage-backed securities	\$ 2,345	\$ 125	\$ -	\$ 2,470
Total	<u>\$ 2,345</u>	<u>\$ 125</u>	<u>\$ -</u>	<u>\$ 2,470</u>

The amortized cost and approximate fair value of U.S. and other government obligations available-for-sale and mortgage-backed securities held-to-maturity by contractual maturity as of September 30, 2011, 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>Held-to-Maturity</u>	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 2,000	\$ 2,006	\$ -	\$ -
Due after five years through ten years			1,123	1,175
Due after ten years	<u>827</u>	<u>868</u>	<u>31,899</u>	<u>32,827</u>
	<u>\$ 2,827</u>	<u>\$ 2,874</u>	<u>\$ 33,022</u>	<u>\$ 34,002</u>

As of September 30, 2011, 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>	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Other equity securities	<u>\$ 509</u>	<u>\$ 6</u>	<u>\$ -</u>	<u>\$ 2</u>
Total	<u>\$ 509</u>	<u>\$ 6</u>	<u>\$ -</u>	<u>\$ 2</u>

There was one sale of an available-for sale investment security in 2011 for a gain of \$0.2 million. There were no sales of investment securities available-for-sale during 2010.

5. LOANS

Loans held for sale as of September 30, 2011 and 2010, consist of the following (in thousands):

	2011	2010
One-to-four family mortgage loans	\$ 154,402	\$ 156,676
Home equity lines of credit	10	
Deferred fees	<u>1,410</u>	<u>1,058</u>
Total	<u>\$ 155,822</u>	<u>\$ 157,734</u>

Loans held for investment as of September 30, 2011 and 2010, consist of the following (in thousands):

	2011	2010
Mortgage loans:		
One-to-four family	\$ 212,822	\$ 205,201
Construction	2,644	4,945
Land	<u>6,224</u>	<u>8,255</u>
Total mortgage real estate loans	<u>221,690</u>	<u>218,401</u>
Consumer and other loans:		
Home equity loans — fixed rate	242,488	293,619
Home equity lines of credit	196,730	229,012
Auto loans	3,114	8,852
Student loans	19,450	23,524
Commercial and nonresidential	23,703	24,464
Other consumer	<u>16,031</u>	<u>16,891</u>
Total consumer and other loans	<u>501,516</u>	<u>596,362</u>
Total loans receivable	723,206	814,763
Deferred costs	3,063	3,715
Less allowance for loan losses	<u>(39,560)</u>	<u>(50,273)</u>
Total	<u>\$ 686,709</u>	<u>\$ 768,205</u>

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 those areas.

As of September 30, 2011 and 2010, nonaccrual loans totaled \$38.6 million and \$36.7 million, and renegotiated loans totaled \$131.8 million and \$127.1 million, respectively.

For purposes of impairment testing, loans greater than an established threshold and nonhomogeneous classified loans were individually evaluated for impairment. Loans below those scopes were collectively evaluated as homogeneous pools. Renegotiated loans are evaluated at the present value of expected future cash flows discounted at the loan's effective interest rate. The required valuation allowance is included in the allowance for losses in the consolidated balance sheets. At September 30, 2011 and 2010, the Company's recorded investment in impaired loans and the related allowance are (in thousands):

	2011		2010	
	Recorded Investment	Valuation Allowance	Recorded Investment	Valuation Allowance
Total nonaccrual and renegotiated loans	\$ 170,364		\$ 163,771	
Less nonaccrual loans held-for-sale			(110)	
Total impaired loans	170,364		163,661	
Loans excluded from individual evaluation	159,899		157,183	
Impaired loans evaluated	<u>\$ 10,465</u>		<u>\$ 6,478</u>	
Valuation allowance required	\$ 5,621	\$ 701	\$ 1,630	\$ 1,188
No valuation allowance required	<u>4,844</u>		<u>4,848</u>	
Impaired loans evaluated	<u>\$ 10,465</u>	<u>\$ 701</u>	<u>\$ 6,478</u>	<u>\$ 1,188</u>

The recorded investment in impaired loans is net of applications of cash interest payments and net of previous direct write-downs of \$1.2 million and \$2.1 million against the loan balance outstanding at September 30, 2011 and 2010, respectively.

The average recorded investment in total impaired loans for the year ended September 30, 2011 and 2010, amounted to \$167.4 million and \$178.6 million, respectively.

Interest payments received on nonaccrual loans are recorded as interest income unless collection of the remaining recorded investment is doubtful at which time payments received are recorded as reductions of principal. Interest on renegotiated loans is recognized on a cash-basis until a reasonable period of payment history has been established.

During the year ended September 30, 2011, the Bank's wholly owned subsidiary, Shelter Mortgage Company, LLC originated 2,667 FHA and VA-insured mortgage loans with proceeds of approximately \$428 million.

During the year ended September 30, 2010, the Bank's wholly owned subsidiary, Shelter Mortgage Company, LLC originated 3,271 FHA and VA-insured mortgage loans with proceeds of approximately \$524 million.

A summary of the activity in the allowance for losses on loans as of September 30, 2011 and 2010, are as follows (in thousands):

	2011	2010
Balance — beginning of year	<u>\$ 50,273</u>	<u>\$ 58,699</u>
Provision charged to income	<u>28,357</u>	<u>54,933</u>
Charge-offs on uninsured loans	(9,177)	(11,152)
Charge-offs on insured loans	(32,223)	(54,168)
Recoveries on uninsured loans	<u>2,330</u>	<u>1,961</u>
Net charge-offs	<u>(39,070)</u>	<u>(63,359)</u>
Balance — end of year	<u>\$ 39,560</u>	<u>\$ 50,273</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 over the life of the loans. As of September 30, 2011 and 2010, approximately \$443 million and \$521 million, respectively, of home equity loans held for sale and held for investment and \$2.3 million and \$3.4 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 \$31.4 million and \$41.0 million at September 30, 2011 and 2010, 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, 2011 and 2010, is insured charge-offs on insured loans and probable insurance recoveries of approximately \$22.6 million and \$47.1 million, respectively. These amounts are also reflected in the recoveries from credit insurance — net, on the statements of operations off set by insurance premiums of \$17.9 million and \$25.6 million for the years ended September 30, 2011 and 2010, respectively.

6. PREMISES AND EQUIPMENT

Premises and equipment as of September 30, 2011 and 2010, are summarized as follows (in thousands):

	2011	2010
Cost:		
Land and land improvements	\$ 1,493	\$ 1,493
Office buildings	6,909	6,880
Furniture and equipment	31,446	30,760
Leasehold improvements	<u>26,729</u>	<u>26,410</u>
	66,577	65,543
Less accumulated depreciation	<u>(45,148)</u>	<u>(41,304)</u>
Total	<u>\$ 21,429</u>	<u>\$ 24,239</u>

The Company's future minimum rental commitments under operating leases for leased premises as of September 30, 2011, are as follows (in thousands):

Years Ending September 30	Amount
2012	\$ 7,119
2013	5,654
2014	4,574
2015	3,964
2016	2,491
Thereafter	<u>3,121</u>
Total	<u>\$26,923</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 \$8,399,000 and \$8,438,000 for the years ended September 30, 2011 and 2010, respectively.

7. MORTGAGE SERVICING RIGHTS

An analysis of activity in the Company's first and second MSR's as of September 30, 2011 and 2010, is as follows (in thousands):

	Cost of Servicing Rights	Valuation Allowance	Mortgage Servicing Rights
Balance — October 1, 2010	\$ 13,419	\$ (446)	\$ 12,973
New MSR's capitalized	7,348		7,348
Amortization	(3,668)	91	(3,577)
Impairment		(260)	(260)
Sale of servicing	<u>(4,296)</u>	<u>401</u>	<u>(3,895)</u>
Balance — September 30, 2010	12,803	(214)	12,589
New MSR's capitalized	2,833		2,833
Amortization	(2,469)	71	(2,398)
Impairment	<u> </u>	<u>(1,741)</u>	<u>(1,741)</u>
Balance — September 30, 2011	<u>\$ 13,167</u>	<u>\$ (1,884)</u>	<u>\$ 11,283</u>

The fair value of MSR's as of September 30, 2011, approximated \$12.5 million and was determined using a discount rate of 9% and prepayment speeds ranging from 13.20% to 42.00%, depending upon the stratification of the specific right. The fair value of MSR's as of September 30, 2010, approximated \$14.1 million and was determined using a discount rate of 9.00% and prepayment speeds ranging from 16.44% to 42.00%, 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.

The following table outlines the key economic assumptions used to determine the fair value of the Company's MSR assets at September 30, 2011; and it outlines the sensitivities of those fair values to immediate 10% and 20% adverse changes in those assumptions (in thousands, except rates).

Weighted-average prepayment speed assumption	21.30 %
Impact on fair value of 10% adverse change	(881)
Impact on fair value of 20% adverse change	(2,018)
Weighted-average option adjusted spread	3.98 %
Impact on fair value of 100 basis points adverse change	(3,439)
Impact on fair value of 200 basis points adverse change	(4,861)

Estimated future amortization expense related to MSR assets at September 30, 2011, is summarized as follows (in thousands):

Years Ending September 30	Amount
2012	\$ 3,209
2013	2,476
2014	1,837
2015	1,360
2016	<u>1,004</u>
Total	<u>\$ 9,886</u>

Information regarding loans serviced for investors for the years ended September 30, 2011 and 2010, is as follows (in thousands):

	2011	2010
Total principal balance of loans serviced:		
First mortgage loans	\$ 1,493,506	\$ 1,910,357
First mortgage loans — subserviced	17,259	19,240
Home equity loans	<u>5,501</u>	<u>7,336</u>
Total	<u>\$ 1,516,266</u>	<u>\$ 1,936,933</u>
Number of loans serviced:		
First mortgage loans	\$ 9,859	\$ 11,631
First mortgage loans — subserviced	151	166
Home equity loans	<u>313</u>	<u>392</u>
Total	<u>\$ 10,323</u>	<u>\$ 12,189</u>
Funds held at Guaranty Financial for investors	<u>\$ 16,787</u>	<u>\$ 56,666</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.

8. DEPOSITS

Deposits for the years ended September 30, 2011 and 2010, are summarized as follows (in thousands):

	2011	2010
Non-interest bearing demand accounts	\$ 220,433	\$ 186,885
Interest-bearing demand accounts	119,680	103,745
Money market accounts	551,463	577,637
Savings passbook accounts	93,883	81,478
Certificates of deposit	<u>115,769</u>	<u>159,929</u>
Total	<u>\$ 1,101,228</u>	<u>\$ 1,109,674</u>

There were no brokered deposits at September 30, 2011 and 2010. As of September 30, 2011 and 2010, deposits (excluding noninterest bearing custodial accounts) with balances greater than or equal to \$100,000 amounted to \$223 million and \$217 million, respectively.

Certificates of deposit accounts as of September 30, 2011, mature during the fiscal year indicated as follows (in thousands):

Years Ended September 30	Amount
2012	\$ 101,246
2013	7,549
2014	4,317
2015	1,492
2016	<u>1,165</u>
Total	<u>\$ 115,769</u>

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 was signed into law. The Act increased Federal Deposit Insurance Corporation (FDIC) deposit insurance from \$100,000 to \$250,000 per depositor through December 31, 2009. Separately, Congress extended the temporary increase in the standard coverage of FDIC insurance on deposits to a limit of \$250,000 until December 2013.

In addition, on November 21, 2008, the FDIC released the Final Rule for the FDIC Temporary Liquidity Guarantee Program (“TLG Program”), which provided unlimited deposit insurance, for noninterest-bearing transaction deposit accounts at FDIC-insured participating institutions. The Company elected to continue to participate in the TLG Program and, as a result, was required to pay additional insurance premiums to the FDIC in an amount equal to annualized 10-basis points on balances in noninterest-bearing transaction accounts that exceeded \$250,000 FDIC deposit insurance limits, as determined on a quarterly basis.

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), beginning December 31, 2010 and continuing through December 31, 2012, all funds held in noninterest-bearing transaction accounts will be fully guaranteed by the FDIC for the full amount of the account.

In addition to the continuation of insurance coverage for noninterest-bearing transaction accounts, the Dodd-Frank Act permanently increased the standard maximum FDIC deposit insurance amount to \$250,000.

9. BORROWINGS

Borrowings as of September 30, 2011 and 2010, are summarized as follows (dollars in thousands):

Description	Maturity Date	Interest Rate at the Year-End		2011	2010
		2011	2010		
Note payable to Federal Home Loan Bank	October 1, 2010		0.26%	\$ -	\$ 45,000
Total				\$ -	\$ 45,000

The \$45 million of notes payable to the FHLB maturing October 1, 2010, was a short-term borrowing which was subsequently repaid.

The Company is required to maintain unencumbered loans and securities such that the outstanding balance of FHLB advances does not exceed FHLB designated percentages (55% for first mortgages, 9% for second mortgages, and 95% for agency MBS). In addition, any outstanding notes are collateralized by FHLB stock. There were no amounts outstanding from the FHLB as of September 30, 2011.

The Company is required to maintain unencumbered loans and securities such that the outstanding balance of Federal Reserve Board (“FRB”) advances does not exceed FRB designated percentages (65% for first mortgages and 46% for second mortgages). There were no amounts outstanding from the FRB as of September 30, 2011.

As of September 30, 2011, the Company had the ability to borrow up to \$70 million from the FHLB and \$62 million from the Federal Reserve. Such borrowing ability is premised on available collateral on hand and is subject to periodic and unilateral review by each of these agencies.

10. REGULATORY CAPITAL

Regulatory Capital Requirements — The Bank is subject to various regulatory capital requirements administered by the Office of the Comptroller of the Currency (the “OCC”), which became the Bank’s primary regulator after the Office of Thrift Supervision (the “OTS”) was merged into the OCC as part of the Dodd-Frank Act. Failure to meet minimum capital requirements can initiate certain mandatory, and possible additional discretionary actions by regulators, including, but not limited to sale or liquidation of the Bank. 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).

On March 11, 2009, the Bank consented to the issuance of an Order to Cease and Desist (the “Order”) by the OTS.

The Order requires that the Bank notify and in certain cases receive the permission of, the OTS prior to (i) declaring, making or paying any dividends or other capital distributions, including the repurchase or redemption of its capital stock; (ii) making changes to its directors or senior executive officers; (iii) increasing its total assets in any quarter in excess of an amount equal to net interest credited on deposit liabilities during the quarter; (iv) making any golden parachute payments or prohibited indemnification payments; (v) entering into, renewing, extending or revising any contractual arrangement related to compensation or benefits with any of its directors or senior executive officers; (vi) entering into third-party contracts outside the normal course of business; (vii) entering into certain transactions with affiliates; and (viii) accepting any brokered deposits. The Bank’s board was required to develop and submit to the OTS a three-year business plan, which must be reviewed at least quarterly by the Bank’s management and board for material deviations between the plan’s projections and actual results (the “Variance Analysis Report”). Within forty-five days following the end of each quarter, the Corporation is required to provide the OTS its Variance Analysis Report for that quarter.

The Order requires that the Bank meet and maintain both a core capital ratio equal or greater than 8% and a total risk-based capital ratio equal to or greater than 12%. This is measured on a quarterly basis. The Bank must also submit to the OTS, within prescribed time periods, a Fair Lending Compliance Program, an Intercompany Cost-Sharing Agreement, a revised allowance for loans and lease losses (ALLL) policy, and a revised Asset Classification policy. The ALLL, the Bank’s loan repurchase reserves and the quality of the Bank’s assets must be monitored quarterly by the Board. The Order also requires the Board approve a schedule of quarterly reduction targets for reducing the level of adversely classified assets which is monitored at least quarterly by the Bank’s management and board for material deviations between the targeted amounts and actual results (the “Quarterly Classified Assets Variance Report”). Within forty-five days following the end of each quarter, the Corporation is required to provide the OTS its Quarterly Classified Assets Variance Report for that quarter.

At September 30, 2011, the Bank had a core capital ratio of 5.37% and a total risk-based capital ratio of 8.92%, indicating that the bank is adequately capitalized, but below the required capital ratios set forth by the Order.

The Bank is working with its advisors to explore possible alternatives to raise additional equity capital. Certain existing litigation will require resolution prior to the Bank raising additional capital. No agreements have been reached with respect to any possible capital infusion transaction.

Failure to meet the requirements of the Order may result in one or more regulatory sanctions; however, no further regulatory sanctions have been issued at this time.

At September 30, 2011, the most recent notification from the OCC categorized the Bank as adequately capitalized under the regulatory framework for prompt corrective action. As of September 30, 2011 and 2010, the Bank's regulatory capital levels and ratios relative to its minimum capital requirements are as follows (dollars in thousands):

2011	Actual Capital		Required Capital	
	Amount	Ratio	Amount	Ratio
OCC capital adequacy:				
Tangible capital	\$ 64,676	5.37 %	\$ 18,080	1.50 %
Core capital	64,676	5.37	48,214	4.00
Risk-based capital	74,837	8.92	67,109	8.00
FDICIA regulations to be well capitalized:				
Tier 1 leverage ratio	64,676	5.37	60,268	5.00
Tier 1 risk-based ratio	63,969	7.63	50,332	6.00
Total risk-based ratio	74,837	8.92	83,887	10.00
Required by the Order:				
Core capital	64,676	5.37	96,429	8.00
Risk-based capital	74,837	8.92	100,664	12.00
2010				
OTS capital adequacy:				
Tangible capital	\$ 78,910	5.98 %	\$ 19,788	1.50 %
Core capital	78,910	5.98	52,768	4.00
Risk-based capital	90,216	9.72	74,232	8.00
FDICIA regulations to be well capitalized:				
Tier 1 leverage ratio	78,910	5.98	65,959	5.00
Tier 1 risk-based ratio	78,910	8.42	55,674	6.00
Total risk-based ratio	90,216	9.72	92,790	10.00
Required by the Order:				
Core capital	78,910	5.98	105,535	8.00
Risk-based capital	90,216	9.72	111,348	12.00

11. EMPLOYEE BENEFIT PLANS

The Bank has a participatory 401(k) plan which covers substantially all full-time 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, subject to Internal Revenue Service (IRS) limitations. Participants may also make after-tax Roth contributions up to 10% of their compensation in addition to their pretax deferrals. The Bank can make discretionary matching contributions, discretionary qualified nonelective contributions and discretionary contributions. Participants are immediately vested in their voluntary contributions plus actual earning thereon. Vesting in the Bank's discretionary matching contribution and discretionary contribution portion occurs upon three years of service. Qualified nonelective contributions are 100% vested immediately. The Bank made discretionary matching contributions of 10% of the amount contributed by each employee up to the first 6% of compensation in fiscal 2011. The Bank's expense for this plan amounted to \$0.2 million and \$0 for the years ended September 30, 2011 and 2010, respectively.

During fiscal 2008, the Bank adopted a phantom stock plan for key employees. Under this plan, the Bank 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 \$(0.1) million and \$0.1 million in fiscal 2011 and 2010, respectively, for the 27,275 and 37,850 phantom shares granted, respectively. As of September 30, 2011, there was no unrecognized compensation cost related to the phantom shares. As of September 30, 2010, unrecognized compensation cost related to the phantom shares was approximately \$0.1 million.

12. INCOME TAXES

The provision for income taxes for the years ended September 30, 2011 and 2010, consists of the following (in thousands):

	2011	2010
Current:		
Federal	\$ (583)	\$ (17,967)
State	<u>(12)</u>	<u>15</u>
Total current tax benefit	<u>(595)</u>	<u>(17,952)</u>
Deferred:		
Federal		17,967
State		
Total deferred tax expense		<u>17,967</u>
Total income tax expense (benefit)	<u>\$ (595)</u>	<u>\$ 15</u>

The income tax expense differs from that computed at the federal statutory tax rate for the years ended September 30, 2011 and 2010, is as follows (in thousands):

	2011	2010
Loss before income taxes and noncontrolling interest	<u>\$ (10,939)</u>	<u>\$ (20,141)</u>
Tax at federal statutory rates	\$ (3,719)	\$ (6,848)
(Deduct) add effect of:		
Income allocated to members of LLC subsidiaries (minority interest)	(1,204)	(1,314)
State income taxes	(951)	(1,027)
Deferred tax valuation allowance	5,754	11,767
Uncertain tax positions	(285)	(11)
Bank-owned life insurance	(1,148)	(1,133)
Other	<u>958</u>	<u>(1,419)</u>
Total	<u>\$ (595)</u>	<u>\$ 15</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, 2011 and 2010, are as follows (in thousands):

	2011	2010
Deferred tax assets:		
Allowance for losses on loans	\$ 15,686	\$ 19,136
Accrued payroll and pension	624	560
Prepayment and other reserves	3,460	3,907
Loans at cost marked-to-market for tax purposes	28	61
State loss carryforwards	7,689	7,710
Federal loss carryforwards	41,873	36,478
AMT credit carryforward	1,668	1,668
Other	<u>560</u>	<u>641</u>
Total deferred tax assets	<u>71,588</u>	<u>70,161</u>
Deferred tax liabilities:		
Deferred loan costs	767	1,132
FHLB dividend paid in stock	2,836	2,723
Fixed assets	1,587	1,303
Mortgage servicing rights	4,245	4,514
Credit insurance recoverable	12,463	15,616
Net unrealized gains on securities available-for-sale	91	92
Other	<u>785</u>	<u>1,720</u>
Total deferred tax liabilities	<u>22,774</u>	<u>27,100</u>
Total net deferred tax assets before valuation allowance	48,814	43,061
Valuation allowance	<u>(48,814)</u>	<u>(43,061)</u>
Total net deferred tax assets	<u>\$ -</u>	<u>\$ -</u>

The Company increased its valuation allowance against deferred tax assets by \$5.8 million at September 30, 2011 and \$11.8 million at September 30, 2010. A full valuation allowance has been recorded against the net deferred tax asset as of September 30, 2011, because management has determined it is more likely than not that the Company will not realize the benefit of these deferred tax assets.

The Company has a federal net operating loss carryforward of \$122.3 million that, if unused, will expire beginning in fiscal 2027. The Company also has state net operating loss carryforwards of \$161.0 million that, if unused, will expire beginning in fiscal 2012. The Company also has alternative minimum tax credits of \$1.7 million which will not expire.

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, 2011,

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.

The Company adopted accounting standards related to the accounting for uncertain tax positions. The guidance 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, 2009	\$ 335
Increases for tax positions related to prior years	81
Decreases for tax positions related to prior years	(20)
Decrease for lapse of statute of limitations	<u>(72)</u>
Balance — September 30, 2010	324
Decreases for audit settlements	(73)
Decreases for tax positions related to prior years	(189)
Decreases for lapse of statute of limitations	<u>(62)</u>
Balance — September 30, 2011	<u>\$ -</u>

Tax years that remain subject to examination by major tax jurisdictions include fiscal 2008 through fiscal 2011. The Company does not anticipate realizing any unrecognized tax benefits within 12 months of September 30, 2011.

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is \$0 as of September 30, 2011, and \$0.3 million as of September 30, 2010. The total amount of interest and penalties included in the consolidated statements of income as it pertains to the unrecognized tax benefits for fiscal 2011 and fiscal 2010 are \$(0.1) million and \$0, respectively. Included in the total liability for unrecognized tax benefits as of September 30, 2011 and 2010, are interest of \$0 and \$0.1 million, respectively. No penalties are included in the total liability for unrecognized tax benefits as of September 30, 2011 and 2010, respectively.

13. 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, 2011 and 2010, are as follows (in thousands):

2011			
	Notional Amount	Balance Sheet Category	Fair Value
Assets			
Commitments to extend credit	\$ 224,157	Other Assets	\$ 712
Unused lines of credit	39,306		
Total Assets			<u>712</u>
Liabilities			
Forward commitments to sell loans	\$ 121,227	Accrued expenses and other liabilities	\$ (1,010)
Option contracts (notional amount)	4,000	Accrued expenses and other liabilities	<u>16</u>
Total Liabilities			<u>(994)</u>
Net negative fair value impact			<u><u>\$ (282)</u></u>
2010			
	Amount	Balance Sheet Category	Fair Value
Assets			
Commitments to extend credit	\$ 227,054	Other Assets	\$ 159
Unused lines of credit	41,588		
Total Assets			<u>159</u>
Liabilities			
Forward commitments to sell loans	\$ 106,326	Accrued expenses and other liabilities	\$ (96)
Option contracts (notional amount)	6,000	Accrued expenses and other liabilities	<u>49</u>
Total Liabilities			<u>(47)</u>
Net positive fair value impact			<u><u>\$ 112</u></u>

The following tables summarize the income statement categories of the gain or (loss) recognized in income on financial instruments (in thousands):

2011		
	Statement of Operations Category	Amount recognized
Commitments to extend credit	Gain on sale of loans-net	\$ 553
Forward commitments to sell loans	Gain on sale of loans-net	(947)
Option contracts (notional amount)	Gain on sale of loans-net	
2010		
	Statement of Operations Category	Amount recognized
Commitments to extend credit	Gain on sale of loans-net	\$ (632)
Forward commitments to sell loans	Gain on sale of loans-net	903
Option contracts (notional amount)	Gain on sale of loans-net	

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 \$712,000 and \$159,000 in other assets as of September 30, 2011 and 2010, respectively. Commitments to extend credit for other loans are not considered derivatives under derivative instrument and hedging accounting guidance.

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 \$994,000 and \$47,000 in other liabilities as of September 30, 2011 and 2010, respectively. 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 loans and previously sold 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 \$5.7 million and \$8.8 million as of September 30, 2011 and 2010, respectively.

14. 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 — See Note 3 — “Fair Value Measurements” for information.

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. Loan balances are assigned fair values based on discounted cash flow analysis. The discount rate is based on the LIBOR swap curve, with rate adjustments for credit quality, cost, and profit factors.

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 noninterest-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, 2011 and 2010, consist of the following (in thousands):

	2011	
	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 124,070	\$ 124,070
Securities available-for-sale	7,193	7,193
Securities held-to-maturity	33,022	34,002
Loans held for sale	155,822	155,822
Commitments for first mortgage loans	712	712
Forward commitments and options	(994)	(994)
Loans held for investment — net	686,709	669,662
FHLB stock	27,135	27,135
Deposits	(1,101,228)	(1,082,538)

	2010	
	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 165,045	\$ 165,045
Securities available-for-sale	14,305	14,305
Securities held-to-maturity	2,345	2,470
Loans held for sale	157,734	157,734
Commitments for first mortgage loans	159	159
Forward commitments and options	(47)	(47)
Loans held for investment — net	768,205	737,893
FHLB stock	27,135	27,135
Deposits	(1,109,674)	(1,084,703)
Borrowings	(45,000)	(45,000)

15. CONTINGENCIES

In the normal course of business, the Company is involved in legal proceedings. The Company accrues a liability for such matters when it is probable that a liability has been incurred and the amount can be reasonably estimated. When only a range of possible loss can be established, the most probable amount in the range is accrued. If no amount within this range is a better estimate than any other amount within the range, the minimum amount in the range is accrued. The Company cannot predict the ultimate outcome of pending legal proceedings. It is possible that an adverse outcome could have a material adverse effect on the Company's consolidated financial statements.

The Company is currently pursuing litigation against one of its third-party credit loss insurance carriers regarding policy coverage and related premiums. Management believes this credit loss insurance contract will continue to be enforceable.

16. SUBSEQUENT EVENTS

The Company has determined that there were no subsequent events that would require adjustment to the accompanying consolidated financial statements through December 29, 2011, the date the consolidated financial statements were issued.

* * * * *