BofI Holding, Inc.
Form 10-K
September 23, 2008
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U. S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the year ended June 30, 2008

OR

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Commission file number: 000-51201

BofI HOLDING, INC.

(Exact name of registrant as specified in its charter)

Delaware	**33-0867444**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
12777 High Bluff Drive, Suite 100 **San Diego, CA**	**92130**
(Address of principal executive offices)	(Zip Code)

Registrant s Telephone Number, Including Area Code: (858) 350-6200

Securities registered under Section 12(b) of the Exchange Act:

Title of each class	**Name of each exchange on which registered**
Common stock, $.01 par value	NASDAQ National Market

Securities registered under Section 12(g) of the Exchange Act: None

Indicated by a check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ¨ Yes x No

Indicated by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ¨ Yes x No

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. x Yes ¨ No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filed, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated file ¨ Accelerated filer ¨
Non-accelerated filer x Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ¨ Yes x No

The aggregate market value of the voting and non-voting stock held by non-affiliates of the Registrant, based upon the closing sales price of the common stock on the NASDAQ National Market of $7.15 on December 31, 2007 was $44,797,774.

The number of shares of the Registrant s common stock outstanding as of August 31, 2008 was 8,299,563.

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s definitive Proxy Statement for the period ended June 30, 2008 are incorporated by reference into Part III.

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Forward Looking Statements

This report may contain various forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include projections, statements of the plans and objectives of management for future operations, statements of future economic performance, assumptions underlying these statements, and other statements that are not statements of historical facts. Forward-looking statements are subject to significant business, economic and competitive risks, uncertainties and contingencies, many of which are beyond the control of BofI Holding, Inc. (BofI). Should one or more of these risks, uncertainties or contingencies materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated. Among the key risk factors that may have a direct bearing on BofI s results of operations and financial condition are:

competitive practices in the financial services industries;

operational and systems risks;

general economic and capital market conditions, including fluctuations in interest rates;

economic conditions in certain geographic areas; and

the impact of current and future laws, governmental regulations and accounting and other rulings and guidelines affecting the financial services industry in general and BofI operations particularly.

In addition, actual results may differ materially from the results discussed in any forward-looking statements for the reasons, among others, discussed under the heading Factors that May Affect Our Performance in the Management s Discussion and Analysis of Financial Condition and Results of Operations, herein under Item 7.

References in this report to the Company, us, we, our, BofI Holding, or BofI are all to BofI Holding, Inc. on a consolidated basis. References in this report to Bank of Internet, Bank of Internet USA, the Bank, or our bank are to Bank of Internet USA, our consolidated subsidiary.

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PART I

Item 1. Business

Overview

BofI Holding, Inc. is the holding company for Bank of Internet USA, a consumer-focused, nationwide savings bank operating primarily through the Internet. We provide a variety of consumer banking services, focusing primarily on gathering retail deposits over the Internet and originating and purchasing multifamily, single-family and home equity mortgage loans, vehicle loans and mortgage-backed securities. We attract and service our customers primarily through the Internet which affords us low operating expenses and allows us to pass these savings along to our customers in the form of attractive interest rates and low fees on our products.

We operate our Internet-based bank from a single location in San Diego, California, currently serving approximately 29,000 retail deposit and loan customers across all 50 states. At June 30, 2008, we had total assets of $1,194.2 million, loans of $631.4 million, mortgage-backed and other investment securities of $510.0 million, total deposits of $570.7 million and borrowings of $534.2 million. Our deposits consist primarily of interest-bearing checking and savings accounts and time deposits. Our loans are primarily first mortgages secured by multifamily (five or more units) and single family real property. Our mortgage-backed securities consist of mortgage pass-through securities issued by government-sponsored entities and AAA-rated non-agency collateralized mortgage obligations.

Our mission statement is to become a premier provider of consumer banking products and to increase shareholder value through growth in our assets and earnings.

Over the last two years, we have limited the impact of the current credit problems in the mortgage markets by redirecting our asset gathering from retail online originations to wholesale purchases of whole loans and mortgage-backed securities with higher credit quality. Our online delivery channels and online advertising can be opened, closed or expanded rapidly allowing us to change product offerings faster and with less cost than many traditional banks. We believe our speed and flexibility will be a competitive advantage as we look to re-enter retail mortgage originations in the next several years as the housing market and mortgage markets become more favorable.

Our business strategy is to lower the cost of delivering banking products and services by leveraging technology, while continuing to grow our assets and deposits to achieve increased economies of scale. We have designed our automated Internet-based banking platform and workflow process to handle traditional banking functions with reduced paperwork and human intervention. Our thrift charter allows us to operate in all 50 states and our online presence allows us increased flexibility to target a large number of loan and deposit customers based on demographics, geography and price. We plan to continue to increase our deposits by attracting new customers with competitive pricing, targeted marketing and new products and services. Within the next 18 months, we plan to increase our originations of single family loans by attracting new customers through our websites. We also plan to continue to purchase pools of high quality single family and multifamily mortgage loans and mortgage-backed securities.

Our present goals are to:

- Increase our total assets to more than $3.0 billion;
- Improve our annualized efficiency ratio to a level below 30%; and
- Increase our annualized return on average common stockholder s equity above 15.0%.

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Copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports are available, free of charge, through the Securities and Exchange Commission s website at www.sec.gov and our website at www.bofiholding.com as soon as reasonably practicable after their filing with the Securities and Exchange Commission. The information contained therein or connected thereto is not incorporated into this Annual Report on Form 10-K.

Lending and Investment Activities

General. We divide our loan acquisition activities into two primary channels - retail and wholesale. Our retail channel originates loans nationwide either directly to consumer or through dealer or broker arrangements. Our wholesale channel purchases closed loans in flow or bulk from a variety of business partners. Our originations, purchases and sales of mortgage loans include both fixed and adjustable interest rate loans. Originations are sourced, underwritten, processed, controlled and tracked primarily through our customized websites and software. We believe that, due to our automated systems, our lending business is scalable, allowing us to handle increasing volumes of loans and enter into new geographic lending markets with only a small increase in personnel, in accordance with our strategy of leveraging technology to lower our operating expenses.

We purchase mortgage-backed securities when their risk-adjusted returns exceed those of our loan origination or loan purchase opportunities

Loan Products. Our loans primarily consist of first mortgage loans secured by single family and multifamily properties and, to a lesser extent, commercial properties. We also provide home equity second mortgages, primarily closed end loans and, to a lesser extent, lines of credit. Further details regarding our loan programs are discussed below:

Single Family Loans. We typically offer or purchase fixed and adjustable rate, single family mortgage loans in all 50 states, both conforming and jumbo loans, although we constantly monitor our geographic reach for risk and are currently not lending in all states. Our largest single-family first mortgage loan was $4.1 million as of June 30, 2008. We either sell the single-family first mortgage loans that we originate to wholesale lending institutions with servicing rights released to the purchaser or retain the mortgage loan in our portfolio. In more recent years, the Bank elected to significantly decrease or eliminate certain online single family loan offerings in favor of purchasing loan pool. The Bank plans to monitor the market and expand product offerings when spreads adequately compensate the Bank for the associated risk.

Home Equity Loans. We originate adjustable rate and fixed rate closed end home equity loans secured by second liens on single family residential properties. We also have originated adjustable rate home equity lines of credit. We hold all of the home equity loans that we originate and perform the loan servicing directly on these loans. Our portfolio of home equity loans as of June 30, 2008 had an average outstanding balance of $31,000 and a largest single loan amount of $215,000. We offer closed end home equity loans with fixed interest rates and adjustable rates based on U.S. Treasury security yields. Some of our home equity loans originated have initial fixed rate periods (three, five or seven years) before starting a regular adjustment period (annually), as well as interest rate floors, ceilings and rate change caps. During 2008, we increased our online home equity loan offerings.

Multifamily Loans. We originate and purchase adjustable rate multifamily mortgage loans. We either sell the loans we originate or we retain them for the portfolio and perform the loan servicing directly on these loans. Our multifamily loans as of June 30, 2008 ranged in amount from approximately $25,000 to $3.5 million and were secured by first liens on properties typically ranging from five to 70 units. We offer multifamily loans with interest rates that adjust based on a variety of industry standard indices, including U.S. Treasury security yields, LIBOR and Eleventh District Cost of Funds. Many of our loans originated and purchased typically have initial fixed rate periods (three, five or seven years) before starting a regular adjustment period (annually, semi-annually or monthly) as well as prepayment protection clauses, interest rate floors, ceilings and rate change caps.

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Commercial Real Estate Loans. We purchase and originate commercial real estate loans. We either sell the loans we originate or we retain them for the portfolio. Our commercial real estate loans as of June 30, 2008 ranged in amount from approximately $114,000 to $2.4 million, and were secured by first liens on mixed-use, shopping and retail centers, office buildings and multi-tenant industrial properties. We offer commercial real estate loans with similar terms and interest rates as our multifamily loans.

Consumer Recreational Vehicle and Automobile Loans. In March 2007, we began originating fixed rate loans secured by recreational vehicles (RVs) and sourced through a network of RV dealers in 20 states or directly with the consumer. We hold all of the RV loans that we originate and perform the loan servicing directly on these loans. Our RV loans as of June 30, 2008 ranged in amount up to approximately $491,000 with an average outstanding balance of $41,000 and were secured by motor homes or travel trailers. Over the last eight months of fiscal 2008, the Bank has elected to significantly decrease its RV loan production. The Bank also originates automobile loans on a direct basis and through a network of dealers.

Other. We provide overdraft lines of credit for our qualifying deposit customers with checking accounts and we purchase participations in business loans made by other banks.

Loan Portfolio Composition. The following table sets forth the composition of our loan portfolio in amounts and percentages by type of loan at the end of each fiscal year-end since June 30, 2004:

	At June 30,									
	2008		**2007**		**2006**		**2005**		**2004**	
	(Dollars in thousands)									
Residential real estate loans:										
Single family (one to four units)	$ 165,473	26.2%	$ 104,960	20.8%	$ 113,242	21.4%	$ 62,157	12.9%	$ 21,589	6.1%
Home equity	41,977	6.6%	18,815	3.8%	628	0.1%	246	0.1%	164	0.0%
Multifamily (five units or more)	330,778	52.2%	325,880	64.6%	402,166	75.9%	406,660	84.1%	320,971	90.6%
Commercial real estate and land loans	33,731	5.3%	11,256	2.2%	13,743	2.6%	14,181	2.9%	11,659	3.3%
Consumer Recreational vehicle	56,968	9.0%	42,327	8.4%		0.0%		0.0%		0.0%
Other	4,439	0.7%	981	0.2%	81	0.0%	40	0.0%	63	0.0%
Total loans held for investment	$ 633,366	100%	$ 504,219	100%	$ 529,860	100%	$ 483,284	100%	$ 354,446	100%
Allowance for loan losses	(2,710)		(1,450)		(1,475)		(1,415)		(1,045)	
Unamortized premiums/discounts, net of deferred loan fees	757		5,137		5,256		5,003		1,860	
Net loans held for investment	$ 631,413		$ 507,906		$ 533,641		$ 486,872		$ 355,261	

The following table sets forth the amount of loans maturing in our total loans held for investment at June 30, 2008 based on the contractual terms to maturity:

	Term to Contractual Maturity				
	Less Than Three Months	Over Three Months through One Year	Over One Year through Five Years	Over Five Years	Total
	(Dollars in thousands)				
June 30, 2008	$ 122	$	$ 7,691	$ 625,553	$ 633,366

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The following table sets forth the amount of our loans at June 30, 2008 that are due after June 30, 2009 and indicates whether they have fixed or floating or adjustable interest rate loans:

	Fixed	Floating or Adjustable	Total
	(Dollars in thousands)		
Single family (one to four units)	$ 27,126	$ 138,334	$ 165,460
Home equity	40,050	1,927	41,977
Multifamily (five units or more)	35,513	295,265	330,778
Commercial real estate and land	886	32,845	33,731
Consumer recreational vehicle	56,968		56,968
Other	4,330		4,330
Total	$ 164,873	$ 468,371	$ 633,244

Our mortgage loans are secured by properties primarily located in the western United States. The following table shows the largest states and regions ranked by location of these properties at June 30, 2008:

Percent of Loan Principal Secured by Real Estate Located in State

State	Total Real Estate Loans	Single Family	Home Equity	Multifamily	Commercial and Land
California-south [1]	30.10%	23.18%	8.66%	36.33%	29.61%
California-north [2]	14.79%	26.52%	5.93%	9.77%	17.55%
Colorado	4.19%	2.32%	2.67%	5.06%	6.73%
Washington	9.14%	10.05%	6.59%	8.67%	12.44%
Arizona	3.93%	1.21%	7.00%	5.31%	
Texas	5.18%	2.67%		7.27%	3.45%
Oregon	3.60%	1.31%	1.94%	4.64%	6.77%
Florida	5.56%	7.44%	7.48%	4.94%	
Illinois	2.78%	1.48%	4.20%	3.40%	1.20%
All other states	20.73%	23.82%	55.53%	14.61%	22.25%
	100%	100%	100%	100%	100%

[1] Consists of loans secured by real property in California with zip code ranges from 90000 to 92999.
[2] Consists of loans secured by real property in California with zip code ranges from 93000 to 96999.

The ratio of the loan amount to the value of the property securing the loan is called the loan-to-value ratio or LTV. The following table shows the LTVs of our loan portfolio on weighted average and median bases at June 30, 2008. The LTVs were calculated by dividing (a) the loan principal balance less principal repayments by (b) the appraisal value of the property securing the loan at the time of the funding or, for certain purchased seasoned loans, an adjusted appraised value based upon an independent review at the time of the purchase.

	Total Real Estate Loans	Single Family	Home Equity [1]	Multifamily	Commercial and Land

Weighted Average LTV	54.50%	59.12%	60.02%	51.64%	52.99%
Median LTV	58.09%	61.64%	62.37%	45.70%	48.65%

[1] Amounts represent combined loan to value calculated by adding the current balances of both the 1st and 2nd liens of the borrower and dividing that sum by an independent estimated value of the property at the time of origination.

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Lending Activities. The following table summarizes the volumes of real estate loans originated, purchased and sold for each fiscal year since 2004:

	For the Fiscal Years Ended June 30,				
	2008	2007	2006	2005	2004
	(Dollars in thousands)				
Loans Held for Sale:					
Single family (one to four units):					
Beginning balance	$	$	$ 189	$ 435	$ 3,602
Loan originations	516	7,579	20,762	19,312	76,550
Loans purchases					
Proceeds from sale of loans held for sale	(518)	(7,609)	(21,059)	(19,652)	(80,081)
Gains on sales of loans held for sale	2	30	108	94	364
Other					
Ending balance	$	$	$	$ 189	$ 435
Loans Held for Investment:					
Single family (one to four units):					
Beginning balance	$ 104,960	$ 113,242	$ 62,156	$ 21,588	$ 41,689
Loan originations		840	386	3,380	1,641
Loans purchases	95,667	42,258	78,778	50,623	7,855
Loans sold					
Principal repayments	(34,726)	(51,380)	(28,078)	(13,435)	(29,597)
Foreclosure and charge-off	(428)				
Ending balance	$ 165,473	$ 104,960	$ 113,242	$ 62,156	$ 21,588
Home equity:					
Beginning balance	$ 18,815	$ 628	$ 247	$ 165	$ 435
Loan originations	34,761	19,684	373		
Loans purchases					
Loans sold					
Principal repayments	(11,599)	(1,497)	8	82	(270)
Other					
Ending balance	$ 41,977	$ 18,815	$ 628	$ 247	$ 165
Multifamily (five units or more):					
Beginning balance	$ 325,880	$ 402,166	$ 406,660	$ 320,971	$ 191,426
Loan originations		2,484	6,142	36,241	57,337
Loans purchases	87,113	750	84,990	108,826	120,264
Loans sold					
Principal repayments	(82,115)	(79,520)	(95,626)	(59,378)	(48,056)
Charge-off	(100)				
Ending balance	$ 330,778	$ 325,880	$ 402,166	$ 406,660	$ 320,971
Commercial real estate and land:					
Beginning balance	$ 11,256	$ 13,743	$ 14,181	$ 11,659	$ 11,839
Loan originations	85		752	5,715	5,467
Loans purchases	24,726	500			
Loans sold					
Principal repayments	(2,336)	(2,986)	(1,190)	(3,193)	(5,647)

Other		(1)			
Ending balance	$ 33,731	$ 11,256	$ 13,743	$ 14,181	$ 11,659
Consumer Recreational vehicle and auto:					
Beginning balance	$ 42,327	$			
Loan originations	25,712	43,485			
Loans purchases					
Loans sold					
Principal repayments	(10,617)	(1,158)			
Repossession and charge-off	(454)				
Ending balance	$ 56,968	$ 42,327	$	$	$
Other:					
Beginning balance	$ 981	$ 81	$ 40	$ 63	$ 62
Loan originations	4,330	956	67	26	33
Loans purchases					
Loans sold					
Principal repayments	(866)	(57)	(26)	(49)	(33)
Charge-off	(6)	1			1
Ending balance	$ 4,439	$ 981	$ 81	$ 40	$ 63
TOTAL LOANS HELD FOR INVESTMENT	$ 633,366	$ 504,219	$ 529,860	$ 483,284	$ 354,446
Allowance for loan losses	(2,710)	(1,450)	(1,475)	(1,415)	(1,045)
Unamortized premiums, net of deferred loan fees	757	5,137	5,256	5,003	1,860
NET LOANS	$ 631,413	$ 507,906	$ 533,641	$ 486,872	$ 355,261

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The following table summarizes the amount funded, the number and the size of real estate loans and RV loans originated and purchased for each fiscal year since 2004:

	For the Fiscal Years Ended June 30,				
	2008	2007	2006	2005	2004
Type of Loan	(Dollars in thousands)				
Single family (one to four units):					
Loans originated					
Amount funded	$ 516	$ 840	$ 21,147	$ 22,692	$ 78,191
Number of loans	2	1	76	83	317
Average loan size	$ 258	$ 840	$ 278	$ 273	$ 247
Loans purchased					
Amount funded	$ 95,667	$ 42,258	$ 78,778	$ 50,623	$ 7,855
Number of loans	209	197	240	208	11
Average loan size	$ 458	$ 215	$ 328	$ 243	$ 714
Home equity:					
Loans originated					
Amount funded	$ 34,761	$ 19,684	$ 373		
Number of loans	1027	520	3		
Average loan size	$ 34	$ 38	$ 124		
Loans purchased					
Amount funded					
Number of loans					
Average loan size					
Multifamily (five or more units):					
Loans originated					
Amount funded	$	$ 2,484	$ 6,142	$ 36,241	$ 57,337
Number of loans		5	14	53	84
Average loan size	$	$ 497	$ 439	$ 684	$ 683
Loans purchased					
Amount funded	$ 87,113	$ 750	$ 84,990	$ 108,826	$ 120,264
Number of loans	81	3	199	152	116
Average loan size	$ 1,075	$ 250	$ 427	$ 716	$ 1,037
Commercial real estate and land:					
Loans originated					
Amount funded	$ 85		$ 752	$ 5,715	$ 5,467
Number of loans	1		2	7	5
Average loan size	$ 85		$ 376	$ 816	$ 1,093
Loans purchased					
Amount funded	$ 24,726	$ 500			
Number of loans	20	1			
Average loan size	$ 1,236	$ 500			
Consumer Recreational vehicle and auto:					
Loans originated					
Amount funded	$ 25,712	$ 43,485			
Number of loans	710	938			
Average loan size	$ 36	$ 46			
Loans purchased					
Amount funded					
Number of loans					
Average loan size					
Other:					
Loans originated					
Amount funded					
Number of loans					
Average loan size					

Loans purchased	
Amount funded	$ 4,330
Number of loans	39
Average loan size	$ 111

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Loan Marketing. We market our lending products directly to customers through a variety of channels depending on the product. When we market single family mortgage and home equity loans, we target Internet comparison shoppers generally in all 50 states through our purchase of advertising on search engines, such as Google and Yahoo, and popular product comparison sites, such as Bankrate.com. For home equity loans, we also buy customer leads and loan applications from major lead aggregators and from our marketing affiliates and partners with affinity agreements. Previously, we marketed multifamily loans primarily in five states through Internet search engines and through traditional origination techniques, such as direct mail marketing, personal sales efforts and limited media advertising. More recently, we have decreased our multifamily marketing, however, we expect to use these marketing techniques in the future when the residential mortgage markets stabilize. We currently market our RV loans on a direct basis and on an indirect basis through RV dealers.

Loan Originations. We originate loans through four different origination channels: online retail, online wholesale and direct and indirect.

Online Retail Loan Origination. We originate single family, home equity and multifamily mortgage loans directly online through our websites, where our customers can review interest rates and loan terms, enter their loan applications and lock in interest rates directly over the Internet. All online loan offerings are accessed though our bank website bankofinternet.com. During fiscal 2008, we added direct RV and direct auto loans. We maintain and update the rate and other information on this website. We process our first mortgage, home equity loan second mortgage, RV and auto applications through our work flow system and underwrite the loan with our personnel. Our primary website for multifamily loans is ApartmentBank.com, which is where customers can obtain loan rates and terms, prequalify loan requests, submit loan applications, communicate with loan officers and monitor loan processing in a secure, online environment. Multifamily loan applications are underwritten and processed internally by our personnel. We designed our multifamily website and underlying software to expedite the origination, processing and management of multifamily loans.

Online Broker Origination. We have developed a limited number of relationships with independent multifamily loan brokers and we manage these relationships and our wholesale loan pipeline through our Broker Advantage website. Through this password-protected website, our approved independent loan brokers can compare programs, terms and pricing on a real time basis and communicate with our staff. We expect to expand this channel in the future.

Direct Loan Origination. We believe that, particularly in multifamily and commercial mortgage lending, traditional loan originators are needed to achieve our desired origination volume. Our internal software, known as Origination Manager, allows the loan originator to have direct online access to our multifamily loan origination system and originate and manage their loan portfolios in a secure online environment from anywhere in the nation. Routine tasks are automated, such as researching loan program and pricing updates; prequalifying loans; submitting loan applications;, viewing customer applications, credit histories and other application documents and monitoring the status of loans in process. We expect to expand this channel in the future.

Indirect Loan Origination. In March 2007, we signed an agreement with a large RV dealer operating in 20 states to source RV loans on new and used RVs sold through the dealer locations. Applications are submitted via facsimile to our office location from each dealer. Dealer proposals are input into our system and reviewed for compliance with pre-established credit standards for RV borrowers. For those loans which meet our term sheet requirements, we underwrite and process loans in-house with the assistance of the finance department of the RV dealer. Our approval letters are faxed back to dealers who complete the execution of the customer contract and earn participation fees based upon final contract rates and terms executed by the borrower. During fiscal 2008 we reduced our volume of indirect RV business and we expect to continue to reduce the volume in the future.

Wholesale Loan Purchases. We purchase selected single family, multifamily and commercial real estate loans from other lenders to supplement and diversify our loan portfolio geographically. We currently purchase loans from major banks and mortgage companies. At June 30, 2008, approximately $309.2 million, or 48.8%, of our loan portfolio was acquired from other lenders who are servicing the loans on our behalf, of which 51.5% were multifamily loans and 48.5% were single family loans.

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Loan Servicing. We typically retain servicing rights for all home equity, multifamily and RV loans that we originate. We typically do not acquire servicing rights on purchased single family and multifamily loans, and we typically release-servicing rights to the purchaser when we sell single family loans that we originate.

Loan Underwriting Process and Criteria. We individually underwrite the loans that we originate and all loans that we purchase. Our loan underwriting policies and procedures are written and adopted by our board of directors and our loan committee. Each loan, regardless of how it is originated, must meet underwriting criteria set forth in our lending policies and the requirements of applicable lending regulations of the Office of Thrift Supervision (OTS).

We have designed our loan application and review process so that much of the information that is required to underwrite and evaluate a loan is created electronically during the loan application process. Therefore we can automate many of the mechanical procedures involved in preparing underwriting reports and reduce the need for human interaction, other than in the actual credit decision process. We believe that our systems will allow us to handle increasing volumes of loans with only a small increase in personnel, in accordance with our strategy of leveraging technology to lower our operating expenses.

We perform underwriting directly on all multifamily and commercial loans that we originate and purchase. We rely primarily on the cash flow from the underlying property as the expected source of repayment, but we also endeavor to obtain personal guarantees from all borrowers or substantial principals of the borrower. In evaluating multifamily and commercial loans, we review the value and condition of the underlying property, as well as the financial condition, credit history and qualifications of the borrower. In evaluating the borrower s qualifications, we consider primarily the borrower s other financial resources, experience in owning or managing similar properties and payment history with us or other financial institutions. In evaluating the underlying property, we consider primarily the net operating income of the property before debt service and depreciation, the ratio of net operating income to debt service and the ratio of the loan amount to the appraised value.

We perform underwriting directly on all home equity and RV loans that we originate. In the underwriting process we consider the borrower s credit score, credit history, documented income, existing and new debt obligations, the value of the collateral, and other internal and external factors.

Lending Limits. As a savings association, we generally are subject to the same lending limit rules applicable to national banks. With limited exceptions, the maximum amount that we may lend to any borrower, including related entities of the borrower, at one time may not exceed 15% of our unimpaired capital and surplus, plus an additional 10% of unimpaired capital and surplus for loans fully secured by readily marketable collateral. We are additionally authorized to make loans to one borrower, by order of the Director of the OTS, in an amount not to exceed the lesser of $30.0 million or 30% of our unimpaired capital and surplus for the purpose of developing residential housing, if certain specified conditions are met. See Regulation Regulation of Bank of Internet USA.

At June 30, 2008, Bank of Internet s loans-to-one-borrower limit was $12 .7 million, based upon the 15% of unimpaired capital and surplus measurement. At June 30, 2008, no single loan was larger than $4.1 million and our largest single lending relationship had an outstanding balance of $4.7 million.

Loan Quality and Credit Risk. Since inception through June 30, 2007, the end of our last fiscal year, we had no mortgage foreclosures and no loan charge-offs. During the fiscal year ended June 30, 2008, we experienced our first mortgage loan foreclosure and consumer loan charge-off during a period of major deterioration in housing values and consumer credit. We believe that our level of nonperforming loans has been and remains today relatively low. Given the significant down turn in the mortgage and consumer credit markets, we expect in the future to have additional loans that default or become nonperforming. Nonperforming assets are defined as nonperforming loans and real estate acquired by foreclosure or deed-in-lieu thereof. Generally, nonperforming loans are defined as nonaccrual loans and loans 90 days or more overdue. Troubled debt restructurings are defined as loans that we have agreed to modify by accepting below market terms either by granting interest rate concessions or by deferring principal or interest payments. Our policy with respect to nonperforming assets is to place such assets on nonaccrual status when, in the judgment of management, the probability of collection of interest is deemed to be insufficient to warrant further accrual. When a loan is placed on nonaccrual status, previously accrued but unpaid interest will be deducted from interest income. Our general policy is to not accrue interest on loans past due 90 days or more, unless the individual borrower circumstances dictate otherwise.

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See Management Discussion and Analysis Asset Quality and Allowance for Loan Loss for a history of nonperforming assets and allowance for loan loss.

Investment Portfolio. In addition to loans, we invest available funds in high grade mortgage-backed securities, investment grade fixed income securities and preferred securities of government sponsored entities. We also invest available funds in term deposits of other FDIC-insured financial institutions. Our investment policy, as established by our board of directors, is designed to maintain liquidity and generate a favorable return on investment without incurring undue interest rate risk, credit risk or portfolio asset concentration risk. Under our investment policy, we are currently authorized to invest in agency mortgage-backed obligations issued or fully guaranteed by the United States government, AAA rated non-agency mortgage-backed obligations, specific federal agency obligations, specific time deposits, negotiable certificates of deposit issued by commercial banks and other insured financial institutions, investment grade corporate debt securities and other specified investments. We also buy and sell mortgage-backed securities to facilitate liquidity and to help manage our interest rate risk.

In the last two fiscal years, we have increased our purchases of mortgage-backed securities because we believed the mortgage-backed securities provided better risk adjusted yields than certain single-family whole loan originations or whole loan pools.

The following table sets forth, at June 30, 2008, the dollar amount of our investment portfolio by type, based on the contractual terms to maturity and the weighted average yield for each range of maturities:

	Total Amount		Due within One Year		Due After One but within Five Years		Due After Five but within Ten Years		Due After Ten Years	
	Amount	Yield[1]	Amount	Yield[1]	Amount	Yield[1]	Amount	Yield[1]	Amount	Yield[1]
	(Dollars in thousands)									
Investment Securities Available-for-Sale:										
Mortgage-backed securities U.S. agency[2]	$ 198,347	5.73%	$ 1,403	5.55%	$ 6,537	5.56%	$ 17,466	5.69%	$ 172,941	5.74%
Preferred Stock -FNMA	9,072	8.19%		0.00%		0.00%		0.00%	9,072	8.19%
Total securities	$ 207,419	5.84%	$ 1,403	5.55%	$ 6,537	5.56%	$ 17,466	5.69%	$ 182,013	5.86%
Total fair value of securities	$ 209,119	5.84%	$ 1,408	5.55%	$ 6,579	5.56%	$ 17,606	5.69%	$ 183,526	5.86%
Investment Securities Held to Maturity:										
Mortgage-backed securities - U.S. agency[2]	$ 21,529	5.21%	$ 321	5.23%	$ 1,475	5.25%	$ 2,579	5.24%	$ 17,154	5.20%
Mortgage-backed securities - AAA non-U.S. agency[2]	258,328	9.14%		0.00%	17,741	9.09%	27,582	9.07%	213,005	9.15%
U.S. Government agency -debt	9,983	6.13%	485	6.13%	2,265	6.13%	3,729	6.13%	3,504	6.13%
Trust preferred collateralized debt	11,055	4.06%		0.00%		0.00%		0.00%	11,055	4.06%
Total securities	$ 300,895	8.57%	$ 806	5.77%	$ 21,481	8.51%	$ 33,890	8.46%	$ 244,718	8.60%
Total fair value of securities	$ 304,604	8.57%	$ 812	5.77%	$ 22,057	8.51%	$ 34,758	8.46%	$ 246,977	8.60%

[1] Weighted average yield is based on amortized cost of the securities.
[2] Maturities of mortgage-backed securities are determined based on contractual principal payments, assuming no prepayments.

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The following table sets forth changes in our investment portfolio for each fiscal year since 2004:

	2008	2007	2006	2005	2004
	(Dollars in thousands)				
Securities at beginning of period[1]	$ 357,970	$ 139,636	$ 70,477	$ 3,665	$ 441
Purchases	493,183	364,349	100,408	97,695	3,409
Sales	(210,618)	(74,346)		(18,667)	
Repayments, prepayments and amortization of premium	(132,661)	(71,706)	(29,764)	(12,226)	(185)
Impairment charge on FNMA preferred stock	(1,000)				
(Decrease) increase in unrealized gains/losses on available-for-sale securities[2]	3,140	37	(1,485)	10	
Securities at end of period[1]	$ 510,014	$ 357,970	$ 139,636	$ 70,477	$ 3,665

[1] Includes both available for sale and held to maturity portfolios.
[2] Through June 30, 2004, we did not have any securities designated as available-for-sale.

Deposit Products and Services

Deposit Products. We offer a full line of deposit products over the Internet to customers in all 50 states. Our deposit products consist of demand deposits (interest bearing and non-interest bearing), savings accounts and time deposits. Our customers access their funds through ATMs, debit cards, Automated Clearing House funds (electronic transfers) and checks. We also offer the following additional services in connection with our deposit accounts:

Online Bill Payment Service. Customers can pay their bills online through electronic funds transfer or a written check prepared and sent to the payee.

Online Check Imaging. Online images of cancelled checks and deposit slips are available to customers 24 hours a day. Images of cancelled checks are available real time (at the time the check clears our bank) and may be printed or stored electronically.

ATM Cards or VISA® Check Cards. Each customer may choose to receive a free ATM card or VISA® check card upon opening an account. Customers can access their accounts at ATMs and any other location worldwide that accept VISA® check cards. We do not charge a fee for ATM/VISA® usage, and we reimburse our customers up to $8 per month for fees imposed by third-party operators of ATM/VISA® locations.

Overdraft Protection. Overdraft protection, in the form of an overdraft line of credit, is available to all checking account customers who request the protection and qualify.

Electronic Statements. Statements are produced and imaged automatically each month and may be printed or stored electronically by the customer.

Deposit Marketing. We currently market to deposit customers through targeted, online marketing in all 50 states by purchasing key word advertising on Internet search engines, such as Google, and placement on product comparison sites, such as Bankrate.com. We target deposit customers based on demographics, such as age, income, geographic location and other criteria. We also pay for customer leads and applications from our marketing affiliates and partners with affinity agreements

As part of our deposit marketing strategies, we actively manage deposit interest rates offered on our websites and displayed in our advertisements. Senior management is directly involved in executing overall growth and interest rate guidance established by our asset/liability committee, or ALCO. Within these parameters, management and staff survey our competitors interest rates and evaluate consumer demand for various products and our existing deposit mix. They then establish our marketing campaigns accordingly and monitor and adjust our marketing campaigns on an ongoing basis. Within minutes, our management and staff can react to changes in deposit inflows and external events by altering interest rates reflected on our websites and in our advertising. Our external advertising cost per new account was approximately $0.80, $7.51 and $20.34 for the fiscal years 2008, 2007 and 2006, respectively.

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The number of deposit accounts at June 30, 2008 and at each of June 30, 2007, 2006, 2005 and 2004 is set forth below.

	At June 30,				
	2008	**2007**	**2006**	**2005**	**2004**
Checking and savings accounts	9,415	8,315	8,195	8,829	9,588
Time deposits	15,490	17,502	14,303	10,998	4,065
Total number of deposit accounts	24,905	25,817	22,498	19,827	13,653

Deposit Composition. The following table sets forth the dollar amount of deposits by type and weighted average interest rates at June 30, 2008 and at each of June 30, 2007, 2006, 2005 and 2004:

	At June 30,									
	2008		**2007**		**2006**		**2005**		**2004**	
	Amount	**Rate[1]**	**Amount**	**Rate[1]**	**Amount**	**Rate [1]**	**Amount**	**Rate [1]**	**Amount**	**Rate [1]**
	(Dollars in thousands)									
Noninterest-bearing	$ 5,509		$ 993		$ 1,203		$ 8,225		$ 2,279	
Interest-bearing:										
Demand	61,616	3.22%	48,575	3.52%	35,978	2.79%	33,187	1.93%	26,725	1.35%
Savings	56,202	3.38%	22,840	3.75%	28,980	3.58%	50,408	2.13%	94,120	1.96%
Time deposits:										
Under $100	268,747	4.84%	298,767	5.06%	228,204	4.52%	178,566	3.60%	88,082	3.44%
$100 or more	178,630	4.91%	176,774	5.09%	129,839	4.54%	90,665	3.54%	58,635	3.20%
Total time deposits	447,377	4.87%	475,541	5.07%	358,043	4.52%	269,231	3.58%	146,717	3.35%
Total interest-bearing	565,195	4.54%	546,956	4.88%	423,001	4.31%	352,826	3.22%	267,562	2.66%
Total deposits	$ 570,704	4.50%	$ 547,949	4.87%	$ 424,204	4.30%	$ 361,051	3.14%	$ 269,841	2.64%

[1] Based on weighted average stated interest rates at the end of the period.

The following tables set forth the average balance of each type of deposit and the average rate paid on each type of deposit for the periods indicated:

	2008			**2007**			**2006**			**2005**			**2004**	
	Average Balance	**Interest Expense**	**Avg. Rate Paid**	**Average Balance**	**Interest Expense**	**Avg. Rate Paid**	**Average Balance**	**Interest Expense**	**Avg. Rate Paid**	**Average Balance**	**Interest Expense**	**Avg. Rate Paid**	**Average Balance**	**Interest Expense**
	(Dollars in thousands)													
d	$ 48,308	$ 1,670	3.46%	$ 34,409	$ 1,066	3.10%	$ 35,693	$ 962	2.70%	$ 28,330	$ 483	1.70%	$ 29,600	$ 416
.	28,623	1,056	3.69%	25,696	960	3.74%	36,595	1,078	2.95%	76,842	1,599	2.08%	64,197	1,252
eposits	506,761	25,632	5.06%	399,855	19,541	4.89%	321,817	12,890	4.01%	205,530	6,856	3.34%	132,166	4,866
terest bearing deposits	$ 583,692	$ 28,358	4.86%	$ 459,960	$ 21,567	4.69%	$ 394,105	$ 14,930	3.79%	$ 310,702	$ 8,938	2.88%	$ 225,963	$ 6,534
eposits	$ 585,933	$ 28,358	4.84%	$ 461,024	$ 21,567	4.68%	$ 398,126	$ 14,930	3.75%	$ 315,448	$ 8,938	2.83%	$ 227,966	$ 6,534

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The following table shows the maturity dates of our certificates of deposit at June 30, 2008, 2007 and 2006:

	2008	2007	2006
	(Dollars in thousands)		
Within 12 months	$ 233,767	$ 258,404	$ 245,726
13 to 24 months	81,156	100,086	70,283
25 to 36 months	33,343	44,988	28,317
37 to 48 months	61,744	15,574	8,685
49 months and thereafter	37,367	56,489	5,032
Total	$ 447,377	$ 475,541	$ 358,043

The following table shows maturities of our time deposits having principal amounts of $100,000 or more at June 30, 2008, 2007 and 2006:

	Term to Maturity				
Time deposits with balances of $100,000 or more at June 30,	Within Three Months	Over Three Months to Six Months	Over Six Months to One Year	Over One Year	Total
	(Dollars in thousands)				
2008	$ 29,916	$ 26,919	$ 34,284	$ 87,511	$ 178,630
2007	$ 26,795	$ 20,997	$ 42,139	$ 86,843	$ 176,774
2006	$ 29,696	$ 18,624	$ 42,006	$ 39,513	$ 129,839

Borrowings

In addition to deposits, we have historically funded our asset growth through advances from the Federal Home Loan Bank (FHLB). Our bank can borrow up to 40.0% of its total assets from the FHLB, and borrowings are collateralized by mortgage loans and mortgage-backed securities pledged to the FHLB. Based on loans and securities pledged at June 30, 2008, we had a total borrowing capacity of approximately $443.9 million, of which $399.0 million was outstanding and $44.9 million was available. At June 30, 2008, we also had a $10.0 million unsecured fed funds purchase line with a major bank under which no borrowings were outstanding.

The Company has sold securities under various agreements to repurchase for total proceeds of $130.0 million. The repurchase agreements have fixed interest rates between 3.24% and 4.65% and scheduled maturities (after 5 years) between January 2012 and December 2017. Under these agreements, the Company may be required to repay the $130.0 million and repurchase its securities before the scheduled maturity if the issuer requests repayment on scheduled quarterly call dates. The weighted-average remaining contractual maturity period is 6.4 years and the weighted average remaining period before such repurchase agreements could be called is 1.2 years.

On December 16, 2004, we completed a transaction in which we formed a trust and issued $5.0 million of trust-preferred securities. The net proceeds from the offering were used to purchase approximately $5.2 million of junior subordinated debentures of our company with a stated maturity date of February 23, 2035. The debentures are the sole assets of the trust. The trust preferred securities are mandatorily redeemable upon maturity, or upon earlier redemption as provided in the indenture. We have the right to redeem the debentures in whole (but not in part) on or after specific dates, at a redemption price specified in the indenture plus any accrued but unpaid interest through the redemption date. Interest accrues at the rate of three-month LIBOR plus 2.4%, which was 5.04% at June 30, 2008, with interest to be paid quarterly starting in February 2005.

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The table below sets forth the amount of our borrowings, the maximum amount of borrowings in each category during any month-end during each reported period, the approximate average amounts outstanding during each reported period and the approximate weighted average interest rate thereon at or for the fiscal years ended June 30, 2008, 2007, 2006, 2005 and 2004:

	At of For The Fiscal Years Ended June 30,				
	2008	2007	2006	2005	2004
	(Dollars in thousands)				
Advances from the FHLB[1]:					
Average balance outstanding	$ 270,022	$ 239,742	$ 193,632	$ 122,166	$ 69,932
Maximum amount outstanding at any month-end during the period	398,966	254,216	236,177	172,562	101,446
Balance outstanding at end of period	398,966	227,292	236,177	172,562	101,446
Average interest rate at end of period	3.77%	4.39%	4.19%	3.49%	3.19%
Average interest rate during period	4.23%	4.34%	3.86%	3.45%	3.79%
Securities sold under agreements to repurchase:					
Average balance outstanding	$ 118,497	$ 30,648			
Maximum amount outstanding at any month-end during the period	130,000	90,000			
Balance outstanding at end of period	130,000	90,000			
Average interest rate at end of period	4.23%	4.39%			
Average interest rate during period	4.34%	4.41%			
Notes payable:					
Average balance outstanding				$ 2,541	$ 1,119
Maximum amount outstanding at any month-end during the period				5,000	3,060
Balance outstanding at end of period					1,300
Average interest rate at end of period					5.25%
Average interest rate during period[2]				6.19%	5.36%
Junior subordinated debentures:					
Average balance outstanding	$ 5,155	$ 5,155	$ 5,155	$ 2,782	
Maximum amount outstanding at any month-end during the period	5,155	5,155	5,155	5,155	
Balance outstanding at end of period	5,155	5,155	5,155	5,155	
Average interest rate at end of period	5.04%	7.76%	7.59%	5.68%	
Average interest rate during period	7.16%	8.01%	7.02%	5.47%	

[1] Advances from the FHLB have been reduced by debt issue costs of $74, $108 and $223 for the fiscal years ended June 30, 2008, 2007 and 2006, respectively.
[2] Rate excludes impact of write-off of $46,000 in deferred loan costs as a result of prepaying the note payable in March 2005.

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Technology

We have purchased, customized and developed software systems to provide products and services to our customers. Most of our key customer interfaces were designed by us specifically to address the needs of an Internet-only bank and its customers. Our website and CRM software drive our customer self-service model, reducing the need for human interaction while increasing our overall operating efficiencies. Our CRM software enables us to collect customer data over our websites, which is automatically uploaded into our customer databases. The databases drive our workflow processes by automatically linking to third-party processors and storing all customer contract and correspondence data, including emails, hard copy images and telephone notes. We intend to continue to improve our systems and implement new systems, with the goal of providing for increased transaction capacity without materially increasing personnel costs.

The following summarizes our current technology resources:

Core Banking Systems. We outsource substantially all of our core banking systems. The outsourcer is responsible for all of our basic core processing applications, including general ledger, loans, deposits, bill pay, ATM networks, electronic fund transfers, item processing and imaging. These outsourced services for our core banking systems are located in California, Texas and Kansas, with a backup location in Branson, Missouri. We use a variety of vendors to provide automated information for our customers, including credit, identity authentication, tax status and property appraisal.

Internet and CRM Systems. We developed software for our website interface with loan and deposit customers, including collection and initial processing of new customer information. We also developed software to manage workflow and fraud control and provide automated interfaces to our outsourced service providers. We host our primary web servers in San Diego, California, and fully control and manage these servers with a staff of technology personnel. Web servers used by our customers to access real time account data are located in Kansas, with a backup location in Texas.

Systems Architecture. Our internally developed software is based on a Microsoft development language and Intel-based hardware. Our outsourced core processing system uses IBM hardware and software. We use a variety of specialized companies to provide hardware and software for firewalls, network routers, intrusion detection, load balancing, data storage and data backup. To aid in disaster recovery, customer access to our websites is supported by a fully redundant network and our servers are mirrored so that most hardware failures or software bugs should cause no more than a few minutes of service outage. Mirroring means that our server is backed up continuously so that all data is stored in two physical locations.

Security

Because we operate almost exclusively through electronic means, we believe that we must be vigilant in detecting and preventing fraudulent transactions. We have implemented stringent computer security and internal control procedures to reduce our susceptibility to identity theft, hackers, theft and other types of fraud. We have implemented an automated approach to detecting identity theft that we believe is highly effective, and we have integrated our fraud detection processes into our CRM technology. For example, when opening new deposit accounts, our CRM programs automatically collect customers personal and computer identification from our websites, send the data to internal and third-party programs which analyze the data for potential fraud, and quickly provide operating personnel with a summary report for final assessment and decision making during the account-opening process.

We continually evaluate the systems, services and software used in our operations to ensure that they meet high standards of security. The following are among the security measures that are currently in place:

Encrypted Transactions. All banking transactions and other appropriate Internet communications are encrypted so that sensitive information is not transmitted over the Internet in a form that can be read or easily deciphered.

Secure Log-on. To protect against the possibility of unauthorized downloading of a customer s password protected files, user identification and passwords are not stored on the Internet or our web server.

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Authenticated Session Integrity. An authenticated user is any user who signs onto our website with a valid user ID and password. To protect against fraudulent bank customers, our server is programmed to alert our core processing vendor of any attempted illegitimate entry so that its staff can quickly investigate and respond to such attempts.

Physical Security. Our servers and network computers reside in secure facilities. Currently, computer operations supporting our outsourced core banking systems are based in Lenexa, Kansas with backup facilities in Houston, Texas. Only employees with proper photographic identification may enter the primary building. The computer operations are located in a secure area that can be accessed only by using a key card and further password identification. In addition, our marketing and account opening servers reside in a secure third-party location in San Diego with a mirror site at our corporate offices. These servers are on a different network separate from our outsourced core back-office processing system and maintain the same level of security services as our outsourced core processing servers in Lenexa, Kansas.

Service Continuity. Our core system outsourcer and our bank provide a fully redundant network. Our server is also mirrored. This network and server redundancy is designed to provide reliable access to our bank. However, if existing customers are not able to access their accounts over the Internet, customers retain access to their funds through paper checks, ATM cards, customer service by telephone and an automated telephone response system.

Monitoring. All customer transactions on our servers produce one or more entries into transaction logs, which we monitor for unusual or fraudulent activity. We are notified and log any attempt by an authenticated user to modify a command or request from our websites. Additionally, all financial transactions are logged, and these logs are constantly reviewed for abnormal or unusual activity.

Intellectual Property and Proprietary Rights

We register our various Internet URL addresses with service companies, and work actively with bank regulators to identify potential naming conflicts with competing financial institutions. Policing unauthorized use of proprietary information is difficult and litigation may be necessary to enforce our intellectual property rights.

We own the Internet domain names bankofinternet.com, bofi.com, apartmentbank.com, seniorbofi.com, myrvbank.com, insurancesales.com, investmentsales.com, bancodeinternet.com and many other similar names. Domain names in the United States and in foreign countries are regulated, and the laws and regulations governing the Internet are continually evolving. Additionally, the relationship between regulations governing domain names and laws protecting intellectual property rights is not entirely clear. As a result, we may in the future be unable to prevent third parties from acquiring domain names that infringe or otherwise decrease the value of our trademark and other intellectual property rights.

Employees

At June 30, 2008, we had 44 full time employees. None of our employees are represented by a labor union or subject to a collective bargaining agreement. We have not experienced any work stoppage and consider our relations with our employees to be good.

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Competition

The market for banking and financial services is intensely competitive, and we expect competition to continue to intensify in the future. We believe that competition in our market is based predominantly on price, customer service and brand recognition. Our competitors include:

- large, publicly-traded, Internet-based banks, as well as smaller Internet-based banks;
- brick and mortar banks, including those that have implemented websites to facilitate online banking; and
- traditional banking institutions such as thrifts, finance companies, credit unions and mortgage banks.

In real estate lending, we compete against traditional real estate lenders, including large and small savings banks, commercial banks, mortgage bankers and mortgage brokers. Many of our current and potential competitors have greater brand recognition, longer operating histories, larger customer bases and significantly greater financial, marketing and other resources and are capable of providing strong price and customer service competition. In order to compete profitably, we may need to reduce the rates we offer on loans and investments and increase the rates we offer on deposits, which actions may adversely affect our overall financial condition and earnings. We may not be able to compete successfully against current and future competitors.

REGULATION

General

Savings and loan holding companies and savings associations are extensively regulated under both federal and state law. This regulation is intended primarily for the protection of depositors and not for the benefit of our stockholders. The following information describes aspects of the material laws and regulations applicable to us and our subsidiary, and does not purport to be complete. The discussion is qualified in its entirety by reference to all particular applicable laws and regulations.

Legislation is introduced from time to time in the U.S. Congress that may affect the operations of our company and Bank of Internet USA. In addition, the regulations governing us and Bank of Internet USA may be amended from time to time by the OTS. Any such legislation or regulatory changes in our future could adversely affect Bank of Internet USA. No assurance can be given as to whether or in what form any such changes may occur.

Regulation of BofI Holding, Inc.

General. We are a savings and loan holding company subject to regulatory oversight by the OTS. As such, we are required to register and file reports with the OTS and are subject to regulation and examination by the OTS. In addition, the OTS has enforcement authority over us and our subsidiary, which also permits the OTS to restrict or prohibit activities that are determined to be a serious risk to Bank of Internet USA.

Activities Restrictions. Our activities, other than through Bank of Internet USA or any other SAIF-insured savings association we may hold in the future, are subject to restrictions applicable to bank holding companies. Bank holding companies are prohibited, subject to certain exceptions, from engaging in any business or activity other than a business or activity that the Federal Reserve Board has determined to be closely related to banking. The Federal Reserve Board has by regulation determined that specified activities satisfy this closely-related-to-banking standard. We currently do not engage in any activities that fall under this standard.

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Regulation of Bank of Internet USA

General. As a federally chartered, FDIC-insured savings association, Bank of Internet USA is subject to extensive regulation by the OTS and the FDIC. Lending activities and other investments of Bank of Internet USA must comply with various statutory and regulatory requirements. Bank of Internet USA is also subject to reserve requirements promulgated by the Federal Reserve Board. The OTS, together with the FDIC, regularly examines Bank of Internet USA and prepares reports for Bank of Internet USA s board of directors on any deficiencies found in the operations of Bank of Internet USA. The relationship between Bank of Internet USA and depositors and borrowers is also regulated by federal and state laws, especially in such matters as the ownership of savings accounts and the form and content of mortgage documents utilized by Bank of Internet USA.

Bank of Internet USA must file reports with the OTS and the FDIC concerning its activities and financial condition, in addition to obtaining regulatory approvals prior to entering into specified transactions such as mergers with or acquisitions of other financial institutions, raising capital or issuing trust preferred securities. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the SAIF and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulations, whether by the OTS, the FDIC or the Congress, could have a material adverse effect on us, Bank of Internet USA and our operations.

Insurance of Deposit Accounts. In February 2006, the Budget Reconciliation Bill (S. 1932) was enacted by the U.S. Congress. The legislation provides for legislative reforms to modernize the federal deposit insurance system. Among other things, provisions in the legislation and subsequent implementing regulations merged the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) into the new Deposit Insurance Fund (DIF) effective March 31, 2006; indexed the $100,000 deposit insurance limit to inflation beginning in 2010 and every succeeding five years while giving the FDIC and the National Credit Union Administration (NCUA) boards authority to determine whether raising the standard maximum deposit insurance is warranted; increased the deposit insurance limit for certain retirement accounts to $250,000 and indexed that limit to inflation; established a general range of 1.15 percent to 1.50 percent within which the FDIC Board of Directors may set the DIF reserve ratio; required certain actions by the FDIC if the reserve ratio varies within this range; and allowed the FDIC Board to set assessments for deposit insurance according to risk for all insured institutions. The legislation granted a one-time initial assessment credit to recognize institutions past contributions to the insurance fund.

The FDIC charges an annual assessment for the insurance of deposits based on the risk a particular institution poses to its deposit insurance fund. This risk classification is based on an institution s capital group and supervisory subgroup assignment. The FDIC may terminate insurance of deposits upon a finding that Bank of Internet USA has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or the OTS.

Regulatory Capital Requirements and Prompt Corrective Action. The prompt corrective action regulation of the OTS requires mandatory actions and authorizes other discretionary actions to be taken by the OTS against a savings association that falls within undercapitalized capital categories specified in the regulation.

Under the regulation, an institution is well capitalized if it has a total risk-based capital ratio of at least 10.0%, a Tier 1 risk-based capital ratio of at least 6.0% and a leverage ratio of at least 5.0%, with no written agreement, order, capital directive, prompt corrective action directive or other individual requirement by the OTS to maintain a specific capital measure. An institution is adequately capitalized if it has a total risk-based capital ratio of at least 8.0%, a Tier 1 risk-based capital ratio of at least 4.0% and a leverage ratio of at least 4.0% (or 3.0% if it has a composite rating of 1 and is not experiencing or anticipating significant growth). The regulation also establishes three categories for institutions with lower ratios: undercapitalized, significantly undercapitalized and critically undercapitalized. At June 30, 2008, Bank of Internet USA met the capital requirements of a well capitalized institution under applicable OTS regulations.

In general, the prompt corrective action regulation prohibits an insured depository institution from declaring any dividends, making any other capital distribution, or paying a management fee to a controlling person if, following the distribution or payment, the institution would be within any of the three undercapitalized categories. In addition, adequately capitalized institutions may accept brokered deposits only with a waiver from the FDIC, but are subject to restrictions on the interest rates that can be paid on such deposits. Undercapitalized institutions may not accept, renew or roll-over brokered deposits.

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If the OTS determines that an institution is in an unsafe or unsound condition, or if the institution is deemed to be engaging in an unsafe and unsound practice, the OTS may, if the institution is well capitalized, reclassify it as adequately capitalized; if the institution is adequately capitalized but not well capitalized, require it to comply with restrictions applicable to undercapitalized institutions; and, if the institution is undercapitalized, require it to comply with restrictions applicable to significantly undercapitalized institutions. Finally, pursuant to an interagency agreement, the FDIC can examine any institution that has a substandard regulatory examination score or is considered undercapitalized without the express permission of the institution s primary regulator.

OTS capital regulations also require savings associations to meet three additional capital standards:

- tangible capital equal to at least 1.5% of total adjusted assets;
- leverage capital (core capital) equal to 4.0% of total adjusted assets; and
- risk-based capital equal to 8.0% of total risk-weighted assets.

These capital requirements are viewed as minimum standards by the OTS, and most institutions are expected to maintain capital levels well above the minimum. In addition, the OTS regulations provide that minimum capital levels greater than those provided in the regulations may be established by the OTS for individual savings associations upon a determination that the savings association s capital is or may become inadequate in view of its circumstances. Bank of Internet USA is not subject to any such individual minimum regulatory capital requirement and our regulatory capital exceeded all minimum regulatory capital requirements as of June 30, 2008. See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

Loans-to-One-Borrower Limitations. Savings associations generally are subject to the lending limits applicable to national banks. With limited exceptions, the maximum amount that a savings association or a national bank may lend to any borrower, including related entities of the borrower, at one time may not exceed 15% of the unimpaired capital and surplus of the institution, plus an additional 10% of unimpaired capital and surplus for loans fully secured by readily marketable collateral. Savings associations are additionally authorized to make loans to one borrower by order of the Director of the OTS, in an amount not to exceed the lesser of $30.0 million or 30% of unimpaired capital and surplus for the purpose of developing residential housing, if the following specified conditions are met:

- the purchase price of each single family dwelling in the development does not exceed $500,000;
- the savings association is in compliance with its fully phased-in capital requirements;
- the loans comply with applicable loan-to-value requirements; and
- the aggregate amount of loans made under this authority does not exceed 150% of unimpaired capital and surplus.

Qualified Thrift Lender Test. Savings associations must meet a qualified thrift lender, or QTL, test. This test may be met either by maintaining a specified level of portfolio assets in qualified thrift investments as specified by the HOLA, or by meeting the definition of a domestic building and loan association under the Internal Revenue Code of 1986, as amended, or the Code. Qualified thrift investments are primarily residential mortgage loans and related investments, including mortgage related securities. Portfolio assets generally mean total assets less specified liquid assets, goodwill and other intangible assets and the value of property used in the conduct of Bank of Internet USA s business. The required percentage of qualified thrift investments under the HOLA is 65% of portfolio. An association must be in compliance with the QTL test or the definition of domestic building and loan association on a monthly basis in nine out of every 12 months. Associations that fail to meet the QTL test will generally be prohibited from engaging in any activity not permitted for both a national bank and a savings association. At June 30, 2008, Bank of Internet USA was in compliance with its QTL requirement and met the definition of a domestic building and loan association.

Liquidity Standard. Savings associations are required to maintain sufficient liquidity to ensure safe and sound operations.

Affiliate Transactions. Transactions between a savings association and its affiliates are quantitatively and qualitatively restricted pursuant to OTS regulations. Affiliates of a savings association include, among other entities, the savings association s holding company and companies that are under common control with the savings association. In general, a savings association or its subsidiaries are limited in their ability to engage in covered transactions with affiliates. In addition, a savings association and its subsidiaries may engage in certain covered transactions and other specified transactions with affiliates only on terms and under circumstances that are substantially the same, or at least as favorable to the savings association or its subsidiary, as those prevailing at the time for comparable transactions with nonaffiliated companies.

The OTS regulations generally exclude all non-bank and non-savings association subsidiaries of savings associations from treatment as affiliates, except to the extent that the OTS or the Federal Reserve Board decides to treat these subsidiaries as affiliates. The regulations also require savings associations to make and retain records that reflect affiliate transactions in reasonable detail and provide that specified classes of savings associations may be required to give the OTS prior notice of affiliate transactions.

Capital Distribution Limitations. OTS regulations impose limitations upon all capital distributions by savings associations, like cash dividends, payments to repurchase or otherwise acquire its shares, payments to stockholders of another institution in a cash-out merger and other distributions charged against capital. Under these regulations, a savings association may, in circumstances described in those regulations:

- be required to file an application and await approval from the OTS before it makes a capital distribution;
- be required to file a notice 30 days before the capital distribution; or
- be permitted to make the capital distribution without notice or application to the OTS.

Community Reinvestment Act and the Fair Lending Laws. Savings associations have a responsibility under the Community Reinvestment Act and related regulations of the OTS to help meet the credit needs of their communities, including low- and moderate-income neighborhoods. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. An institution s failure to comply with the provisions of the Community Reinvestment Act could, at a minimum, result in regulatory restrictions on its activities and the denial of applications. In addition, an institution s failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in the OTS, other federal regulatory agencies or the Department of Justice taking enforcement actions against the institution.

Federal Home Loan Bank System. Bank of Internet USA is a member of the FHLB system. Among other benefits, each FHLB serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the board of directors of the individual FHLB. As an FHLB member, Bank of Internet USA is required to own capital stock in an FHLB in specified amounts based on either its aggregate outstanding principal amount of its residential mortgage loans, home purchase contracts and similar obligations at the beginning of each calendar year or its outstanding advances from the FHLB.

Federal Reserve System. The Federal Reserve Board requires all depository institutions to maintain noninterest-bearing reserves at specified levels against their transaction accounts (primarily checking, NOW, and Super NOW checking accounts) and nonpersonal time deposits. At June 30, 2008, Bank of Internet USA was in compliance with these requirements.

Activities of Subsidiaries. A savings association seeking to establish a new subsidiary, acquire control of an existing company or conduct a new activity through a subsidiary must provide 30 days prior notice to the FDIC and the OTS and conduct any activities of the subsidiary in compliance with regulations and orders of the OTS. The OTS has the power to require a savings association to divest any subsidiary or terminate any activity conducted by a subsidiary that the OTS determines to pose a serious threat to the financial safety, soundness or stability of the savings association or to be otherwise inconsistent with sound banking practices.

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Item 1A. Risk Factors

See Management Discussion and Analysis of Financial Condition and Results of Operations - Factors that May Affect Our Performance.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our principal executive offices, which also serve as our bank s main office and branch, are located at 12777 High Bluff Drive, Suite 100, San Diego, California 92130, and our telephone number is (858) 350-6200. This facility occupies a total of approximately 12,300 square feet under a lease that expires in October 31, 2012.

Item 3. Legal Proceedings

We may from time to time become a party to legal proceedings arising in the ordinary course of our business. We are not currently a party to any material legal proceedings, lawsuit or claim.

Item 4. Submission of Matters to a Vote of Security Holders

None.

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PART II

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

Our common stock began trading on the NASDAQ National Market on March 15, 2005 under the symbol BOFI. There were 8,299,563 shares of common stock outstanding held by approximately 115 registered owners as of August 31, 2008. The following table sets forth, for the calendar quarters indicated, the range of high and low sales prices for the common stock of BofI Holding, Inc. for each quarter during the last two fiscal years. Sales prices represent actual sales of which our management has knowledge. The transfer agent and registrar of our common stock is Computershare.

	BofI Holding, Inc. Common Stock	
	High	**Low**
Quarter ended:		
June 30, 2006	$ 8.23	$ 7.24
September 30, 2006	$ 7.88	$ 6.20
December 31, 2006	$ 7.05	$ 6.09
March 31, 2007	$ 8.00	$ 6.80
June 30, 2007	$ 7.67	$ 6.95
September 30, 2007	$ 7.75	$ 7.06
December 31, 2007	$ 7.24	$ 7.00
March 31, 2008	$ 7.15	$ 5.50
June 30, 2008	$ 8.04	$ 5.57

Dividends

Our board of directors has never declared or paid any cash dividends on our common stock and does not expect to do so for the foreseeable future.

The holders of record of our Series A preferred stock, which was issued in 2003 and 2004, are entitled to receive dividends at the rate of six percent (6%) of the stated value per share of $10,000 per share per year. The holders of record of our Series B preferred stock, which were issued in June, July and August of 2008, are entitled to receive dividends at the rate of eight percent (8%) of the stated value per share of $1,000 per share per year. Dividends on the Series A and Series B preferred stock accrue and are payable quarterly. Dividends on the preferred stock must be paid prior and in preference to any declaration or payment of any distribution on any outstanding shares of junior stock, including our common stock.

Other than dividends to be paid on our preferred stock, we currently intend to retain any earnings to finance the growth and development of our business. Our ability to pay dividends, should our board of directors elect to do so, depends largely upon the ability of our bank to declare and pay dividends to us as our principal source of revenue is dividends paid to us by our bank. Future dividends will depend primarily upon our earnings, financial condition and need for funds, as well as government policies and regulations applicable to us and our bank that limit the amount that may be paid as dividends without prior approval.

Issuer Purchases of Equity Securities

Stock Repurchases

On June 30, 2005, our board of directors approved a common stock buyback program to purchase up to 5% of BofI outstanding common shares when and if the opportunity arises. The buyback program became effective on August 23, 2005 with no termination date. The program authorizes BofI to buy back common stock at its discretion, subject to market conditions. During the fiscal year starting July 1, 2007 through June 30, 2008, the Company did not buy back any of its common shares under this program. Prior to July 1, 2007, a total of 319,500 shares of BofI were purchased under the June 2005 buyback program.

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Net Settlement of Restricted Stock Awards

Effective November 2007, the stockholders of the Company approved an amendment to the 2004 Stock Incentive Plan, which among other changes, permitted net settlement of restricted stock awards for purposes of payment of a grantee s income tax obligation. During the fiscal year ended June 30, 2008, there were 8,777 restricted stock award shares which were retained by the Company and converted to cash at the rate of $7.39 per share to fund the grantee s income tax obligations.

Sale of Unregistered Securities

In June 2008 the Company commenced a private offering of a newly created series of its preferred stock designated Series B 8% Cumulative Convertible Nonparticipating Perpetual Preferred Stock (the Series B preferred stock). The Series B preferred stock has a liquidation preference of $1,000 per share over shares of common stock. In the event of liquidation, the Series B preferred stock ranks *pari* passu with the Series A. The Series B preferred stock is entitled to cumulative dividends at a rate of 8.0% per annum when and as declared by the Company s board of directors quarterly in arrears on January 15, April 15, July 15 and October 15 of each year. Each share of Series B preferred stock is immediately convertible at the option of the holder into 111 shares of the Company s common stock, par value $0.01 per share common stock, which is equivalent to a conversion price of $9.00 per share of common stock. Under certain circumstances specified in the certificate of designation governing the Series B preferred stock, the Company may require holders of Series B preferred stock to convert their shares into common stock. Generally, the Series B preferred stock has no voting rights and may be redeemed by the Company at a 5% premium starting in June of 2011, a 3% premium starting in June 2012 or a 2% premium anytime after June 2013.

During the year ended June 30, 2008, the Company issued $3,750,000 of Series B preferred stock representing 3,750 shares at a $1,000 face value. The Company declared dividends to holders of its Series B preferred stock totaling $3, for the year ended June 30, 2008. Subsequent to June 30, 2008, the Company issued another $1,040,000 of Series B preferred stock representing 1,040 shares. The net proceeds of the offering will be used for general corporate purposes, including additional capital funding to support asset growth at the Bank.

Equity Compensation Plan Information

The following table provides information regarding the aggregate number of securities to be issued under all of our stock options and equity-based plans upon exercise of outstanding options, warrants and other rights and their weighted-average exercise prices as of June 30, 2008. There were no securities issued under equity compensation plans not approved by security holders.

Plan category	Number of securities to be issued upon exercise of outstanding options and units granted	Weighted-average exercise price of outstanding options and units granted	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflecting in column (a))
Equity compensation plans approved by security holders	1,016,747	$ 7.08	814,723
Equity compensation plans not approved by security holders			N/A
Total	1,016,747	$ 7.08	814,723

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Item 6. Selected Financial Data

The following selected consolidated financial information should be read in conjunction with Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations and the audited consolidated financial statements and footnotes included elsewhere in this Form 10-K.

	At or for the Fiscal Years Ended June 30,				
	2008	2007	2006	2005	2004
	(Dollars in thousands, except per share amounts)				
Selected Balance Sheet Data:					
Total assets	$ 1,194,245	$ 947,163	$ 737,835	$ 609,508	$ 405,039
Loans, net of allowance for loan losses	631,413	507,906	533,641	486,872	355,261
Loans held for sale				189	435
Allowance for loan losses	2,710	1,450	1,475	1,415	1,045
Investment securities available for sale	209,119	296,068	127,261	62,766	
Investment securities held to maturity	300,895	61,902	12,375	7,711	3,665
Total deposits	570,704	547,949	424,204	361,051	269,841
Securities sold under agreements to repurchase	130,000	90,000			
Advances from the FHLB	398,966	227,292	236,177	172,562	101,446
Note payable					1,300
Junior subordinated debentures	5,155	5,155	5,155	5,155	
Total stockholders equity	83,082	72,750	70,246	68,650	31,759
Selected Income Statement Data:					
Interest and dividend income	$ 63,301	$ 44,586	$ 32,713	$ 22,481	$ 15,772
Interest expense	45,281	33,738	22,758	13,512	9,242
Net interest income	18,020	10,848	9,955	8,969	6,530
Provision (benefit) for loan losses	2,226	(25)	60	370	255
Net interest income after provision for loan losses	15,794	10,873	9,895	8,599	6,275
Noninterest income	1,379	1,180	1,342	907	1,190
Noninterest expense	10,162	6,450	5,789	4,745	3,819
Income before income tax expense (benefit)	7,011	5,603	5,448	4,761	3,646
Income tax expense (benefit)	2,815	2,284	2,182	1,892	1,471
Net income	$ 4,196	$ 3,319	$ 3,266	$ 2,869	$ 2,175
Net income attributable to common stock	$ 3,884	$ 3,007	$ 2,906	$ 2,464	$ 2,035
Per Share Data:					
Net income:					
Basic	$ 0.47	$ 0.36	$ 0.35	$ 0.43	$ 0.45
Diluted	$ 0.46	$ 0.36	$ 0.34	$ 0.40	$ 0.39
Book value per common share	$ 8.95	$ 8.19	$ 7.77	$ 7.47	$ 5.57
Tangible book value per common share	$ 8.95	$ 8.19	$ 7.77	$ 7.47	$ 5.57
Weighted average number of common shares outstanding:					
Basic	8,261,100	8,283,098	8,340,973	5,696,984	4,502,284
Diluted	8,375,550	8,405,215	8,516,278	6,190,312	5,160,482
Common shares outstanding at end of period	8,299,563	8,267,590	8,380,725	8,299,823	4,506,524
Performance Ratios and Other Data:					
Loan originations for investment	$ 64,888	$ 67,449	$ 7,720	$ 45,362	$ 64,478
Loan originations for sale	516	7,579	20,762	19,312	76,550

Loan purchases	205,067	44,976	165,906	163,384	129,193
Return on average assets	0.40%	0.41%	0.49%	0.59%	0.67%
Return on average common stockholders equity	5.41%	4.50%	4.56%	6.73%	8.42%
Interest rate spread [1]	1.40%	0.98%	1.12%	1.61%	1.81%
Net interest margin [2]	1.72%	1.36%	1.51%	1.87%	2.04%
Efficiency ratio [3]	52.4%	53.6%	51.24%	48.05%	49.47%
Capital Ratios:					
Equity to assets at end of period	6.96%	7.68%	9.52%	11.26%	7.84%
Tier 1 leverage (core) capital to adjusted tangible assets [4]	7.09%	7.90%	8.91%	9.02%	7.84%
Tier 1 risk-based capital ratio [4]	13.95%	14.76%	15.25%	14.08%	11.11%
Total risk-based capital ratio [4]	14.40%	15.05%	15.59%	14.45%	11.48%
Tangible capital to tangible assets [4]	7.09%	7.90%	8.91%	9.02%	7.84%
Asset Quality Ratios:					
Net charge-offs to average loans outstanding	0.18%				
Nonperforming loans to total loans	0.66%	0.05%			
Allowance for loan losses to total loans held for investment at end of period	0.43%	0.28%	0.28%	0.29%	0.29%
Allowance for loan losses to nonperforming loans	65.29%	541.04%			

[1] Interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average rate paid on interest-bearing liabilities.

[2] Net interest margin represents net interest income as a percentage of average interest-earning assets.

[3] Efficiency ratio represents noninterest expense as a percentage of the aggregate of net interest income and noninterest income.

[4] Reflects regulatory capital ratios of Bank of Internet USA only.

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

The following discussion and analysis contains forward-looking statements that are based upon current expectations. Forward-looking statements involve risks and uncertainties. Our actual results and the timing of events could differ materially from those anticipated in our forward-looking statements due to various important factors, including those set forth under Factors the May Affect Our Performance and elsewhere in this Form 10-K. The following discussion and analysis should be read together with the Selected Financial Data and our consolidated financial statements, including the related notes, included elsewhere in this Form 10-K.

Overview

Our company, BofI Holding, Inc., is the holding company for Bank of Internet USA, a consumer-focused, nationwide savings bank operating primarily over the Internet. We generate retail deposits in all 50 states and originate loans for our customers directly through our websites, including www.bankofinternet.com, www.bofi.com and www.apartmentbank.com. We are a unitary savings and loan holding company and, along with Bank of Internet USA, are subject to primary federal regulation by the OTS.

Net income for the fiscal year ended June 30, 2008 was $4.2 million, or $0.46 per diluted share, as compared to $3.3 million, or $0.36 per diluted share, in fiscal 2007 and $3.3 million, or $0.34 per diluted share, in 2006. Growth in our interest earning assets, particularly our loans and investment securities, has been the primary driver of the increase in net income. Higher interest earning assets caused net interest income (interest income from loans and investments minus interest expense from deposits and borrowings) to grow to $18.0 million for the fiscal year ended June 30, 2008 compared to $10.8 million for fiscal 2007 and $10.0 million for 2006.

During the year ended June 30, 2008, our net interest margin (net interest income divided by average interest earning assets) increased 36 basis points to 1.72% compared to 1.36% for the year ended June 30, 2007. The improvement in our net interest margin was due primarily to increases in the yields of our loans and securities. During fiscal 2008 we purchased higher yielding loans and mortgage-backed securities. We also sold lower yielding agency mortgage-backed securities and replaced them with higher yielding non-agency securities.

Total assets at June 30, 2008 were $1,194.2 million as compared to $947.2 million at June 30, 2007 and $737.8 million at June 30, 2006. Assets grew $247.0 million or 26.1% during the last fiscal year primarily due to the purchase of mortgage-backed securities and mortgage loan pools, and the origination of RV and home equity loans. These investments were funded with growth in deposits, advances from the FHLB, and borrowings from securities sold under agreements to repurchase. Total assets grew $209.4 million or 28.4% in fiscal 2007 due to the purchase of mortgage-backed securities and the origination and purchase of mortgage loans, and total assets grew $128.3 million or 21.1% in fiscal 2006 from the previous year as a result of the purchase of mortgage-backed securities

On September 7, 2008, the U.S. Treasury, the Federal Reserve and the Federal Housing Finance Agency (FHFA) announced that the FHFA was putting Fannie Mae and Freddie Mac under conservatorship and giving management control to their regulator, the FHFA. The U.S. Treasury also announced that dividends on Fannie Mae and Freddie Mac common and preferred stock were eliminated. Based upon the government announcement, we sold our investment in Fannie Mae Preferred stock on September 8, 2008 at a significant loss. The book value of our Fannie Mae preferred stock investment was $9.1 million at June 30, 2008 and the loss realized after the sale in the first quarter of fiscal 2009 was $7.9 million pretax or approximately $4.7 million after tax.

Our future performance will also depend on many factors, including changes in interest rates, competition for deposits and quality loans, the credit performance of our assets, regulatory actions and our ability to improve operating efficiencies. (See Factors that May Affect our Performance).

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Critical Accounting Policies

The following discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements and the notes thereto, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make a number of estimates and assumptions that affect the reported amounts and disclosures in the consolidated financial statements. On an ongoing basis, we evaluate our estimates and assumptions based upon historical experience and various factors and circumstances. We believe that our estimates and assumptions are reasonable under the circumstances. However, actual results may differ significantly from these estimates and assumptions that could have a material effect on the carrying value of assets and liabilities at the balance sheet dates and our results of operations for the reporting periods.

Investment Securities Currently, we classify investment securities as either available-for-sale or held to maturity. Securities available for sale are reported at estimated fair value, with unrealized gains and losses, net of the related tax effects, excluded from operations and reported as a separate component of accumulated other comprehensive income or loss. The fair value of securities traded in active markets are obtained from market quotes. If quoted prices in active markets are not available, we determine the fair value from our internal pricing models. Securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Amortization of purchase premiums and accretion of discounts on securities are recorded as yield adjustments on such securities using the effective interest method. The specific identification method is used for purposes of determining cost in computing realized gains and losses on investment securities sold.

At each reporting date, we monitor our available-for-sale and held to maturity securities for other-than-temporary impairment. Other-than-temporary impairment losses are recognized in noninterest income with a corresponding reduction in the carrying value of the investment.

Allowance for Loan Losses The allowance for loan losses is maintained at a level estimated to provide for probable losses in the loan portfolio. Management determines the adequacy of the allowance based on reviews of individual loans and pools of loans, recent loss experience, current economic conditions, the risk characteristics of the various categories of loans and other pertinent factors. This evaluation is inherently subjective and requires estimates that are susceptible to significant revision as more information becomes available. The allowance is increased by the provision for loan losses, which is charged against current period operating results and recoveries of loans previously charged-off. The allowance is decreased by the amount of charge-offs of loans deemed uncollectible.

Under the allowance for loan loss policy, impairment calculations are determined based on general portfolio data for general reserves and loan level data for specific reserves. Specific loans are evaluated for impairment and are generally classified as nonperforming or in foreclosure when they are 90 days or more delinquent. A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan s effective interest rate or the fair value of the collateral if repayment of the loan is expected primarily from the sale of collateral.

General loan loss reserves are calculated by grouping each loan by collateral type and by grouping the loan-to-value ratios of each loan within the collateral type. An estimated allowance rate for each loan-to-value group within each type of loan is multiplied by the total principal amount in the group to calculate the required general reserve attributable to that group. Management uses an allowance rate that provides a larger loss allowance for loans with greater loan-to-value ratios. Specific reserves are calculated when an internal asset review of a loan identifies a significant adverse change in the financial position of the borrower or the value of the collateral. The specific reserve is based on discounted cash flows, observable market prices or the estimated value of underlying collateral.

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Average Balances, Net Interest Income, Yields Earned and Rates Paid

The following tables set forth, for the periods indicated, information regarding (i) average balances; (ii) the total amount of interest income from interest-earning assets and the weighted average yields on such assets; (iii) the total amount of interest expense on interest-bearing liabilities and the weighted average rates paid on such liabilities; (iv) net interest income; (v) interest rate spread; and (vi) net interest margin.

	For the Fiscal Years Ended June 30,								
	2008			2007			2006		
	Average Balance[1]	Interest Income/ Expense	Average Yields Earned/ Rates Paid	Average Balance[1]	Interest Income/ Expense	Average Yields Earned/ Rates Paid	Average Balance[1]	Interest Income/ Expense	Average Yields Earned/ Rates Paid
	(Dollars in thousands)								
Assets:									
Loans [2] [3]	$ 550,307	$ 33,499	6.09%	$ 512,599	$ 29,370	5.73%	$ 533,522	$ 27,629	5.18%
Federal funds sold	23,147	1,013	4.38%	11,755	614	5.22%	7,129	310	4.35%
Interest-earning deposits in other financial institutions	7,821	457	5.84%	14,333	791	5.52%	14,947	666	4.46%
Mortgage-backed and other investment securities [4]	451,846	27,524	6.09%	249,128	13,164	5.28%	94,297	3,642	3.86%
Stock of the FHLB, at cost	14,205	808	5.69%	12,084	647	5.35%	9,675	466	4.82%
Total interest-earning assets	1,047,326	63,301	6.04%	799,899	44,586	5.57%	659,570	32,713	4.96%
Noninterest-earning assets	14,681			11,738			9,493		
Total assets	$ 1,062,007			$ 811,637			$ 669,063		
Liabilities and Stockholders Equity:									
Interest-bearing demand and savings	$ 76,028	$ 2,726	3.59%	$ 60,007	$ 2,025	3.37%	$ 72,288	$ 2,040	2.82%
Time deposits	506,761	25,632	5.06%	399,855	19,542	4.89%	321,817	12,890	4.01%
Securities sold under agreements to repurchase	118,497	5,137	4.34%	30,648	1,352	4.41%			
Advances from the FHLB	270,022	11,417	4.23%	239,742	10,406	4.34%	193,632	7,466	3.86%
Other borrowings	5,155	369	7.16%	5,155	413	8.01%	5,155	362	7.02%
Total interest-bearing liabilities	976,463	45,281	4.64%	735,407	33,738	4.59%	592,892	22,758	3.84%
Noninterest-bearing demand deposits	3,144			1,052			4,021		
Other noninterest-bearing liabilities	5,553			3,219			2,500		
Stockholders equity	76,847			71,959			69,650		

Total liabilities and stockholders equity	$ 1,062,007	$ 811,637	$ 669,063
Net interest income	$ 18,020	$ 10,848	$ 9,955
Interest rate spread [5]	1.40%	0.98%	1.12%
Net interest margin [6]	1.72%	1.36%	1.51%

[1] Average balances are obtained from daily data.
[2] Loans include loans held for sale, loan premiums and unearned fees.
[3] Interest income includes reductions for amortization of loan and investment securities premiums and earnings from accretion of discounts and loan fees. Loan fee income is not significant.
[4] All investments are taxable.
[5] Interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average rate paid on interest-bearing liabilities.
[6] Net interest margin represents net interest income as a percentage of average interest-earning assets.

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Results of Operations

Our results of operations depend on our net interest income, which is the difference between interest income on interest-earning assets and interest expense on interest-bearing liabilities. Our net interest income has grown primarily as a result of the growth in our assets. We also earn non-interest income primarily from prepayment fee income from multifamily borrowers who repay their loans before maturity and from gains on sales of investment securities. The largest component of non-interest expense is salary and benefits, which is a function of the number of personnel, which increased from 25 full time employees at June 30, 2006 to 44 full time equivalent employees at June 30, 2008. We are subject to federal and state income taxes, and our effective tax rates were 40.15%, 40.8%, and 40.0% for the fiscal years ended June 30, 2008, 2007, and 2006, respectively. Other factors that affect our results of operations include expenses relating to occupancy, data processing and other miscellaneous expenses.

Comparison of the Year Ended June 30, 2008 and 2007

Net Interest Income. Net interest income totaled $18.0 million for the fiscal year ended June 30, 2008 compared to $10.8 million for the fiscal year ended June 30, 2007. The following table sets forth the effects of changing rates and volumes on our net interest income. Information is provided with respect to (i) effects on interest income and interest expense attributable to changes in volume (changes in volume multiplied by prior rate); (ii) effects on interest income and interest expense attributable to changes in rate (changes in rate multiplied by prior volume); and (iii) changes in rate/volume (change in rate multiplied by change in volume) for the fiscal year ended June 30, 2008 compared to the fiscal year ended June 30, 2007.

	Fiscal Year Ended June 30, 2008 vs. 2007 Increase (Decrease) Due to			
	Volume	Rate	Rate/Volume	Total Increase (Decrease)
	(Dollars in thousands)			
Increase/(decrease) in interest income:				
Loans	$ 2,161	$ 1,845	$ 123	$ 4,129
Federal funds sold	595	(99)	(97)	399
Interest-earning deposits in other financial institutions	(359)	46	(21)	(334)
Mortgage-backed and other investment securities	10,704	2,018	1,638	14,360
Stock of the FHLB, at cost	113	41	7	161
	$ 13,214	$ 3,851	$ 1,650	$ 18,715
Increase/(decrease) in interest expense:				
Interest-bearing demand and savings	$ 540	$ 132	$ 29	$ 701
Time deposits	5,228	680	182	6,090
Securities sold under agreements to repurchase	3,874	(21)	(68)	3,785
Advances from the FHLB	1,314	(264)	(39)	1,011
Other borrowings		(44)		(44)
	$ 10,956	$ 483	$ 104	$ 11,543

Interest Income. Interest income for the year ended June 30, 2008 totaled $63.3 million, an increase of $18.7 million, or 41.9%, compared to $44.6 million in interest income for the year ended June 30, 2007 primarily due to interest-earning asset growth. Average interest-earning assets for the year ended June 30, 2008 increased by $247.4 million compared to the year ended June 30, 2007 due to the purchase of mortgage-backed and investment securities which increased $202.7 million during the year ended June 30, 2008 compared to 2007. Also increasing by $37.7 million was the average balance of the loan portfolio, primarily the result of our purchase of pools of multifamily and single family loans and the originations of RV and home equity loans. Average interest earning balances associated with our stock of the FHLB increased by $2.1 million in the year ended June 30, 2008 compared to the year ended June 30, 2007 because our required minimum investment increased, in line with our increased advances from the FHLB. For the year ended June 30, 2008, the growth in average balances contributed additional interest income of $13.2 million, and the average rate increase resulted in a net $3.9 million increase in interest income. The average yield earned on our interest-earning assets increased to 6.04%

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for the year ended June 30, 2008, up from 5.57% for the same period in 2007 due primarily to the higher yields on our loan portfolio and our mortgage-backed securities portfolio.

Interest Expense. Interest expense totaled $45.3 million for the year ended June 30, 2008; an increase of $11.6 million, compared to $33.7 million in interest expense during the year ended June 30, 2007. Average interest-bearing balances for the year ended June 30, 2008 increased $241.1 million compared to the same period in 2007, due to higher deposit totals from increased customer accounts and additional borrowings from the FHLB. The average interest-bearing balances of advances from the FHLB increased $30.3 million as primarily short term advances were added to replace time deposits. Our addition of short-term fixed rate borrowings is a part of our strategy to manage our interest rate risk. For the year ended June 30, 2008, the growth in the average balance of interest bearing liabilities resulted in additional interest expense of $11.0 million, and increases in interest rates resulted in a net increase of $0.5 million in interest expense. The average rate paid on all of our interest-bearing liabilities increased to 4.64% for the year ended June 30, 2008 from 4.59% for the year ended June 30, 2007. The maturity of lower-rate term deposits and the addition of new term deposits in the first half of the year at higher rates caused the average term deposit rates to increase to 5.06% in fiscal 2008 from 4.89% in fiscal 2007. New lower rate FHLB advances added during the last half of fiscal 2008 caused the average FHLB advance rate to decrease to 4.23% in fiscal 2008 from 4.34% in fiscal 2007. These rate changes in fiscal 2008 were accompanied by an increase in the weighted average rate paid on interest-bearing demand and savings accounts, which increased to 3.59% from 3.37%, and the average rate paid on other borrowings that decreased to 7.16% in fiscal 2008 from 8.01% in fiscal 2007. The increase in the rate paid on checking and savings was due to competitive increases in our rates for money market savings accounts and interest-bearing checking accounts. Our average rate on term deposits increased 17 basis points between fiscal 2008 and 2007.

Provision for Loan Losses. Provision for loan losses was $2.2 million for the year ended June 30, 2008 and a benefit of $25,000 for fiscal 2007. The provisions were made to maintain our allowance for loan losses at levels which management believed to be adequate. The assessment of the adequacy of our allowance for loan losses is based upon a number of quantitative and qualitative factors, including levels and trends of past due and nonaccrual loans, loss history and changes in the volume and mix of loans and collateral values.

See Asset Quality and Allowance for Loan Loss for discussion of our allowance for loan loss and the related loss provisions.

Noninterest Income. The following table sets forth information regarding our noninterest income for the periods shown.

	For Fiscal Year Ended June 30,	
	2008	**2007**
	(Dollars in thousands)	
Prepayment penalty fee income	$ 287	$ 399
Mortgage banking income	2	93
Net gain on securities	711	403
Banking service fees and other income	379	285
Total noninterest income	$ 1,379	$ 1,180

Noninterest income totaled $1.4 million for the year ended June 30, 2008 compared to $1.2 million for the same period in 2007. The increase of $199,000 in fiscal 2008 was primarily due to an increase in gain on sale of securities of $308,000, offset by the lower prepayment penalty income of $112,000 and lower mortgage banking income of $91,000. Lower prepayment penalty income in fiscal 2008 was generally the result of fewer new multifamily loans and the expiration of penalties on seasoned multifamily loans. Mortgage banking income decreased due to a reduction in the number of single family and multifamily loans originated for sale.

The increase in gains on sales of securities for fiscal 2008 was partially offset by an other-than-temporary impairment charge on an investment in Fannie Mae preferred stock. The net gain on sale of mortgage-backed securities for fiscal 2008 increased to $1.7 million compared to $0.4 million realized in fiscal 2007. The increased net gain was the result of our strategy to sell lower

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yielding government agency mortgage-backed securities and reinvest the proceeds in higher yielding whole loan pool purchases and non-agency AAA mortgage-backed securities. An other-than- temporary-impairment charge of $1.0 million partially offset the realized gains and was recorded as of June 30, 2008 as a result of the decline in the market value of our $10.1 million investment in Fannie Mae (FNMA) 8 1/4% Series S FNMA Preferred stock. Subsequent to June 30, 2008, the U.S. Treasury, the Federal Reserve and the Federal Housing Finance Agency (FHFA) announced that the FHFA was putting Fannie Mae and Freddie Mac under conservatorship and giving management control to their regulator, the FHFA. The U.S. Treasury also announced that dividends on the FNMA Preferred stock were eliminated. Based upon the government announcement of the conservatorship and the elimination of dividends on FNMA Preferred, the Bank sold on September 8, 2008 its entire position in FNMA Preferred at a realized loss of an additional $7.9 million or approximately $4.7 million after income tax.

Noninterest Expense. The following table sets forth information regarding our noninterest expense for the periods shown:

	For Fiscal Year Ended June 30,	
	2008	2007
	(Dollars in thousands)	
Salaries, employee benefits and stock-based compensation	$ 5,426	$ 2,993
Professional services	654	537
Occupancy and equipment	373	363
Data processing and internet	656	586
Advertising and promotional	750	584
Depreciation and amortization	132	88
FDIC and OTS regulatory fees	744	238
Other general and administrative	1,427	1,061
Total noninterest expenses	$ 10,162	$ 6,450

Noninterest expense totaled $10.2 million for the year ended June 30, 2008, an increase of $3.7 million compared to fiscal 2007. Salaries, employee benefits and stock-based compensation increased $2.4 million during fiscal 2008 due primarily to the addition of staffing for RV and home equity loan products and the addition of our new CEO. Included in the $2.4 million increases was $675,000 of one-time expense related to the new CEO and a contract amendment of the former CEO. Professional services increased $117,000 in fiscal 2008 compared to 2007 generally due to an increase in professional, legal services and consulting fees associated with Bank pool purchases and product development. Data processing and Internet expenses increased $70,000 in fiscal 2008 compared to fiscal 2007 due to increases in service bureau charges associated with new deposit and loan customers and additional software for investment securities. Advertising and promotion expense increased $166,000, primarily due to increased activity for our new home equity loan products. FDIC and OTS regulatory fees increased $506,000 due to higher standard assessment rates and due to the deposit and asset growth of the Bank. Other general and administrative costs increased in fiscal 2008 mainly due increases in loan expenses of $173,000 compared to fiscal 2007.

Income Tax Expense. Income tax expense was $2.8 million for the year ended June 30, 2008 compared to $2.3 million for fiscal 2007. Our effective tax rates were 40.15% and 40.8% for the year ended June 30, 2008 and 2007, respectively. The decrease in the effective tax rate is primarily due to higher level of non-taxable dividend income.

Comparison of the Years Ended June 30, 2007 and 2006

Net Interest Income. Net interest income totaled $10.8 million for the fiscal year ended June 30, 2007 compared to $10.0 million for the fiscal year ended June 30, 2006. The following table sets forth the effects of changing rates and volumes on our net interest income. Information is provided with respect to (i) effects on interest income and interest expense attributable to changes in volume (changes in volume multiplied by prior rate); (ii) effects on interest income and interest expense attributable to changes in rate (changes in rate multiplied by prior volume); and (iii) changes in rate/volume (change in rate multiplied by change in volume) for the fiscal year ended June 30, 2007 compared to the fiscal year ended June 30, 2006.

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	Fiscal Year Ended June 30, 2007 vs. 2006 Increase (Decrease) Due to			
	Volume	Rate	Rate/Volume	Total Increase (Decrease)
	(Dollars in thousands)			
Increase/(decrease) in interest income:				
Loans	$ (1,084)	$ 2,940	$ (115)	$ 1,741
Federal funds sold	201	62	41	304
Interest-earning deposits in other financial institutions	(27)	158	(6)	125
Mortgage-backed and other investment securities	5,980	1,341	2,201	9,522
Stock of the FHLB, at cost	116	52	13	181
	$ 5,186	$ 4,553	$ 2,134	$ 11,873
Increase/(decrease) in interest expense:				
Interest-bearing demand and savings	$ (347)	$ 399	$ (67)	$ (15)
Time deposits	3,126	2,839	687	6,652
Securities sold under agreements to repurchase			1,352	1,352
Advances from the FHLB	1,778	939	223	2,940
Other borrowings		51		51
	$ 4,557	$ 4,228	$ 2,195	$ 10,980

Interest Income. Interest income for the year ended June 30, 2007 totaled $44.6 million, an increase of $11.9 million, or 36.4%, compared to $32.7 million in interest income for the year ended June 30, 2006. Earning asset growth and higher average rates contributed to the increase in interest income. Average interest-earning assets for the year ended June 30, 2007 increased by $140.3 million compared to the year ended June 30, 2006 due to the purchase of mortgage-backed and investment securities which increased $154.8 million during the year ended June 30, 2007 compared to 2006. Partially offsetting the increase was a $20.9 million decrease in the average balance of the loan portfolio, primarily the result of our multifamily and single family loan payoff in excess of originations and purchases. The mortgage-backed securities we purchase provide a guarantee from a government sponsored entity like FNMA, while single-family whole loan originations and purchases do not have a credit guarantee and the mortgage-backed securities offer increased liquidity compared to whole loans. Average interest earning balances associated with our stock of the FHLB increased by $2.4 million in the year ended June 30, 2007 compared to the year ended June 30, 2006 because our required minimum investment increased, in line with our increased advances from the FHLB. For the year ended June 30, 2007, the growth in average balances contributed additional interest income of $5.2 million, and the average rate increase resulted in a net $6.7 million increase in interest income. The average yield earned on our interest-earning assets increased to 5.57% for the year ended June 30, 2007, up from 4.96% for the same period in 2006 due primarily to the higher yields on our loan portfolio and our mortgage-backed securities portfolio. Loan rate increases from adjustable rate loans contributed to the increase in the loan portfolio yield. In the second half of fiscal 2007, we originated higher yielding home equity and RV loans which also contributed to the increase in loan yield. Higher market rates on new loan pools and mortgage-backed securities purchases also caused the increase in the yield on earning assets.

Interest Expense. Interest expense totaled $33.7 million for the year ended June 30, 2007, an increase of $10.9 million, compared to $22.8 million in interest expense during the year ended June 30, 2006. Average interest-bearing balances for the year ended June 30, 2007 increased $142.5 million compared to the same period in 2006, due to higher deposit totals from increased customer accounts and additional borrowings from the FHLB. The average interest-bearing balances of advances from the FHLB increased $46.1 million as primarily new 5- and 10-year fixed-rate advances were added. Our addition of long-term fixed rate borrowings is a part of our strategy to manage our interest rate risk. For the year ended June 30, 2007, the growth in the average balance of interest bearing liabilities resulted in additional interest expense of $4.6 million, and increases in interest rates resulted in a net increase of $6.4 million in interest expense. The average rate paid on all of our interest-bearing liabilities increased to 4.59% for the year ended June 30, 2007 from 3.84% for the year ended June 30, 2006. The maturity of lower-rate term deposits and the addition of new term deposits at higher rates caused the average term deposit rates to increase to 4.89% in fiscal 2007 from 4.01% in fiscal 2006. Similarly, new higher rate FHLB advances added during fiscal 2007 caused the average FHLB advance rate to increase to 4.34% in fiscal 2007 from 3.86% in fiscal 2006. These rate changes in fiscal 2007 were accompanied by an increase in the weighted average rate paid on interest-bearing demand and savings accounts, which increased to 3.37% from 2.82%, and the average rate paid

on other borrowings that increased to 8.01% in fiscal 2007 from 7.02% in fiscal 2006. The increase in the rate paid on checking and savings was due to competitive increases in our rates for money market savings accounts and interest-bearing checking accounts. Our average rate on term deposits increased 88 basis points between fiscal 2007 and 2006. Long-term U.S. Treasury rates, which generally influence our mortgage market rates, did not move proportionally higher and the yield curve inverted during fiscal 2007. As a result, the rate on our loan portfolio increased only 55 basis points. Deposit market rates increased faster than loan rates in fiscal 2007 causing our net interest margin to decline to 1.36% from 1.51% in fiscal 2006.

Provision for Loan Losses. Provision for loan losses was a benefit of $25,000 for the year ended June 30, 2007 and an expense of $60,000 for fiscal 2006.

See Asset Quality and Allowance for Loan Loss for discussion of our allowance for loan loss and the related loss provisions.

Noninterest Income. The following table sets forth information regarding our noninterest income for the periods shown:

	For Fiscal Year Ended June 30,	
	2007	2006
	(Dollars in thousands)	
Prepayment penalty fee income	$ 399	$ 721
Mortgage banking income	93	289
Gain on sale of securities	403	
Banking service fees and other income	285	332
Total noninterest income	$ 1,180	$ 1,342

Noninterest income totaled $1.2 million for the year ended June 30, 2007 compared to $1.3 million for the same period in 2006. The decrease of $0.1 million in fiscal 2007 was primarily due to the lower prepayment penalty income of $322,000, lower mortgage banking income of $196,000, partially offset by an increase in gain on sale of securities. Lower prepayment penalty income was generally the result of fewer new multifamily loans and the seasoning and expiration of penalties on seasoned loans. Mortgage banking income decreased due to a reduction in the number of single family and multifamily loan originated for sale. The increase in gains on sales of securities resulted from mortgage backed securities that were sold primarily to provide proceeds to invest in higher yielding investment securities and whole loans.

Noninterest Expense. The following table sets forth information regarding our noninterest expense for the periods shown.

	For Fiscal Year Ended June 30,	
	2007	2006
	(Dollars in thousands)	
Salaries, employee benefits and stock-based compensation	$ 2,993	$ 2,795
Professional services	537	443
Occupancy and equipment	363	347
Data processing and internet	586	491
Advertising and promotional	584	338
Depreciation and amortization	88	89
FDIC and OTS regulatory fees	238	188
Other general and administrative	1,061	1,098
Total noninterest expenses	$ 6,450	$ 5,789

Noninterest expense totaled $6.5 million for the year ended June 30, 2007, an increase of $0.7 million compared to fiscal 2006. Salary expense increased $116,000 due primarily to the addition of staff to accommodate the addition of RV and home equity loan products. Stock-based compensation increased for the year ended June 30, 2007 by $82,000 due to additional stock option and

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restricted stock grants in July 2006. Professional services increased $94,000 in fiscal 2007 compared to 2006 generally due to an increase in professional filing services and consulting fees. Data processing and Internet expenses increased $95,000 in fiscal 2007 compared to fiscal 2006 due to increased development costs for new websites and increases in service bureau charges associated with new deposit and loan customers. Advertising and promotion expense increased $246,000, primarily due to increased activity for our new home equity loan products.

Income Tax Expense. Income tax expense was $2.3 million for the year ended June 30, 2007 compared to $2.2 million for fiscal 2006. Our effective tax rates were 40.8% and 40.0% for the year ended June 30, 2007 and 2006, respectively. The increase in the effective tax rate is primarily due to adjustments for the tax treatment for incentive stock options.

Comparison of Financial Condition at June 30, 2008 and June 30, 2007

Total assets increased by $247.0 million, or 26.1%, to $1,194.2 million at June 30, 2008 from $947.2 million at June 30, 2007. The increase in total assets resulted primarily from purchases of non-agency AAA mortgage-backed securities net of sales of U.S. agency securities and repays, resulting in increases in mortgage-backed securities of $152.0 million. Also, we increased loans by $123.5 million through pool purchases and originations. Total liabilities increased by $236.8 million, or 27.1%, to $1,111.2 million at June 30, 2008 from $874.4 million at June 30, 2007. The increase in total liabilities resulted primarily from growth in short-term advances from FHLB of $171.7 million.

Stockholders equity increased by $10.2 million, or 14.0%, to $83.0 million at June 30, 2008 from $72.8 million at June 30, 2007. The increase was the result of $4.2 million in net income and the issuance of Series B preferred stock of $3.8 million, the increase in comprehensive income of $1.9 million, and additional paid in capital of $0.9 million resulting from the exercise of stock options and stock-based compensation expense.

Our net deposit growth of $22.8 million during the fiscal year ended June 30, 2008 resulted from a $50.9 million net increase in checking and savings account balances offset by a $28.1 million decrease in time deposits. The increase in checking and savings and the decrease in time deposits are the result of lower rates being offered on time deposits. The additional proceeds from our liability and equity growth were invested in originations and purchases of loans held for investment, which totaled $270.0 million for the year ending June 30, 2008. Also, to supplement our loan activity, we purchased $493.2 million in mortgage-backed and investment securities. We increased our purchases of mortgage-backed securities during the year ended June 30, 2008 because we believed they provided better risk adjusted yields than certain single family whole loan originations or whole loan pools. We expect to continue to purchase mortgage-backed securities to supplement our loan portfolio in the next fiscal year.

Asset Quality and Allowance for Loan Loss

Nonperforming Assets

Nonperforming loans and foreclosed assets or nonperforming assets consisted of the following:

		June 30,			
	2008	**2007**	**2006**	**2005**	**2004**
		(dollars in thousands)			
Nonperforming assets:					
Non-accrual loans:					
Loans secured by real estate:					
Single family	$ 1,793	$ 221	$	$	$
Home equity loans					
Multifamily					
Commercial	2,358				
Total nonaccrual loans secured by real estate	4,151	221			
RV / Auto		7			
Other					
Total nonperforming loans	4,151	228			
Foreclosed real estate	219				

Repossessed vehicles	262				
Total nonperforming assets	$ 4,632	$ 228	$	$	$
Total nonperforming loans as a percentage of total loans	0.66%	0.05%			
Total nonperforming assets as a percentage of total assets	0.39%	0.02%			

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The increase in nonperforming loans at June 30, 2008 compared to 2007 was due primarily to one commercial mortgage loan for $2.4 million which was in the foreclosure process at June 30, 2008. No reserve for impairment was allocated to the $2.4 million loan based upon a current appraisal of the collateral. The 1.8 million in single family nonperforming loans represents six loans in four states ranging in amounts from $399,000 to $97,000. The increase in nonperforming single family loans reflects the nationwide downturn in residential housing values. If residential housing values continue to decline, we are likely to experience growth in the level of nonperforming and foreclosed loans in future periods.

The Bank had one single family mortgage loan with an outstanding principal balance of $421,000 which was considered a troubled debt restructuring at June 30, 2008. A troubled debt restructuring is a performing loan with temporary modifications of principal and interest payments or an extension of maturity dates. Under these arrangements, loan terms are typically reduced to no less than a required monthly interest payment. If the borrower is unable to return to scheduled principal and interest payments at the end of the modification period, foreclosure procedures will be initiated. There were no troubled debt restructurings at the end of fiscal 2007 or at any prior fiscal year end.

Allowance for Loan Losses

We maintain an allowance for loan losses in an amount that we believe is sufficient to provide adequate protection against probable incurred losses in our loan portfolio. We evaluate quarterly the adequacy of the allowance based upon reviews of individual loans, recent loss experience, current economic conditions, risk characteristics of the various categories of loans and other pertinent factors. The evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance is increased by the provision for loan losses, which is charged against current period operating results. The allowance is decreased by the amount of charge-offs of loans deemed uncollectible and increased by recoveries of loans previously charged off.

Under our allowance for loan loss policy, impairment calculations are determined based on general portfolio data for general reserves and loan level data. Specific loans are evaluated for impairment and are generally classified as nonperforming or in foreclosure if they are 90 days or more delinquent. A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors that we consider in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan s effective interest rate or the fair value of the collateral if repayment of the loan is expected from the sale of collateral.

General loan loss reserves are calculated by grouping each loan by collateral type and by grouping the loan-to-value ratios of each loan within the collateral type. An estimated impairment rate for each loan-to-value group within each type of loan is multiplied by the total principal amount in the group to calculate the required general reserve attributable to that group. We use an allowance rate that provides a larger loss allowance for loans with greater loan-to-value ratios, measured at the time the loan was funded. The internal asset review committee of our board of directors reviews and approves the bank s calculation methodology. Specific reserves are to be calculated when an internal asset review of a loan identifies a significant adverse change in the financial position of the borrower or the value of the collateral. The specific reserve is based on discounted cash flows, observable market prices or the estimated value of underlying collateral.

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The following table sets forth the changes in our allowance for loan losses, by loan type, from July 1, 2003 through June 30, 2008:

	Single Family	Home Equity	Multi-family	Commercial Real Estate and Land	RV / Auto	Consumer	Total	Total Allowance as a Percentage of Total Loans
				(Dollars in thousands)				
Balance at July 1, 2003	$ 76	$ 1	$ 678	$ 35	$	$	$ 790	0.32%
Provision for loan losses	(34)	(1)	284	6			255	
Balance at June 30, 2004	42		962	41			1,045	0.29%
Provision for loan losses	101		253	16			370	
Balance at June 30, 2005	143		1,215	57			1,415	0.29%
Provision (benefit) for loan losses	81	1	(19)	(3)			60	
Balance at June 30, 2006	224	1	1,196	54			1,475	0.28%
Provision (benefit) for loan losses	32	65	(346)	(5)	223	6	(25)	
Balance at June 30, 2007	256	66	850	49	223	6	1,450	0.28%
Provision (benefit) for loan losses	777	120	393	156	772	8	2,226	
Recoveries					22		22	
Charge-offs	(428)		(100)		(454)	(6)	(988)	
Balance at June 30, 2008	$ 605	$ 186	$ 1,143	$ 205	$ 563	$ 8	$ 2,710	0.43%

The following table sets forth how our allowance for loan losses is allocated by type of loan at each of the dates indicated:

	At June 30,									
	2008		2007		2006		2005		2004	
	Amount of Allowance	Loan Category as a % of Total Loans	Amount of Allowance	Loan Category as a % of Total Loans	Amount of Allowance	Loan Category as a % of Total Loans	Amount of Allowance	Loan Category as a % of Total Loans	Amount of Allowance	Loan Category as a % of Total Loans
					(Dollars in thousands)					
Single family	$ 605	22.32%	$ 256	17.66%	$ 224	15.19%	$ 143	10.11%	$ 42	4.02%
Home equity	186	6.86%	66	4.55%	1	0.07%		0.00%		0.00%
Multifamily	1,143	42.19%	850	58.62%	1,196	81.08%	1,215	85.86%	962	92.06%
Commercial real estate and land	205	7.56%	49	3.38%	54	3.66%	57	4.03%	41	3.92%
Consumer - RV	563	20.77%	223	15.38%		0.00%		0.00%		0.00%

Other	8	0.30%	6	0.41%		0.00%		0.00%		0.00%
Total	$ 2,710	100%	$ 1,450	100%	$ 1,475	100%	$ 1,415	100%	$ 1,045	100%

Our Bank s provisions for loan loss increased to $2.2 million for fiscal 2008 compared to a benefit of $25,000 and a provision of $60,000 for fiscal years 2007 and 2006, respectively. The Bank s loan loss provisions increased in fiscal 2008 due to two factors. First, between June 30, 2008 and June 30, 2007, our net loans increased $123.5 million compared to a net loan decline of $25.7 million during fiscal 2007 and compared to net loan growth of $46.7 million during fiscal 2006. The Bank s general loan loss allowance increases or decreases with the change in net loans. Second, the Bank increased its required percentages for general loan loss allowance during fiscal 2008 due primarily to the general decline in housing values and the corresponding decline in consumer credit.

Prior to fiscal 2008, the Bank had never had a loan charge off. In March 2007, we commenced RV lending with the understanding that some loan charge offs would likely be required. During fiscal 2008, we charged off $432,000 in connection with our RV loan portfolio and we increased our general loan loss percentage and tightened our underwriting standards. We also experienced charge offs of $428,000 in connection with our single family loan portfolio and we increased our general loan loss percentage. We believe our Bank s loan underwriting has been and remains conservative compared to most banks.

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Liquidity and Capital Resources

Liquidity. Our sources of liquidity include deposits, borrowings, payments and maturities of outstanding loans, sales of loans, maturities or gains on sales of investment securities and other short-term investments. While scheduled loan payments and maturing investment securities and short-term investments are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. We generally invest excess funds in overnight deposits and other short-term interest-earning assets. We use cash generated through retail deposits, our largest funding source, to offset the cash utilized in lending and investing activities. Our short-term interest-earning investment securities are also used to provide liquidity for lending and other operational requirements. As an additional source of funds, we have three credit agreements. Bank of Internet USA can borrow up to 40% of its total assets from the FHLB. Borrowings are collateralized by the pledge of certain mortgage loans and investment securities to the FHLB. Based on loans and securities pledged at June 30, 2008, we had a total borrowing capacity of approximately $443.9 million, of which $399.0 million was outstanding and $44.9 million was available. At June 30, 2008, we also had a $10.0 million unsecured fed funds purchase line with a major bank under which no borrowings were outstanding. In the past, we have used long-term borrowings to fund our loans and to minimize our interest rate risk. Our future borrowings will depend on the growth of our lending operations and our exposure to interest rate risk.

We expect to continue to use deposits and advances from the FHLB as the primary sources of funding our future asset growth.

On December 16, 2004, we completed a transaction in which we formed a trust and issued $5.0 million of trust-preferred securities. The net proceeds from the offering were used to purchase approximately $5.2 million of junior subordinated debentures of our company with a stated maturity date of February 23, 2035. The debentures are the sole assets of the trust. The trust preferred securities are mandatorily redeemable upon maturity, or upon earlier redemption as provided in the indenture. We have the right to redeem the debentures in whole (but not in part) on or after specific dates, at a redemption price specified in the indenture plus any accrued but unpaid interest through the redemption date. Interest accrues at the rate of three-month LIBOR plus 2.4%, which was 5.04% at June 30, 2008, with interest to be paid quarterly starting in February 2005. We entered into this transaction to provide additional regulatory capital to our bank to support its growth.

Contractual Obligations. At June 30, 2008, we had $22.8 million in loan commitments outstanding. Time deposits due within one year of June 30, 2008 totaled $233.8 million. We believe the large percentage of time deposits that mature within one year reflects customers hesitancy to invest their funds long term when they expect interest rates to rise. If these maturing deposits do not remain with us, we may be required to seek other sources of funds, including other time deposits and borrowings. Depending on market conditions, we may be required to pay higher rates on deposits and borrowings than we currently pay on time deposits maturing within one year. We believe, however, based on past experience, a significant portion of our time deposits will remain with us. We believe we have the ability to attract and retain deposits by adjusting interest rates offered.

The following table presents our contractual obligations for long-term debt and operating leases as of June 30, 2008 by payment date.

	Payments Due by Period				
	Total	Less than One Year	One to Three Years	Three to Five Years	More Than Five Years
	(In thousands)				
Long-term debt obligations [1]	$ 1,085,965	$ 491,880	$ 246,324	$ 190,109	$ 157,652
Operating lease obligations [2]	1,477	323	678	476	
Total	$ 1,087,442	$ 492,203	$ 247,002	$ 190,585	$ 157,652

[1] Long-term debt includes time deposits, advances from FHLB and borrowings under repurchase agreements. The payment amount represents principal and interest due to recipient.
[2] Payments are for the lease of real property.

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Capital Requirements. Bank of Internet USA is subject to various regulatory capital requirements set by the federal banking agencies. Failure by our bank to meet minimum capital requirements could result in certain mandatory and discretionary actions by regulators that could have a material adverse effect on our consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, our bank must meet specific capital guidelines that involve quantitative measures of our bank s assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Our bank s capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation require our bank to maintain certain minimum capital amounts and ratios. The OTS requires our bank to maintain minimum ratios of tangible capital to tangible assets of 1.5%, core capital to tangible assets of 4.0% and total risk-based capital to risk-weighted assets of 8.0%. At June 30, 2008, our bank met all the capital adequacy requirements to which it was subject.

At June 30, 2008, our bank was well capitalized under the regulatory framework for prompt corrective action. To be well capitalized, our bank must maintain minimum leverage, Tier 1 risk-based and total risk-based capital ratios of at least 5.0%, 6.0% and 10.0%, respectively. No conditions or events have occurred since that date that management believes would change the bank s capital levels. To maintain its status as a well capitalized financial institution under applicable regulations and to support additional growth, we will need to raise additional capital to support our bank s further growth and to maintain its well capitalized status.

Bank of Internet USA capital amounts, ratios and requirements at June 30, 2008 were as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
Tier 1 leverage (core) capital:						
Amount and ratio to adjusted tangible assets	$ 84,562	7.09%	$ 47,717	4.00%	$ 59,646	5.00%
Tier 1 capital:						
Amount and ratio to risk-weighted assets	$ 84,562	13.95%	N/A	N/A	$ 36,373	6.00%
Total capital:						
Amount and ratio to risk-weighted assets	$ 87,272	14.40%	$ 48,498	8.00%	$ 60,622	10.00%
Tangible capital:						
Amount and ratio to tangible assets	$ 84,562	7.09%	$ 17,894	1.50%	N/A	N/A

Quantitative and Qualitative Disclosures About Market Risk

Market risk is defined as the sensitivity of income and capital to changes in interest rates, foreign currency exchange rates, commodity prices and other relevant market rates or prices. The primary market risk to which we are exposed is interest rate risk. Changes in interest rates can have a variety of effects on our business. In particular, changes in interest rates affect our net interest income, net interest margin, net income, the value of our securities portfolio, the volume of loans originated, and the amount of gain or loss on the sale of our loans.

We are exposed to different types of interest rate risk. These risks include lag, repricing, basis, prepayment and lifetime cap risk, each of which is described in further detail below:

Lag/Repricing Risk. Lag risk results from the inherent timing difference between the repricing of our adjustable rate assets and our liabilities. Repricing risk is caused by the mismatch of repricing methods between interest-earning assets and interest-bearing liabilities. Lag/repricing risk can produce short-term volatility in our net interest income during periods of interest rate movements even though the effect of this lag generally balances out over time. One example of lag risk is the repricing of assets indexed to the monthly treasury average, or the MTA. The MTA index is based on a moving average of rates outstanding during the previous 12 months. A sharp movement in interest rates in a month will not be fully reflected in the index for 12 months resulting in a lag in the repricing of our loans and securities based on this index. We expect more of our interest-bearing liabilities will mature or reprice within one year than will our interest-earning assets, resulting in a one year negative interest rate sensitivity gap (the difference between our interest rate sensitive assets maturing or repricing within one year and our interest rate sensitive liabilities maturing or repricing within one year, expressed as a percentage of total interest-earning assets). In a rising interest rate environment, an institution with a negative gap would generally be expected, absent the effects of other factors, to experience a greater increase in its cost of liabilities relative to its yield on assets, and thus a decrease in its net interest income.

Basis Risk. Basis risk occurs when assets and liabilities have similar repricing timing but repricing is based on different market interest rate indices. Our adjustable rate loans that reprice are directly tied to indices based upon U.S. Treasury rates, LIBOR, Eleventh District Cost of Funds and the prime rate. Our deposit rates are not directly tied to these same indices. Therefore, if deposit interest rates rise faster than the adjustable rate loan indices and there are no other changes in our asset/liability mix, our net interest income will likely decline due to basis risk.

Prepayment Risk. Prepayment risk results from the right of customers to pay their loans prior to maturity. Generally, loan prepayments increase in falling interest rate environments and decrease in rising interest rate environments. In addition, prepayment risk results from the right of customers to withdraw their time deposits before maturity. Generally, early withdrawals of time deposits increase during rising interest rate environments and decrease in falling interest rate environments. When estimating the future performance of our assets and liabilities, we make assumptions as to when and how much of our loans and deposits will be prepaid. If the assumptions prove to be incorrect, the asset or liability may perform differently than expected. In the last three fiscal years, the mortgage industry and our bank have experienced high rates of loan prepayments due to historically low interest rates. Market rates began rising in the fiscal year ended June 30, 2004 and, if they continue, mortgage loan prepayments are expected to decrease. In addition, if that occurs, we may experience increased rates of customer early withdrawals of their time deposits.

Lifetime Cap Risk. Our adjustable rate loans have lifetime interest rate caps. In periods of rising interest rates, it is possible for the fully indexed interest rate (index rate plus the margin) to exceed the lifetime interest rate cap. This feature prevents the loan from repricing to a level that exceeds the cap s specified interest rate, thus adversely affecting net interest income in periods of relatively high interest rates. On a weighted average basis, our adjustable rate single family loans at June 30, 2008 had lifetime rate caps that were 500 basis points or more greater than the note rates at June 30, 2008. If market rates rise by more than the interest rate cap, we will not be able to increase these customers loan rates above the interest rate cap.

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The principal objective of our asset/liability management is to manage the sensitivity of net income to changing interest rates. Asset/liability management is governed by policies reviewed and approved annually by our board of directors. Our board of directors has delegated the responsibility to oversee the administration of these policies to the asset/liability committee, or ALCO. The interest rate risk strategy currently deployed by ALCO is to use primarily natural balance sheet hedging (as opposed to derivative hedging) or to avoid holding loans that ALCO views as higher risk. Specifically, we attempt to match the effective duration of our assets with our borrowings. To reduce the repricing risk associated with holding certain adjustable loans, which typically are fixed for the first three to five years, we have matched estimated maturities by obtaining long-term three to five year advances from the FHLB. Other examples of ALCO policies designed to reduce our interest rate risk include limiting the premiums paid to purchase mortgage loans or mortgage-backed securities. This policy addresses mortgage prepayment risk by capping the yield loss from an unexpected high level of mortgage loan prepayments. Once a quarter, ALCO members report to our board of directors the status of our interest rate risk profile.

We measure interest rate sensitivity as the difference between amounts of interest-earning assets and interest-bearing liabilities that mature within a given period of time. The difference, or the interest rate sensitivity gap, provides an indication of the extent to which an institution s interest rate spread will be affected by changes in interest rates. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities and negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. In a rising interest rate environment, an institution with a positive gap would be in a better position than an institution with a negative gap to invest in higher yielding assets or to have its asset yields adjusted upward, which would result in the yield on its assets to increase at a faster pace than the cost of its interest-bearing liabilities. During a period of falling interest rates, however, an institution with a positive gap would tend to have its assets mature at a faster rate than one with a negative gap, which would tend to reduce the growth in its net interest income.

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The following table sets forth the interest rate sensitivity of our assets and liabilities at June 30, 2008:

	Term to Repricing, Repayment, or Maturity at June 30, 2008			
	One Year or Less	Over One Year through Five Years	Over Five Years	Total
	(Dollars in thousands)			
Interest-earning assets:				
Cash and cash equivalents	$ 16,264	$	$	16,264
Interest-earning deposits in other financial institutions	1,980			1,980
Mortgage-backed and other investment securities(1)	326,353	161,332	22,329	510,014
Stock of FHLB, at cost	19,395			19,395
Loans, net of allowance for loan loss (2)	277,892	298,456	55,065	631,413
Loans held for sale				
Total interest-earning assets	641,884	459,788	77,394	1,179,066
Noninterest-earning assets				15,179
Total assets	$ 641,884	$ 459,788	$ 77,394	$ 1,194,245
Interest-bearing liabilities:				
Interest-bearing deposits (3)	$ 351,585	$ 213,610	$	$ 565,195
Securities sold under agreements to repurchase (4)		20,000	110,000	130,000
Advances from the FHLB	227,000	146,966	25,000	398,966
Other borrowings	5,155			5,155
Total interest-bearing liabilities	583,740	380,576	135,000	1,099,316
Other noninterest-bearing liabilities				11,847
Stockholders equity				83,082
Total liabilities and equity	$ 583,740	$ 380,576	$ 135,000	$ 1,194,245
Net interest rate sensitivity gap	$ 58,144	$ 79,212	$ (57,606)	$ 79,750
Cumulative gap	$ 58,144	$ 137,356	$ 79,750	$ 79,750
Net interest rate sensitivity gap as a % of interest-earning assets	9.06%	17.23%	-(74.43)%	6.76%
Cumulative gap as a % of cumulative interest-earning assets	9.06%	12.47%	6.76%	6.76%

(1)

Comprised of U.S. government securities and mortgage-backed securities which are classified as held to maturity and available for sale. The table reflects contractual repricing dates.

(2) The table reflects either contractual repricing dates, or maturities.

(3) The table assumes that the principal balances for demand deposit and savings accounts will reprice in the first year.

(4) Securities sold under agreements to repurchase reflect contractual maturities. Under terms of the agreements, repayment and repricing of repurchase may be accelerated if market rates rise.

Although gap analysis is a useful measurement device available to management in determining the existence of interest rate exposure, its static focus as of a particular date makes it necessary to utilize other techniques in measuring exposure to changes in interest rates. For example, gap analysis is limited in its ability to predict trends in future earnings and makes no assumptions about changes in prepayment tendencies, deposit or loan maturity preferences or repricing time lags that may occur in response to a change in the interest rate environment.

Our net interest margin for the year ended June 30, 2008 increased to 1.72% compared to 1.36% for the year ended June 30, 2007. During the year ended June 30, 2008, interest income earned on loans and on mortgage backed securities was influenced by the amortization of premiums and discounts on purchases, and interest expense paid on deposits and new borrowings were influenced by a sharp decline in the Fed Funds rate.

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We attempt to measure the effect market interest rate changes will have on the net present value of assets and liabilities, which is defined as market value of equity. We analyze the market value of equity sensitivity to an immediate parallel and sustained shift in interest rates derived from the current treasury and LIBOR yield curves. For rising interest rate scenarios, the base market interest rate forecast was increased by 100, 200 and 300 basis points. For the falling interest rate scenarios, we used a 100 basis points decrease due to limitations inherent in the current rate environment. The following table indicates the sensitivity of market value of equity to the interest rate movement described above at June 30, 2008:

	Sensitivity (in thousands)	Percentage Change from Base	Net Present Value as Percentage of Assets
Up 300 basis points	$ 862	1.0%	7.31%
Up 200 basis points	$ 5,324	6.4%	7.58%
Up 100 basis points	$ 5,183	6.2%	7.46%
Base			6.95%
Down 100 basis points	$ 5,292	6.3%	7.24%

The computation of the prospective effects of hypothetical interest rate changes is based on numerous assumptions, including relative levels of interest rates, asset prepayments, runoffs in deposits and changes in repricing levels of deposits to general market rates, and should not be relied upon as indicative of actual results. Furthermore, these computations do not take into account any actions that we may undertake in response to future changes in interest rates.

Factors that May Affect Our Performance

We are subject to changing government laws and regulations, which could adversely affect our operations.

The banking industry, in general, is heavily regulated. As a savings and loan holding company, we are subject to regulation by the OTS and the Federal Deposit Insurance Corporation (FDIC). The economic and political environment influence regulatory policies, and as such, any or all of our business activities are subject to change if and when our primary regulators change applicable policies and regulations. Such changes could affect the way we conduct our business, which could adversely impact our operations and earnings.

Our results of operations could vary as a result of the methods, estimates, and judgments that we use in applying our accounting policies.

The methods, estimates, and judgments that we use in applying our accounting policies have a significant impact on our results of operations. Such methods, estimates, and judgments including methodologies to value our securities, evaluate securities for other-than-temporary impairment and estimate our allowance for loan losses. These methods, estimates, and judgments are, by their nature, subject to substantial risks, uncertainties, and assumptions, and factors may arise over time that lead us to change our methods, estimates, and judgments. Changes in those methods, estimates, and judgments could significantly affect our results of operations.

We may elect to seek additional capital but it may not be available when it is needed and limit our ability to execute our strategic plan.

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We are required by regulatory authorities to maintain adequate levels of capital to support our operations. In addition, we may elect to raise additional capital to support the growth of our business or to finance acquisitions, if any, or we elect to raise additional capital for other reasons. We may seek to do so through the issuance of, among other things, our common stock or securities convertible into our common stock, which could dilute your ownership interest in the Company.

Our ability to raise additional capital, if needed, will depend on conditions in the capital markets, economic conditions and a number of other factors, many of which are outside our control, and on our financial performance. Accordingly, we cannot assure you of our ability to raise additional capital if needed or on terms acceptable to us. If we cannot raise additional capital when needed or on terms acceptable to us, it may have a material adverse effect on our financial condition, results of operations and prospects.

Changes in interest rates could adversely affect our income.

Our income depends to a great extent on the difference between the interest rates earned on interest-earning assets such as loans and investment securities, and the interest rates paid on interest-bearing liabilities such as deposits and borrowings. Our interest-earning assets and interest-bearing liabilities do not react uniformly to changes in interest rates since the two have different time periods for interest rate adjustment. Interest rates are sensitive to factors that are beyond our control, including general economic conditions and the policies of various governmental and regulatory agencies, including the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, influence the origination of loans, the prepayment of loans, and the volume of deposits. Loan originations and repayment rates tend to increase with declining interest rates and decrease with rising interest rates. On the deposit side, increasing interest rates generally lead to interest rate increases on our deposit accounts. The impact of these changes may be greater if we do not effectively manage the relative sensitivity of our assets and liabilities to changes in market interest rates.

Access To Adequate Funding Cannot Be Assured

We have significant sources of liquidity as a result of our federal thrift structure, including consumer deposits, the FHLB, repurchase lending facilities, and the Federal Reserve discount window. We rely primarily upon consumer deposits and FHLB advances. Our ability to attract deposits could be negatively impacted by a perception of our financial prospects or by increased deposit rates available at troubled institutions suffering from shortfalls in liquidity. The FHLB is subject to regulation and other factors beyond our control. These factors may adversely affect the availability and pricing of advances to members such as the Bank. Selected sources of liquidity may become unavailable to the Bank if it was no longer considered to be well-capitalized.

Many of our mortgage and consumer loans, particularly recreational vehicle loans and home equity loans are generally unseasoned, and defaults on such loans would harm our business.

At June 30, 2008, our multifamily residential loans were $330.8 million or 52.2% of our total loans and our commercial real estate loans were $33.7 million, or 5.3% of our total loans. The payment on such loans is typically dependent on the cash flows generated by the projects, which are affected by the supply and demand for multifamily residential units and commercial property within the relative market. If the market for multifamily residential units and commercial property experiences a decline in demand, multifamily and commercial borrowers may suffer losses on their projects and be unable to repay their loans. At June 30, 2008, our recreational vehicle and auto loans were $57.0 million, or 9.0% of our total loans and our home equity loans were $42.0 million or 6.6% of our total loans. Our recreational vehicle lending and our home equity lending programs were started near the end of fiscal 2007, thus we have limited experience with defaults on these loans.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings, capital adequacy and overall financial condition may suffer materially.

Our loans are generally secured by multifamily and, to a lesser extent, commercial and single-family real estate properties, each initially having a fair market value generally greater than the amount of the loan secured. However, even though our loans are typically secured, the risk of default, generally due to a borrower s inability to make scheduled payments on his or her loan, is an inherent risk of the banking business. In determining the amount of the allowance for loan losses, we make various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of our borrowers and the value of the real

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estate serving as collateral for the repayment of our loans. Defaults by borrowers could result in losses that exceed our loan loss reserves. We have originated or purchased many of our loans recently, so we do not have sufficient repayment experience to be certain whether the allowance for loan losses we have established is adequate. We may have to establish a larger allowance for loan losses in the future if, in our judgment, it is necessary. Any increase in our allowance for loan losses will increase our expenses and consequently may adversely affect our profitability, capital adequacy and overall financial condition.

The U.S. government s monetary policies or changes in those policies could have a major effect on our operating results, and we cannot predict what those policies will be or any changes in such policies or the effect of such policies on us.

Any increase in prevailing interest rates due to changes in monetary policies may adversely affect banks such as us, whose liabilities tend to reprice quicker than their assets. The monetary policies of the FRB, affected principally through open market operations and regulation of the discount rate and reserve requirements, have had major effects upon the levels of bank loans, investments and deposits, and prevailing interest rates. It is not possible to predict the nature or effect of future changes in monetary and fiscal policies.

Our inability to manage our growth could harm our business.

We anticipate that our asset size and deposit base will continue to grow over time, perhaps significantly. To manage the expected growth of our operations and personnel, we will be required to, among other things:

- improve existing and implement new transaction processing, operational and financial systems, procedures and controls;
- maintain effective credit scoring and underwriting guidelines; and
- expand our employee base and train and manage this growing employee base.

If we are unable to manage growth effectively, our business, prospects, financial condition and results of operations could be adversely affected.

We face strong competition for customers and may not succeed in implementing our business strategy.

Our business strategy depends on our ability to remain competitive. There is strong competition for customers from existing banks and other types of financial institutions, including those that use the Internet as a medium for banking transactions or as an advertising platform. Our competitors include:

- large, publicly-traded, Internet-based banks, as well as smaller Internet-based banks;
- brick and mortar banks, including those that have implemented websites to facilitate online banking; and
- traditional banking institutions such as thrifts, finance companies, credit unions and mortgage banks.

Some of these competitors have been in business for a long time and have name recognition and an established customer base. Most of our competitors are larger and have greater financial and personnel resources. In order to compete profitably, we may need to reduce the rates we offer on loans and investments and increase the rates we offer on deposits, which actions may adversely affect our business, prospects, financial condition and results of operations.

To remain competitive, we believe we must successfully implement our business strategy. Our success depends on, among other things:

having a large and increasing number of customers who use our bank for their banking needs;

our ability to attract, hire and retain key personnel as our business grows;

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- our ability to secure additional capital as needed;

- the relevance of our products and services to customer needs and demands and the rate at which we and our competitors introduce or modify new products and services;

- our ability to offer products and services with fewer employees than competitors;

- the satisfaction of our customers with our customer service;

- ease of use of our websites; and

- our ability to provide a secure and stable technology platform for financial services that provides us with reliable and effective operational, financial and information systems.

If we are unable to implement our business strategy, our business, prospects, financial condition and results of operations could be adversely affected.

A natural disaster or recurring energy shortage, especially in California, could harm our business.

We are based in San Diego, California, and approximately 44.9% of our total loan portfolio was secured by real estate located in California at June 30, 2008. In addition, the computer systems that operate our Internet websites and some of their back-up systems are located in San Diego, California. Historically, California has been vulnerable to natural disasters. Therefore, we are susceptible to the risks of natural disasters, such as earthquakes, wildfires, floods and mudslides. Natural disasters could harm our operations directly through interference with communications, including the interruption or loss of our websites, which would prevent us from gathering deposits, originating loans and processing and controlling our flow of business, as well as through the destruction of facilities and our operational, financial and management information systems. A natural disaster or recurring power outages may also impair the value of our largest class of assets, our loan portfolio, which is comprised substantially of real estate loans. Uninsured or underinsured disasters may reduce borrowers ability to repay mortgage loans. Disasters may also reduce the value of the real estate securing our loans, impairing our ability to recover on defaulted loans through foreclosure and making it more likely that we would suffer losses on defaulted loans. California has also experienced energy shortages, which, if they recur, could impair the value of the real estate in those areas affected. Although we have implemented several back-up systems and protections (and maintain business interruption insurance), these measures may not protect us fully from the effects of a natural disaster. The occurrence of natural disasters or energy shortages in California could have a material adverse effect on our business, prospects, financial condition and results of operations.

Changes in economic conditions, particularly a further economic slowdown in California, could hurt our business.

Our business can be affected by market conditions, trends in industry and finance, legislative and regulatory changes, and changes in governmental monetary and fiscal policies and inflation, all of which are beyond our control. The housing and real estate sectors slowdown experienced an economic slowdown that has continued into 2008. Further deterioration in economic conditions, particularly within the State of California, could result in the following consequences, among others, any of which could hurt our business materially:

- loan delinquencies may increase

- problem assets and foreclosures may increase

- demand for our products and services may decline; and

collateral for our loans may decline in value

Declining real estate values, particularly in California, could reduce the value of our loan portfolio and impair our profitability and financial condition.

Substantially all of the loans in our portfolio are secured by real estate. At June 30, 2008, approximately 44.9% of our total loan portfolio was secured by real estate located in California. If there is a significant decline in real estate values, especially in California, the collateral for our loans will become less valuable. If such an event were to occur, we may experience charge-offs at a greater level than we would otherwise experience, as the proceeds resulting from foreclosure may be significantly lower than the amounts outstanding on such loans. Declining real estate values frequently accompany periods of economic downturn or recession and increasing unemployment, all of which can lead to lower demand for mortgage loans of the types we originate. These changes would likely have a material adverse effect on our business, prospects, financial condition and results of operations.

We frequently purchase loans in bulk or pools. We may experience lower yields or losses on loan pools because the assumptions we use when purchasing loans in bulk may not always prove correct.

From time to time, we purchase loans in bulk or pools. For the fiscal years ended June 30, 2008, 2007, and 2006, we purchased $178.7 million, $43.0 million, and $165.9 million, respectively, in single family and multifamily mortgage loans. During the fiscal year ended June 30, 2008, we also purchased a commercial real estate loan pool of $24.7 million. When we determine the purchase price we are willing to pay to purchase loans in bulk, management makes certain assumptions about, among other things, how fast borrowers will prepay their loans, the real estate market and our ability to collect loans successfully and, if necessary, to dispose of any real estate that may be acquired through foreclosure. When we purchase loans in bulk, we perform certain due diligence procedures and we purchase the loans subject to customary limited indemnities. To the extent that our underlying assumptions prove to be inaccurate or the basis for those assumptions change (such as an unanticipated decline in the real estate market), the purchase price paid for pools of loans may prove to have been excessive, resulting in a lower yield or a loss of some or all of the loan principal. For example, in the past, we have purchased pools of loans at a premium and some of the loans were prepaid before we expected. Accordingly, we earned less interest income on the purchase than expected. Our success in growing through purchases of loan pools depends on our ability to price loan pools properly and on general economic conditions in the geographic areas where the underlying properties of our loans are located.

Acquiring loans through bulk purchases may involve acquiring loans of a type or in geographic areas where management may not have substantial prior experience. We may be exposed to a greater risk of loss to the extent that bulk purchases contain such loans.

Our success depends in large part on the continuing efforts of a few individuals. If we are unable to retain these personnel or attract, hire and retain others to oversee and manage our company, our business could suffer.

Our success depends substantially on the skill and abilities of our senior management team, including our Chief Executive Officer and President, Gregory Garrabrants, our Chief Operating Officer, Gary Lewis Evans, our Chief Financial Officer, Andrew J. Micheletti, our Chief Loan Officer, Kenn Darling, and our Chief Technology Officer, Michael Berengolts, each of whom performs multiple functions that might otherwise be performed by separate individuals at larger banks, as well as our Chairman Jerry F. Englert and our Vice Chairman Theodore C. Allrich. These individuals may not be able to fulfill their responsibilities adequately, and they may not remain with us. The loss of the services of any of these individuals or other key employees, whether through termination of employment, disability or otherwise, could have a material adverse effect on our business. In addition, our ability to grow and manage our growth depends on our ability to continue to identify, attract, hire, train, retain and motivate highly skilled executive, technical, managerial, sales and marketing, customer service and professional personnel. The implementation of our business plan and our future success will depend on such qualified personnel. Competition for such employees is intense, and there is a risk that we will not be able to successfully attract, assimilate or retain sufficiently qualified personnel. If we fail to attract and retain the necessary technical, managerial, sales and marketing and customer service personnel, as well as experienced professionals, our business, prospects, financial condition and results of operations could be adversely affected.

We depend on third-party service providers for our core banking technology, and interruptions in or terminations of their services could materially impair the quality of our services.

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We rely substantially upon third-party service providers for our core banking technology and to protect us from bank system failures or disruptions. This reliance may mean that we will not be able to resolve operational problems internally or on a timely basis, which could lead to customer dissatisfaction or long-term disruption of our operations. Our operations also depend upon our ability to replace a third-party service provider if it experiences difficulties that interrupt operations or if an essential third-party service terminates. If these service arrangements are terminated for any reason without an immediately available substitute arrangement, our operations may be severely interrupted or delayed. If such interruption or delay were to continue for a substantial period of time, our business, prospects, financial condition and results of operations could be adversely affected.

We are exposed to risk of environmental liability with respect to properties to which we take title.

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

We have risks of systems failure and security risks, including hacking and identity theft.

The computer systems and network infrastructure utilized by us and others could be vulnerable to unforeseen problems. This is true of both our internally developed systems and the systems of our third-party service providers. Our operations are dependent upon our ability to protect computer equipment against damage from fire, power loss, telecommunication failure or similar catastrophic events. Any damage or failure that causes an interruption in our operations could adversely affect our business, prospects, financial condition and results of operations.

Recent Accounting Pronouncements

In March 2006, the FASB issued Statement No. 156, *Accounting for Servicing of Financial Assets-an amendment of FASB Statement No. 140.* This Statement provides the following: 1) revised guidance on when a servicing asset and servicing liability should be recognized; 2) requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable; 3) permits an entity to elect to measure servicing assets and servicing liabilities at fair value each reporting date and report changes in fair value in earnings in the period in which the changes occur; 4) upon initial adoption, permits a onetime reclassification of available-for-sale securities to trading securities for securities which are identified as offsetting the entity s exposure to changes in the fair value of servicing assets or liabilities that a servicer elects to subsequently measure at fair value; and 5) requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional footnote disclosures. This standard is effective as of the beginning of an entity s first fiscal year that begins after September 15, 2006 with the effects of initial adoption being reported as a cumulative-effect adjustment to retained earnings. The adoption of this statement did not have a material impact on the Company s consolidated financial position or results of operations.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* This interpretation clarifies the accounting for uncertainty in income taxes recognized in an entity s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return. Under FIN 48, an income tax position will be recognized if it is more likely than not that it will be sustained upon IRS examination, based upon its technical merits. Once that

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status is met, the amount recorded will be the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 was effective as of the fiscal year beginning July 1, 2007.

The Company adopted FIN 48 effective July 1, 2007. There was no cumulative effect of applying the provisions of FIN 48 and there was no material effect on the Company s provision for income taxes for the year ended June 30, 2008. The Company is subject to federal income tax and income tax of the state of California as well as various other states. The Company s federal income tax returns for the years ended June 30, 2004, 2005, 2006, and 2007 and its California state tax returns for the years ended June 30, 2003, 2004, 2005, 2006 and 2007 are open to audit under the statutes of limitations by the Internal Revenue Service and California Franchise Tax Board. The Company records interest and penalties related to uncertain tax positions as part of income tax expense. The adoption of FIN 48 did not have a material effect on the Company s consolidated financial position or results of operations.

In September 2006, the FASB Emerging Issues Task Force finalized Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* (EITF 06-4). This issue requires that a liability be recorded during the service period when a split-dollar life insurance agreement continues after participants employment or retirement. The required accrued liability will be based on either the post-employment benefit cost for the continuing life insurance or based on the future death benefit depending on the contractual terms of the underlying agreement. This issue is effective for fiscal years beginning after December 15, 2007. The adoption of this statement on July 1, 2008 did not have any impact on the Company s consolidated financial position or results of operations.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, (SFAS No. 159). This Statement allows entities to voluntarily choose, at specified election dates, to measure many financial assets and financial liabilities (as well as certain non-financial instruments that are similar to financial instruments) at fair value. The election is made on an instrument-by-instrument basis and is irrevocable. The Statement is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. Earlier adoption of the Statement is permitted as of the beginning of an entity s fiscal year, provided the choice to early adopt is made within 120 days of the beginning of the fiscal year of adoption and the entity has not yet issued financial statements for any interim period of that fiscal year.

The Company expects to adopt SFAS 159 along with SFAS 157 effective as of July 1, 2008. The Company is currently evaluating, which, if any items it will elect to recognize at fair value at the date of adoption. The impact on the Company s consolidated financial position and results of operations will depend on which items the Company elects to recognize at fair value and the fair value at date of adoption.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

See Management Discussion and Analysis of Financial Condition and Results of Operations Quantitative and Qualitative Disclosures About Market Risk

Item 8. Financial Statements and Supplemental Data

The following financial statements are filed as a part of this report beginning on page F 1.

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Report of Independent Registered Public Accounting Firm	F 2
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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, under supervision and with the participation of the Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures, as defined under Exchange Act Rule 13a-15(e). Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2008, the disclosure controls and procedures were effective to ensure that information required to be disclosed in the Company s Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities Exchange Commission s rules and forms.

Management s Report On Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined under Exchange Act Rules 13a-15(f) and 14d-14(f). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

All internal control systems, no matter how well designed, have inherent limitations and may not prevent or detect misstatements. Therefore, even those systems determined to be effective can only provide reasonable assurance with respect to financial reporting reliability and financial statement preparation and presentation. In addition, projections of any evaluation of effectiveness to future periods are subject to risk that controls become inadequate because of changes in conditions and that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company s internal control over financial reporting as of June 30, 2008. In making the assessment, management used the criteria issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on its assessment, management concluded that, as of June 30, 2008, the Company s internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal controls over financial reporting that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

This annual report does not include an attestation report of the Company s registered public accounting firm regarding internal control over financial reporting. Management s report was not subject to attestation by the Company s registered public accounting firm pursuant to the temporary rules of the Securities and Exchange Commission that permit the Company to provide only management s report in this annual report.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information called for by this item with respect to directors and executive officers is incorporated herein by reference to the information contained in the section captioned Election of Directors in our definitive Proxy Statement for the period ended June 30, 2008, which Proxy Statement will be filed with the Securities and Exchange Commission within 120 days after June 30, 2008.

The information with respect to our audit committee and our audit committee financial expert is incorporated herein by reference to the information contained in the section captioned Election of Directors Committees of the Board of Directors in the Proxy Statement. The information with respect to our Code of Ethics is incorporated herein by reference to the information contained in the section captioned Election of Directors Corporate Governance Code of Business Conduct in the Proxy Statement.

Item 11. Executive Compensation

The information called for by this item is incorporated herein by reference to the information contained in the section captioned Executive Compensation in the Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information called for by this item is incorporated herein by reference to the information contained in the sections captioned Principal Holders of Common Stock and Security Ownership of Directors and Executive Officers in the Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information called for by this item is incorporated herein by reference to the information contained in the sections captioned Executive Compensation Certain Transactions in the Proxy Statement.

Item 14. Principal Accounting Fees and Services

The information called for by this item is incorporated herein by reference to the information contained in the section captioned Independent Public Accountants in the Proxy Statement.

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PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) The following documents are filed as part of this report:

1. Financial Statements: See Index to Consolidated Financial Statements below on page F-1 of this report.

2. Financial Statement Schedules have been omitted since they are either not required, not applicable, or the information is otherwise included.

3. Exhibits:

(b) A list of exhibits required to be filed as part of this report is set forth in the Exhibit Index on page 50 of this Report on Form 10-K, which immediately precedes such exhibits, and is incorporated herein by reference.

EXHIBIT INDEX

Exhibit Number	Description
3.1	Articles of incorporation[1]
3.2	By-laws[1]
4.1	Specimen Stock Certificate of the Registrant[1]
4.2	Certificate of Designation Series A Preferred[1]
4.3	Certificate of Designation Series B Preferred[2]
10.1	Form of Indemnification Agreement between the Registrant and each of its executive officers and directors[1]
10.2*	Amended and Restated 1999 Stock Option Plan, as amended[1]
10.3*	2004 Stock Incentive Plan[1] , as amended November 20, 2007
10.4*	2004 Employee Stock Purchase Plan, including forms of agreements thereunder[1]
10.5	Office Space Lease, dated April 25, 2005, for 12777 High Bluff Drive, San Diego, California 92130 By and Between DL San Diego LP, a Delaware limited partnership, Landlord And Bank of Internet USA, a Federal Savings Bank[2]
10.6*	Employment Agreement, dated July 1, 2003, between Bank of Internet USA and Gary Lewis Evans[1] , as amended October 22, 2007 and March 6, 2008
10.7*	Employment Agreement, dated July 1, 2003, between Bank of Internet USA and Andrew J. Micheletti[1]
10.8*	Employment Agreement, dated July 1, 2003, between Bank of Internet USA and Michael J. Berengolts[1]
10.9	Amended and Restated Declaration of Trust of BofI Trust I dated December 16, 2004[1]
10.10	Website Lease Agreement dated April 2, 2007, Between CWI, Inc., a Kentucky Corporation, Landlord and Bank of Internet US[3]
10.11*	Employment Agreement, dated October 22, 2007, between Bank of Internet USA and Gregory Garrabrants[5]
21.1	Subsidiaries of the Registrant consist of Bank of Internet USA (federal charter) and BofI Trust I (Delaware charter)[1]
23.1	Consent of Crowe Horwath LLP, Independent Registered Public Accounting Firm
24.1	Power of Attorney, incorporated by reference to the signature page to this report
31.1	Chief Executive Officer Certification Pursuant to Section 302 of the Sarbanes- Oxley Act of 2002
31.2	Chief Financial Officer Certification Pursuant to Section 302 of the Sarbanes- Oxley Act of 2002
32.1	Chief Executive Officer Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Indicated management contract or compensatory plan, contract or arrangement.
[1] Incorporated by reference from the same exhibit number in the Registration Statement on Form S-1 (File No. 333-121329) filed by the Company on December 16, 2004 and amended January 26, 2005; February 24, 2005 and March 11, 2005.

[2] Incorporated by reference from Exhibit 99.1 to the Current Report on Form 8-K (File No. 000-51201) filed by the Company on June 30, 2008.

[3] Incorporated by reference from Exhibit 99.1 to the Current Report on Form 8-K (File No. 000-51201) filed by the Company on April 28, 2005.

[4] Incorporated by reference from Exhibit 10.1 to the Current Report on Form 8-K (File No. 000-51201) filed by the Company on April 2, 2007.

[5] Incorporated by reference from Exhibit 10.11 to the Current Report on Form 8-K (File No. 000-51201) filed by the Company on October 23, 2007.

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Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	BOFI HOLDING, INC.
Date: September 23, 2008	By: /s/ Gregory Garrabrants Gregory Garrabrants Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Gregory Garrabrants and Andrew J. Micheletti jointly and severally, his or her attorneys-in-fact, each with the power of substitution, for him or her in any and all capacities, to sign any amendments to this Report on Form 10-K, and file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant as of this 23rd day of September 2008 in the capacities indicated.

Signature	Title
/s/ Gregory Garrabrants Gregory Garrabrants	Chief Executive Officer (Principal Executive Officer), director
/s/ Andrew J. Micheletti Andrew J. Micheletti	Chief Financial Officer (Principal Financial and Accounting Officer)
/s/ Jerry F. Englert Jerry F. Englert	Chairman
/s/ Theodore C. Allrich Theodore C. Allrich	Vice Chairman
/s/ Gary Burke Gary Burke	Director
/s/ Michael Chipman Michael Chipman	Director
/s/ Paul Grinberg	Director

Paul Grinberg	
/s/ Thomas J. Pancheri	Director
Thomas J. Pancheri	
/s/ Connie M. Paulus	Director
Connie M. Paulus	
/s/ Gordon L. Witter	Director

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BOFI HOLDING, INC.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of BofI Holding, Inc.

San Diego, California

We have audited the accompanying consolidated balance sheets of BofI Holding, Inc. and subsidiary (the Company) as of June 30, 2008 and 2007, and the related consolidated statements of income, stockholders equity and comprehensive income, and cash flows for each of the years in the three-year period ended June 30, 2008. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of BofI Holding, Inc. and subsidiary as of June 30, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended June 30, 2008, in conformity with accounting principles generally accepted in the United States of America.

/s/ Crowe Horwath LLP

Grand Rapids, Michigan
September 23, 2008

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BofI HOLDING, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

	June 30, 2008	June 30, 2007
ASSETS		
Cash and due from banks	$ 4,214	$ 1,233
Federal funds sold	12,050	38,475
Total cash and cash equivalents	16,264	39,708
Time deposits in financial institutions	1,980	12,082
Investment securities available for sale	209,119	296,068
Investment securities held to maturity	300,895	61,902
Stock of the Federal Home Loan Bank, at cost	19,395	12,659
Loans net of allowance for loan losses of $2,710 in 2008; $1,450 in 2007	631,413	507,906
Accrued interest receivable	5,740	6,013
Furniture, equipment and software net	391	242
Deferred income tax	918	431
Cash surrender value of life insurance	4,547	4,364
Other assets	3,583	5,788
TOTAL	$ 1,194,245	$ 947,163
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Non-interest bearing	$ 5,509	$ 993
Interest bearing	565,195	546,956
Total deposits	570,704	547,949
Securities sold under agreements to repurchase	130,000	90,000
Advances from the Federal Home Loan Bank	398,966	227,292
Junior subordinated debentures	5,155	5,155
Accrued interest payable	2,366	2,712
Accounts payable and accrued liabilities	3,972	1,305
Total liabilities	1,111,163	874,413
COMMITMENTS AND CONTINGENCIES (Note 14)		
STOCKHOLDERS EQUITY:		
Preferred stock 1,000,000 shares authorized;		
Series A $10,000 stated value; 515 (2008) and 515 (2007) shares issued and outstanding	5,063	5,063
Series B $1,000 stated value; 3,750 (2008) and none (2007) shares issued and outstanding	3,750	
Common stock $0.01 par value; 25,000,000 shares authorized;		
8,627,840 shares issued and 8,299,563 shares outstanding (2008);		
8,587,090 shares issued and 8,267,590 shares outstanding (2007);	86	86
Additional paid-in capital	60,684	59,803
Accumulated other comprehensive income/(loss) net of tax	1,017	(865)
Retained earnings	14,975	11,091
Treasury stock	(2,493)	(2,428)
Total stockholders equity	83,082	72,750

TOTAL	$ 1,194,245	$ 947,163

See notes to consolidated financial statements.

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BofI HOLDING, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except earnings per share)

	Year Ended June 30,		
	2008	2007	2006
INTEREST AND DIVIDEND INCOME:			
Loans, including fees	$ 33,499	$ 29,370	$ 27,629
Investments	29,802	15,216	5,084
Total interest and dividend income	63,301	44,586	32,713
INTEREST EXPENSE:			
Deposits	28,358	21,567	14,930
Advances from the Federal Home Loan Bank	11,417	10,406	7,466
Other borrowings	5,506	1,765	362
Total interest expense	45,281	33,738	22,758
Net interest income	18,020	10,848	9,955
Provision (benefit) for loan losses	2,226	(25)	60
Net interest income, after provision for loan losses	15,794	10,873	9,895
NON-INTEREST INCOME:			
Prepayment penalty fee income	287	399	721
Mortgage banking income	2	93	289
Net gain on securities	711	403	
Banking service fees and other income	379	285	332
Total non-interest income	1,379	1,180	1,342
NON-INTEREST EXPENSE:			
Salaries, employee benefits and stock-based compensation	5,426	2,993	2,795
Professional services	654	537	443
Occupancy and equipment	373	363	347
Data processing and internet	656	586	491
Advertising and promotional	750	584	338
Depreciation and amortization	132	88	89
FDIC and OTS regulatory fees	744	238	188
Other general and administrative	1,427	1,061	1,098
Total non-interest expense	10,162	6,450	5,789
INCOME BEFORE INCOME TAXES	7,011	5,603	5,448
INCOME TAXES	2,815	2,284	2,182
NET INCOME	$ 4,196	$ 3,319	$ 3,266
NET INCOME ATTRIBUTABLE TO COMMON STOCK	$ 3,884	$ 3,007	$ 2,906

Basic earnings per share	$ 0.47	$ 0.36	$ 0.35
Diluted earnings per share	0.46	0.36	0.34

See notes to consolidated financial statements.

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BofI HOLDING, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME

(Dollars in thousands)

	Convertible Preferred Stock		Common Stock Number of Shares						Accumulated Other Comprehensive Income (Loss), Net of Income Tax			
	Shares	Amount	Issued	Treasury	Outstanding	Amount	Additional Paid-in Capital	Retained Earnings		Treasury Stock	Comprehensive Income	Total
BALANCE July 1, 2005	675	$ 6,637	8,299,823		8,299,823	$ 83	$ 56,746	$ 5,178	6			$ 68,650
Comprehensive income:												
Net income								3,266			$ 3,266	3,266
Net unrealized loss from investment securities net of income tax expense									(891)		(891)	(891)
Total comprehensive income											$ 2,375	
Cash dividends on convertible preferred stock								(360)				(360)
Convert preferred stock to common stock	(150)	(1,474)	142,800		142,800	1	1,473					
Stock-based compensation expense							409					409
Restricted stock grant			17,500									
Purchase of Treasury Stock				(163,500)	(163,500)					(1,325)		(1,325)
Stock options exercises			101,602		101,602	1	496					497
BALANCE June 30, 2006	525	5,163	8,561,725	(163,500)	8,380,725	85	59,124	8,084	(885)	(1,325)		70,246
Comprehensive income:												
Net income								3,319			$ 3,319	3,319
Net unrealized gain from investment securities net of income tax									20		20	20

expense												
Total comprehensive income											$ 3,339	
Cash dividends on convertible preferred stock								(312)				(312)
Convert preferred stock to common stock	(10)	(100)	7,690		7,690	1	100					1
Stock-based compensation expense							491					491
Restricted stock grant			16,100									
Restricted stock distributed to trust					33,600							
Purchase of Treasury Stock				(156,000)	(156,000)					(1,103)		(1,103)
Stock options exercises and tax benefits of equity compensation			1,575		1,575		88					88
BALANCE June 30, 2007	515	5,063	8,587,090	(319,500)	8,267,590	86	59,803	11,091	(865)	(2,428)		72,750
Comprehensive income:												
Net income								4,196			$ 4,196	4,196
Net unrealized gain from investment securities net of income tax expense									1,882		1,882	1,882
Total comprehensive income											$ 6,078	
Cash dividends on convertible preferred stock								(312)				(312)
Issuance of convertible preferred stock	3,750	3,750										3,750
Stock-based compensation expense							776					776
Restricted stock grant			20,750	(8,777)	11,973					(65)		(65)
Stock option exercises and tax benefits of equity compensation			20,000		20,000		105					105

BALANCE June 30, 2008	4,265	$ 8,813	8,627,840	(328,277)	8,299,563	$ 86	$ 60,684	$ 14,975	$ 1,017	$ (2,493)	$ 83,082

See notes to consolidated financial statements.

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BofI HOLDING, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Year Ended June 30, 2008	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 4,196	$ 3,319	$ 3,266
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Amortization (accretion) of premiums (discounts) on securities	(1,845)	427	227
Amortization of premiums and deferred loan fees	1,942	1,587	1,885
Amortization of borrowing costs	74	115	115
Stock-based compensation expense	776	491	409
Net gain on sale of available for sale securities	(1,711)	(403)	
Impairment charge on preferred stock	1,000		
Provision (benefit) for loan losses	2,226	(25)	60
Deferred income taxes	(1,741)	418	22
Origination of loans held for sale	(516)	(7,579)	(20,762)
Gain on sales of loans held for sale	(2)	(30)	(108)
Proceeds from sale of loans held for sale	518	7,609	21,059
Depreciation and amortization	132	88	89
Stock dividends from the Federal Home Loan Bank	(697)	(624)	(409)
(Gain) loss on disposal of fixed assets			(10)
Net changes in assets and liabilities which provide (use) cash:			
Accrued interest receivable	273	(2,586)	(1,072)
Other assets	2,506	(2,945)	(2,220)
Accrued interest payable	(346)	1,557	502
Accounts payable and accrued liabilities	2,598	407	(539)
Net cash provided by operating activities	9,383	1,826	2,514
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of mortgage-backed securities available for sale	(210,032)	(303,384)	(95,411)
Purchases of held to maturity investments and time deposits	(286,319)	(75,027)	(21,236)
Proceeds from sale of mortgage-backed securities	212,329	74,746	
Proceeds from repayment of available for sale securities	87,635	59,843	29,179
Repayments of investments held to maturity and time deposits	60,141	29,857	12,343
Purchase of stock of the Federal Home Loan Bank	(6,258)	(924)	(2,576)
Proceeds from redemption of stock of Federal Home Loan Bank	219		
Origination of loans	(64,888)	(67,449)	(7,720)
Purchases of loans, net of discounts and premiums	(205,067)	(44,976)	(165,906)
Principal repayments on loans	141,796	136,598	124,912
Purchases of furniture, equipment and software	(281)	(108)	(87)
Net cash used in investing activities	(270,725)	(190,824)	(126,502)

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BofI HOLDING, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Year Ended June 30,		
	2008	**2007**	**2006**
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase in deposits	$ 22,755	$ 123,745	$ 63,153
Proceeds from the Federal Home Loan Bank advances	257,000	38,000	80,000
Repayment of the Federal Home Loan Bank advance	(85,400)	(47,000)	(16,500)
Proceeds from repurchase agreements	40,000	90,000	
Purchase of treasury stock		(1,103)	(1,325)
Proceeds from exercise of common stock options	91	6	427
Proceeds from issuance of convertible preferred stock Series B	3,750		
Tax benefit from exercise of common stock options	14	82	70
Cash dividends on convertible preferred stock	(312)	(312)	(360)
Net cash provided by financing activities	237,898	203,418	125,465
NET CHANGE IN CASH AND CASH EQUIVALENTS	(23,444)	14,420	1,477
CASH AND CASH EQUIVALENTS Beginning of year	39,708	25,288	23,811
CASH AND CASH EQUIVALENTS End of year	$ 16,264	$ 39,708	$ 25,288
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Interest paid on deposits and borrowed funds	$ 45,552	$ 32,066	$ 22,140
Income taxes paid	$ 2,675	$ 1,710	$ 2,403
Transfers to other real estate	$ 484		

See notes to consolidated financial statements. (Concluded)

BofI HOLDING, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2008, 2007 AND 2006

(Dollars in thousands, except earnings per share)

1. ORGANIZATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation The consolidated financial statements include the accounts of BofI Holding, Inc. and its wholly owned subsidiary, Bank of Internet USA (collectively, the Company). All significant intercompany balances have been eliminated in consolidation.

BofI Holding, Inc. was incorporated in the State of Delaware on July 6, 1999 for the purpose of organizing and launching an Internet-based savings bank. The Bank of Internet USA (the Bank), which opened for business over the Internet on July 4, 2000, is subject to regulation and examination by the Office of Thrift Supervision (OTS), its primary regulator. The Federal Deposit Insurance Corporation (FDIC) insures the Bank s deposit accounts up to the maximum allowable amount.

Use of Estimates In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, and the fair value of certain financial instruments.

Business The Bank provides financial services to consumers through the Internet. The Bank s deposit products are demand accounts, savings accounts and time deposits marketed to consumers located in all 50 states. The Bank s primary lending products are residential single family and multifamily mortgage loans. The Bank s business is primarily concentrated in the state of California and is subject to the general economic conditions of that state.

Cash Flows Cash and cash equivalents include cash due from banks, money market mutual funds and federal funds sold, all of which have original maturities within 90 days. Net cash flows are reported for customer deposit transactions.

Restrictions on Cash Federal Reserve Board regulations require depository institutions to maintain certain minimum reserve balances, which do not earn interest. Included in cash were balances required by the Federal Reserve Bank of San Francisco of $2,689 and $738 at June 30, 2008 and 2007, respectively.

Interest Rate Risk The Bank s assets and liabilities are generally monetary in nature and interest rate changes have an effect on the Bank s performance. The Bank decreases the effect of interest rate changes on its performance by striving to match maturities and interest sensitivity between loans and deposits. A significant change in interest rates could have a material effect on the Bank s results of operations.

Securities Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Declines in the fair value of securities below their cost that are other than temporary are reflected as realized losses. In estimating other-than-temporary losses, management considers: the length of time and extent that fair value has been less than cost, the financial condition and near term prospects of the issuer, and the Company s ability and intent to hold the security for a period sufficient to allow for any anticipated

recovery in fair value.

Loans Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unearned interest, deferred purchase premiums and discounts, deferred loan origination fees and costs, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Premiums and discounts on loans purchased as well as loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method.

Interest income on loans is generally discontinued at the time the loan is 90 days delinquent unless the loan is well secured and in process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loans Held for Sale Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. The Bank generally sells its loans with the servicing released to the buyer. Gains and losses on loan sales are recorded as mortgage banking income, based on the difference between sales proceeds and carrying value.

Allowance for Loan Losses The allowance for loan losses is maintained at a level estimated to provide for probable incurred losses in the loan portfolio. Management determines the adequacy of the allowance based on reviews of individual loans and pools of loans, recent loss experience, current economic conditions, the risk characteristics of the various categories of loans and other pertinent factors. This evaluation is inherently subjective and requires estimates that are susceptible to significant revision as more information becomes available. The allowance is increased by the provision for loan losses, which is charged against current period operating results and recoveries of loans previously charged-off. The allowance is decreased by the amount of charge-offs of loans deemed uncollectible. Allocations of the allowance may be made for specific loans but the entire allowance is available for any loan that, in management s judgment, should be charged off.

Under the allowance for loan loss policy, impairment calculations are determined based on general portfolio data for general reserves and loan level data for specific reserves. Specific loans are evaluated for impairment and are classified as nonperforming or in foreclosure when they are 90 days or more delinquent. A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan s effective interest rate or the fair value of the collateral if repayment of the loan is expected primarily from the sale of collateral.

General loan loss reserves are calculated by grouping each loan by collateral type and by grouping the loan-to-value ratios of each loan within the collateral type. An estimated allowance rate for each loan-to-value group within each type of loan is multiplied by the total principal amount in the group to calculate the required general reserve attributable to that group. Management uses an allowance rate that provides a larger loss allowance for loans with greater loan-to-value ratios. General loan loss reserves for consumer loans are calculated by grouping each loan by credit score (e.g. FICO) at origination and applying an estimated allowance rate to each group. Specific reserves are calculated when an internal asset review of a loan identifies a significant adverse change in the financial position of the borrower or the value of the collateral. The specific reserve is based on discounted cash flows, observable market prices or the estimated value of underlying collateral.

Derivatives All derivative instruments are recorded at their fair values, with changes in fair values included in earnings. If derivative instruments are designated as hedges of fair values, both the change in the fair value of the hedge and the hedged item are included in current earnings. Fair value adjustments related to cash flow hedges are recorded in other comprehensive income and reclassified to earnings when the hedged transaction is reflected in earnings. Ineffective portions of hedges are reflected in earnings as they occur.

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Furniture, Equipment and Software Fixed asset purchases in excess of five hundred dollars are capitalized and recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which are three to seven years. Leasehold improvements are amortized over the lesser of the assets useful lives or the lease term.

Income Taxes Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this 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. The Company records a valuation allowance when management believes it is more likely than not that deferred tax assets will not be realized.

Earnings Per Share Earnings per share (EPS) are presented under two formats: basic EPS and diluted EPS. Basic EPS is computed by dividing the net income (after deducting dividends on preferred stock) by the weighted-average number of common shares outstanding during the year. Diluted EPS is computed by dividing the net income (after deducting dividends on preferred stock) by the weighted-average number of common shares outstanding during the year, plus the impact of dilutive potential common shares, such as stock options and stock warrants. The impact on earnings per share from the convertible preferred stock is antidilutive.

Stock-Based Compensation Effective July 1, 2005, the Company adopted Statement of Financial Accounting Standards(SFAS) No. 123(R), using the modified prospective transition method. Accordingly the company has recorded stock-based employee compensation costs using the fair value method since adoption of SFAS No. 123(R).

Federal Home Loan Bank (FHLB) stock The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value.

Cash Surrender Value of Life Insurance The Bank has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at its cash surrender value, or the amount that can be realized.

Loan Commitments and Related Financial Instruments Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Comprehensive Income Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale, which are also recognized as separate components of equity.

Loss Contingencies Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Dividend Restriction Banking regulations require maintaining certain capital levels and may limit the dividends paid by the bank to the holding company.

Fair Value of Financial Instruments Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Operating Segments While the chief decision-makers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

New Accounting Pronouncements In March 2006, the FASB issued Statement No. 156, *Accounting for Servicing of Financial Assets-an amendment of FASB Statement No. 140.* This Statement provides the following: 1) revised guidance on when a servicing asset and servicing liability should be recognized; 2) requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable; 3) permits an entity to elect to measure servicing assets and servicing liabilities at fair value each reporting date and report changes in fair value in earnings in the period in which the changes occur; 4) upon initial adoption, permits a onetime reclassification of available-for-sale securities to trading securities for securities which are identified as offsetting the entity s exposure to changes in the fair value of servicing assets or liabilities that a servicer elects to subsequently measure at fair value; and 5) requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional footnote disclosures. This standard is effective as of the beginning of an entity s first fiscal year that begins after September 15, 2006 with the effects of initial adoption being reported as a cumulative-effect adjustment to retained earnings. The adoption of this statement did not have a material impact on the company s consolidated financial position or results of operations.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* This interpretation clarifies the accounting for uncertainty in income taxes recognized in an entity s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return. Under FIN 48, an income tax position will be recognized if it is more likely than not that it will be sustained upon IRS examination, based upon its technical merits. Once that status is met, the amount recorded will be the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 was effective as of the fiscal year beginning July 1, 2007.

The Company adopted FIN 48 effective July 1, 2007. There was no cumulative effect of applying the provisions of FIN 48 and there was no material effect on the Company s provision for income taxes for the year ended June 30, 2008. The Company is subject to federal income tax and income tax of the state of California as well as various other states. The Company s federal income tax returns for the years ended June 30, 2004, 2005, 2006, and 2007 and its California state tax returns for the years ended June 30, 2003, 2004, 2005, 2006 and 2007 are open to audit under the statutes of limitations by the Internal Revenue Service and California Franchise Tax Board. The Company records interest and penalties related to uncertain tax positions as part of income tax expense. There was no penalty or interest expense recorded for the years ended June 30, 2008 or 2007. The adoption of FIN 48 did not have a material effect on the Company s consolidated financial position or results of operations.

In September 2006, the FASB Emerging Issues Task Force finalized Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* (EITF 06-4). This issue requires that a liability be recorded during the service period when a split-dollar life insurance agreement continues after participants employment or retirement. The required accrued liability will be based on either the post-employment benefit cost for the continuing life insurance or based on the future death benefit depending on the contractual terms of the underlying agreement. This issue is effective for fiscal years beginning after December 15, 2007. The adoption of this statement on July 1, 2008 did not have any impact on the Company s consolidated financial position or results of operations.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, (SFAS No. 159). This Statement allows entities to voluntarily choose, at specified election dates, to measure many financial assets and financial liabilities (as well as certain non-financial instruments that are similar to financial instruments) at fair value. The election is made on an instrument-by-instrument basis and is irrevocable. The Statement is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. Earlier adoption of the Statement is permitted as

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of the beginning of an entity s fiscal year, provided the choice to early adopt is made within 120 days of the beginning of the fiscal year of adoption and the entity has not yet issued financial statements for any interim period of that fiscal year.

The Company expects to adopt SFAS 159 along with SFAS 157 effective as of July 1, 2008. The Company is currently evaluating, which, if any items it will elect to recognize at fair value at the date of adoption. The impact on the Company s consolidated financial position and results of operations will depend on which items the Company elects to recognize at fair value and the fair value at date of adoption.

2. TIME DEPOSITS IN FINANCIAL INSTITUTIONS

The Company had insured time deposits at various financial institutions totaling $1,980 and $12,082 at June 30, 2008 and 2007, respectively. The carrying amounts of such investments as shown in the balance sheets are at cost. Time deposits at June 30, 2008 of $1,980 will mature within one year. In the year-ended June 30, 2008 the Company decided to reinvest the funds we had invested in time deposits into loans and mortgage-backed securities.

3. INVESTMENT SECURITIES

Available-for-sale Amortized costs and the fair value of investment securities available-for-sale are summarized as follows:

	June 30, 2008			
	Amortized Cost	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
Mortgage-backed securities - U.S. agency (GNMA, FNMA, FHLMC)	$ 198,347	$ 1,787	$ (87)	$ 200,047
Preferred Stock - FNMA	9,072			9,072
	$ 207,419	$ 1,787	$ (87)	$ 209,119

	June 30, 2007			
	Amortized Cost	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
Mortgage-backed securities - U.S. agency (GNMA, FNMA, FHLMC)	$ 297,507	$ 494	$ (1,933)	$ 296,068
	$ 297,507	$ 494	$ (1,933)	$ 296,068

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The amortized cost and fair value of available-for-sale debt securities by contractual maturity at June 30, 2008 are as follows:

	Amortized Cost	Fair Value
Mortgage-backed securities -U.S. agency		
Due within one year	$ 1,403	$ 1,408
Due one to five years	6,537	6,579
Due five to ten years	17,466	17,606
Due after ten years	172,941	174,454
Total Mortgage-backed securities -U.S. agency	$ 198,347	$ 200,047

Contractual maturities are based upon scheduled principal payments assuming no prepayments.

Available-for-sale securities totaling $200,000 and $296,000 were pledged to secure borrowings as of June 30, 2008 and 2007.

Held-to-maturity The carrying amount and the fair value of investment securities held-to-maturity are summarized as follows:

	June 30, 2008			
	Carrying Amount	Unrecognized Gains	Unrecognized Losses	Fair Value
Mortgage-backed securities-U.S. agency	$ 21,529	$ 271	$ (17)	$ 21,783
Mortgage-backed securities-AAA non-agency	258,328	11,547	(4,637)	265,238
U.S. Government agency debt	9,983	49		10,032
Trust preferred collateralized debt	11,055		(3,504)	7,551
Total	$ 300,895	$ 11,867	$ (8,158)	$ 304,604

	June 30, 2007			
	Carrying Amount	Unrecognized Gains	Unrecognized Losses	Fair Value
Mortgage-backed securities (U.S. agency)	$ 17,024	$ 64	$ (80)	$ 17,008
U.S. Government agency debt	38,773		(447)	38,326
Trust preferred collateralized debt	6,105		(105)	6,000
Total	$ 61,902	$ 64	$ (632)	$ 61,334

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The carrying amount and fair values of investment securities held-to-maturity by contractual maturity at June 30, 2008 are as follows:

	Carrying Amount	Fair Value
Mortgage-backed securities (MBS) -U.S. agency [1]		
Due within one year	$ 321	$ 325
Due one to five years	1,475	1,488
Due five to ten years	2,579	2,607
Due after ten years	17,154	17,363
Total MBS-U.S. agency	21,529	21,783
U.S. Government agency debt		
Due within one year	485	487
Due one to five years	2,265	2,276
Due five to ten years	3,729	3,746
Due after ten years	3,504	3,523
Total U.S. Government agency debt	9,983	10,032
Mortgage-backed securities-AAA non-agency [1]		
Due within one year		
Due one to five years	17,741	18,293
Due five to ten years	27,582	28,405
Due after ten years	213,005	218,540
Total MBS-AAA non-agency	258,328	265,238
Trust preferred collateralized debt		
Due after ten years	11,055	7,551
Total trust preferred collateralized debt	11,055	7,551
Total	$ 300,895	$ 304,604

(1) Maturities of mortgage-backed securities were determined based on contractual principal maturities assuming no prepayments.

Held-to-maturity securities totaling $297,000 and $55,000 were pledged to secure borrowings as of June 30, 2008 and 2007.

Securities with unrealized losses at year-end 2008 and 2007, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

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June 30, 2008	Less Than 12 Months		More Than 12 Months		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Securities available for sale:						
MBS-U.S. agency	$ 9,646	$ (40)	$ 4,886	$ (47)	$ 14,532	$ (87)
Sub-total	9,646	(40)	4,886	(47)	14,532	(87)
Securities held to maturity:						
MBS-U.S. agency	1,633	(5)	835	(12)	2,468	(17)
MBS-AAA non-agency	77,855	(4,637)			77,855	(4,637)
Trust preferred collateralized debt	2,839	(2,161)	4,712	(1,343)	7,551	(3,504)
Sub-total	82,327	(6,803)	5,547	(1,355)	87,874	(8,158)
Total	$ 91,973	$ (6,843)	$ 10,433	$ (1,402)	$ 102,406	$ (8,245)

June 30, 2007	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Securities available for sale:						
MBS-U.S. agency	$ 187,312	$ (1,678)	$ 25,448	$ (255)	$ 212,760	$ (1,933)
Securities held to maturity:						
MBS-U.S. agency	8,063	(42)	2,674	(38)	10,737	(80)
U.S. Government agency debt	38,326	(447)			38,326	(447)
Trust preferred collateralized debt	6,000	(105)			6,000	(105)
Total	52,389	(594)	2,674	(38)	55,063	(632)
Total	$ 239,701	$ (2,272)	$ 28,122	$ (293)	$ 267,823	$ (2,565)

There were six securities that were in a continuous loss position at June 30, 2008 for a period of more than 12 months. There were twelve securities that were in a continuous loss position at June 30, 2007 for a period of more 12 months.

The fair values for U.S. agency mortgage-backed securities and preferred stock available-for-sale and the fair values for U.S. Government agency debt securities held-to-maturity are obtained by the Company from quoted prices on active markets. As quoted prices from active markets are not available, the fair values of non-agency securities held to maturity are determined by the Company utilizing matrix pricing, which is a mathematical technique widely used in the industry to value securities based on the securities relationship to other benchmark quoted securities. The Company s pricing matrix for its portfolio of AAA non-agency mortgage-backed securities and its trust preferred collateralized debt securities uses actual and forecasted default rates, actual and forecasted loss severities, collateral seasoning and other individual characteristics of the specific loans comprising the loan pools as well as the structural subordination and overcollateralization characteristics of the securities to estimate future cash flows and select discount rates to calculate each security s fair value.

During fiscal 2008 significant disruptions in the mortgage markets and severe reduction in market liquidity for certain mortgage products, such as private-label mortgage-related securities backed by non-agency loans, actual trades for these instruments became less observable. The Company s determination of the fair values involves significant judgment resulting in a reasonable measurement of fair value in accordance with the requirements of generally accepted accounting principles. The fair values calculated by the Company could be significantly in excess of the actual proceeds that would be received if it were forced to sell these assets in a short period of time into the current market which is characterized by illiquidity and opportunistic pricing by a limited number of market participants.

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The Company monitors securities in its held to maturity and available for sale investment portfolios for other-than- temporary impairment. Impairment may result from factors including credit deterioration and changes in market rates relative to the interest rate of the instrument. The Company considers many factors in determining whether impairment is other than temporary, including but not limited to the length of time the security has had a fair value less than the cost basis, the severity of the unrealized loss, the Company s intent and ability to hold the security for a period of time sufficient for a recovery in value, issuer specific factors such as the issuer s financial condition, external credit ratings and general market conditions. The Company recognized other-than-temporary impairment loss on preferred stock of FNMA in the available for sale securities portfolio of $1,000 during the last quarter of the year ended June 30, 2008. Subsequent to June 30, 2008, the U.S. Treasury, the Federal Reserve and the Federal Housing Finance Agency (FHFA) announced that the FHFA was putting Fannie Mae (FNMA) and Freddie Mac under conservatorship and giving management control to their regulator, the FHFA. The U.S. Treasury also announced that dividends on Fannie Mae preferred stock were eliminated. Based upon the government announcement of the conservatorship and the elimination of dividends on Fannie Mae preferred stock, the Bank sold on September 8, 2008 its entire position in Fannie Mae preferred at a realized loss of an additional $7,900 or approximately $4,740 after income tax.

Recently liquidity and economic uncertainty have increased the volatility of market pricing for mortgage-backed securities and collateralized debt securities. Although the fair value will fluctuate, the majority of our investment portfolio consists of mortgage-backed securities from government agencies and AAA-rated senior mortgage-backed securities (non-agency). If held to maturity, the contractual principal and interest payments of the securities are expected to be received in full. No loss in principal is expected over the lives of the securities and the Company has the ability and intent to hold these securities until they mature or for a period of time sufficient to allow for a recovery in the fair value. The determination of whether a decline in market value is other-than-temporary is necessarily a matter of subjective judgment.

The gross gains and losses realized through earnings upon the sale of available for sale securities were as follows:

	2008	2007	2006
Proceeds	$ 212,329	$ 74,746	$
Gross realized gains	1,801	403	
Gross realized losses	(90)		
Net realized gains	$ 1,711	$ 403	

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4. LOANS

Loans were as follows at June 30:

	2008	2007
Mortgage loans on real estate:		
Residential single family (one to four units)	$ 165,473	$ 104,960
Home equity	41,977	18,815
Residential multifamily (five units or more)	330,778	325,880
Commercial and land	33,731	11,256
Consumer - Recreational vehicle	56,968	42,327
Other	4,439	981
Total	633,366	504,219
Allowance for loan losses	(2,710)	(1,450)
Unamortized premiums/(discounts) net of deferred loan fees	757	5,137
	$ 631,413	$ 507,906

An analysis of the allowance for loan losses is as follows for the year ended June 30:

	2008	2007	2006
Balance beginning of period	$ 1,450	$ 1,475	$ 1,415
Provision (benefit) for loan loss	2,226	(25)	60
Charged off	(988)		
Recoveries	22		
Balance end of period	$ 2,710	$ 1,450	$ 1,475

An analysis of impaired loans is as follows for the year ended June 30:

	2008	2007	2006
Nonperforming loans	$ 4,151	$ 228	$
Troubled debt restructuring	421		
Other impaired loans	737		
Total impaired loans	$ 5,309	$ 228	$

At June 30, 2008, $2,530 of impaired loans had specific allowance allocations of $465 while $2,779 of impaired loans had no specific allowance allocations. The average carrying value of impaired loans was $929 and $57 for the year ended June 30, 2008 and 2007, respectively. The interest income recognized during the periods of impairment is insignificant for those loans impaired at June 30, 2008 or 2007. Loans past due 90 days or more which were still accruing were $656 and $0 at June 30, 2008 and 2007, respectively.

At June 30, 2008 and 2007, approximately 44.89% and 44.08%, respectively, of the Company s loans are collateralized with real-property collateral located in California and therefore exposed to economic conditions within this market region.

In the ordinary course of business, the Company has granted related party loans collateralized by real property to principal officers, directors and their affiliates. There were no new related party loans granted during the year ended June 30, 2008, none in 2007, and one in 2006. Total principal payments on related party loans were $949, $68, and $61 during the years ended June 30, 2008, 2007 and 2006, respectively. At June 30, 2008 and 2007, these loans amounted to $3,036 and $3,985, respectively, and are included in loans held for investment. Interest earned on these loans was $213, $218, and $225 during the years ended June 30, 2008, 2007 and 2006, respectively.

A major shareholder of the Company s common stock is also the controlling shareholder of a large recreational vehicle (RV) sales company which secures indirect RV loans for is customers through relationships with various banks. At June 30, 2008, the Company had $55,330 in loan principal outstanding and $1,995 of unamortized premium from RV loans originated through its banking relationship with the RV sales company of the major shareholder. In March 2007, the Bank also entered into a website marketing agreement with another company of the major shareholder to offer the Bank s loan and deposit products to RV customers. Payments to the company by the Bank for customer acquisitions through the website agreement were not significant for years ended June 30, 2008 and 2007. This agreement was cancelled on February 14, 2008

The Company s loan portfolio consists of approximately 25.91% fixed interest rate loans and 74.09% adjustable interest rate loans as of June 30, 2008. The Company s adjustable rate loans are generally based upon indices using U.S. Treasuries, London Interbank Offered Rate (LIBOR), and 11th District cost of funds.

The Bank originates and purchases mortgage loans with terms that may include repayments that are less than the repayments for fully amortizing loans, including interest only loans, option adjustable-rate mortgages, and other loan types that permit payments that may be smaller than interest accruals. Through June 30, 2008, the net amount of deferred interest on these loan types was not material to the financial position or operating results of the Company.

At June 30, 2008 and 2007, purchased loans serviced by others were $309,214 or 48.82% and $303,526 or 60.20% respectively, of the loan portfolio.

5. FURNITURE, EQUIPMENT AND SOFTWARE

A summary of the cost and accumulated depreciation for furniture, equipment and software is as follows at June 30:

	2008	2007
Leasehold improvements	$ 33	$ 33
Furniture and fixtures	346	297
Computer hardware and equipment	405	329
Software	338	213
Total	1,122	872
Less accumulated depreciation and amortization	(731)	(630)
Furniture, equipment and software net	$ 391	$ 242

Depreciation and amortization expense for the years ended June 30, 2008, 2007 and 2006 amounted to $132, $88, and $89, respectively.

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6. DEPOSITS

Deposit accounts are summarized as follows at June 30:

	2008		2007	
	Amount	**Rate***	**Amount**	**Rate***
Non-interest bearing	$ 5,509	0.00%	$ 993	0.00%
Interest bearing:				
Demand	61,616	3.22%	48,575	3.52%
Savings	56,202	3.38%	22,840	3.75%
Time deposits:				
Under $100	268,747	4.84%	298,767	5.06%
$100 or more	178,630	4.91%	176,774	5.09%
Total time deposits	447,377	4.87%	475,541	5.07%
Total interest bearing	565,195	4.54%	546,956	4.88%
Total deposits	$ 570,704	4.50%	$ 547,949	4.87%

* Based on weighted-average stated interest rates at period end.

The scheduled maturities of time deposits are as follows as of June 30, 2008 (dollars in thousands):

Within 12 months	$ 233,767
13 to 24 months	81,156
25 to 36 months	33,343
37 to 48 months	61,744
49 to 60 months	37,367
Thereafter	
Total	$ 447,377

At June 30, 2008 and 2007, the Company had deposits from principal officers, directors and their affiliates in the amount of $1,089 and $16,743, respectively.

7. ADVANCES FROM THE FEDERAL HOME LOAN BANK

At June 30, 2008 and 2007, the Company s fixed-rate FHLB advances had interest rates that ranged from 2.57% to 5.62% with a weighted average of 3.77% and ranged from 2.84% to 5.62% with a weighted average of 4.39%, respectively.

Fixed-rate advances from FHLB are scheduled to mature as follows at June 30:

	2008		2007	
	Amount	Weighted-Average Rate	Amount	Weighted-Average Rate
Within one year	$ 226,997	3.29%	$ 45,398	3.49%
After one but within two years	58,000	4.56%	68,940	4.37%
After two but within three years	36,969	4.45%	53,000	4.58%
After three but within four years	33,000	4.75%	21,954	4.98%
After four but within five years	19,000	3.59%	33,000	4.75%
After five years	25,000	4.15%	5,000	5.62%
	$ 398,966	3.77%	$ 227,292	4.38%

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At June 30, 2008, a total of $62.0 million of FHLB advances include agreements that allow the FHLB, at its option, to put the advances back to the Company after specified dates. Under the terms of the putable advances, the Company could be required to repay all of the principal and accrued interest before the maturity date. The weighted-average remaining contractual maturity period of the $62.0 million in advances is 3.73 years and the weighted average remaining period before such advances could be put to the Company is 1.05 years.

The Company s advances from FHLB were collateralized by certain real estate loans with an aggregate unpaid balance of $399,000 and $139,900 at June 30, 2008 and 2007, respectively, by the Company s investment in capital stock of FHLB of San Francisco and by its investment in mortgage-backed securities. Generally, each advance is payable in full at its maturity date with a prepayment penalty for fixed rate advances.

The maximum amounts advanced from the FHLB were $398,966, $254,216, and $236,177 during the years ended June 30, 2008, 2007, and 2006, respectively. At June 30, 2008, the Company had $44,909 available for advances from the FHLB for terms up to seven years and $10,000 available under a federal funds line of credit with a major bank.

8. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Company has sold securities under various agreements to repurchase for total proceeds of $130,000. The repurchase agreements have fixed interest rates between 3.24% and 4.65%, weighted average rate of 4.23%, and scheduled maturities between January 2012 and December 2017. Under these agreements, the Company may be required to repay the $130,000 and repurchase its securities before the scheduled maturity if the issuer requests repayment on scheduled quarterly call dates. The weighted-average remaining contractual maturity period is 6.36 years and the weighted average remaining period before such repurchase agreements could be called is 1.16 years.

9. JUNIOR SUBORDINATED DEBENTURES AND NOTE PAYABLE

Junior Subordinated Debentures On December 13, 2004, the Company entered into an agreement to form an unconsolidated trust which issued $5,000 of trust preferred securities in a transaction that closed on December 16, 2004. The net proceeds from the offering were used to purchase $5,155 of junior subordinated debentures (Debentures) of the Company with a stated maturity date of February 23, 2035. The Debentures are the sole assets of the trust. The trust preferred securities are mandatorily redeemable upon maturity, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the Debentures in whole (but not in part) on or after specific dates, at a redemption price specified in the indenture plus any accrued but unpaid interest through the redemption date. Interest accrues at the rate of three-month LIBOR plus 2.4% (5.04% at June 30, 2008), with interest paid quarterly starting February 16, 2005.

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10. INCOME TAXES

The provision for income taxes is as follows for the years ended June 30:

	2008	2007	2006
Current:			
Federal	$ 3,394	$ 1,377	$ 1,591
State	1,162	489	569
	4,556	1,866	2,160
Deferred:			
Federal	(1,333)	305	16
State	(408)	113	6
	(1,741)	418	22
Total	$ 2,815	$ 2,284	$ 2,182

The differences between the statutory federal income tax rate and the effective tax rates are summarized as follows for the years ended June 30:

	2008	2007	2006
Statutory federal tax rate	34.00%	34.00%	34.00%
Increase (decrease) resulting from:			
State taxes net of federal tax benefit	7.27	7.03	6.99
Cash surrender value	(0.89)	(1.00)	(0.95)
Non-deductible stock option expense	0.21	0.94	
Non-taxable dividend income	(1.56)		
Other	1.12	(0.21)	0.01
Effective tax rate	40.15%	40.76%	40.05%

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The components of the net deferred tax asset are as follows at June 30:

	2008	2007
Deferred tax assets:		
Allowance for loan losses and charge-offs	$ 1,570	$ 454
Available-for-sale unrealized net losses		574
State taxes	279	200
Stock-based compensation expense	595	314
Deferred compensation	274	
Securities impaired	448	
	3,166	1,542
Deferred tax liabilities:		
Deferred loan fees	(296)	(138)
FHLB stock dividend	(1,108)	(755)
Other assets - prepaids	(84)	(147)
Depreciation	(80)	(71)
Available-for-sale unrealized net gains	(680)	
	(2,248)	(1,111)
Net deferred tax asset	$ 918	$ 431

The Company establishes a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. As of June 30, 2008 and 2007, the Company believes that it will have sufficient earnings to realize its deferred tax asset and has not provided an allowance.

11. STOCKHOLDERS EQUITY

Common Stock and Common Stock Warrants Changes in common stock issued and outstanding were as follows for the years ended June 30:

	2008		2007		2006	
	Issued	Outstanding	Issued	Outstanding	Issued	Outstanding
Beginning of year	8,587,090	8,267,590	8,561,725	8,380,725	8,299,823	8,299,823
Common stock issued through option exercise	20,000	20,000	1,575	1,575	101,602	101,602
Purchase of Treasury Stock				(156,000)		(163,500)
Common stock issued through preferred stock conversion			7,690	7,690	142,800	142,800
Common stock issued through grants	20,750	11,973	16,100	33,600	17,500	
End of year	8,627,840	8,299,563	8,587,090	8,267,590	8,561,725	8,380,725

During the year ended June 30, 2006, the Company issued 101,602 shares of common stock for $497 (including $70 income tax benefit) from the exercise of nonqualified stock options. Also, the Company reduced its common shares outstanding by purchasing 163,500 shares of treasury stock for $1,325 under the Company s common stock buy back program approved on June 30, 2005.

During the year ended June 30, 2007, the Company issued 1,575 shares of common stock for $88 from the exercise of nonqualified stock options (including $82 income tax benefit). Also, the Company reduced its common shares outstanding by purchasing 156,000 shares of treasury stock for $1,103 under the Company s common stock buy back program approved on June 30, 2005.

During the year ended June 30, 2008, the Company issued 20,000 shares of common stock for $116 from the exercise of nonqualified stock options (including $25 income tax benefit). Also, the Company issued 20,750 shares upon vesting of restricted stock units. Pursuant to the Plan, the company repurchased 8,777 of those shares to fund the tax liability associated with the vesting of the award for a net increase in outstanding shares of 11,973.

Changes in Common Stock Warrants - During the year ended June 30, 2006, all outstanding organizer warrants to purchase 59,950 shares of common stock expired.

Convertible Preferred Stock On October 28, 2003, the Company commenced a private placement of Series A 6% Cumulative Nonparticipating Perpetual Preferred Stock, Convertible through January 1, 2009 (the Series A). The rights, preferences and privileges of the Series A preferred stock were established in a certificate filed by the Company with the State of Delaware on October 27, 2003, and generally include the holder s right to a six percent (6%) per annum cumulative dividend payable quarterly, the Company s right to redeem some or all of the outstanding shares at par after five years and the holders right to convert all or part of the face value of his Series A preferred stock into the Company s common stock at $10.50 per share, increasing in three increments to $18.00 per share after January 1, 2008. The Company s right to redeem the Series A is perpetual and starts immediately after issuance (with a premium payable to the holder starting at 5% in the first year and declining to 1% in the fifth year). The holder s right to convert to the Company s common stock starts immediately after purchase and expires on January 1, 2009.

During the year ended June 30, 2004, the Company issued $6,750 of Series Al preferred stock, convertible through January 1, 2009, representing 675 shares at $10,000 face value, less issuance costs of $113. The Company has declared and paid dividends to holders of its Series A preferred stock totaling $309, $312, and $360 for the years ended June 30, 2008, 2007, and 2006, respectively. In January 2006, 150 shares of preferred stock were converted into common shares. As a result, the Company reduced Series A preferred stock by $1,474 and increased additional paid in capital by $1,474. In January 2007, 10 shares of Series A preferred stock were converted into common shares. As a result, the Company reduced Series A preferred stock by $100 and increased additional paid in capital by $100.

In June 2008 the Company commenced a private offering of up to $14 million in aggregate liquidation amount of a newly created series of its preferred stock designated Series B 8% Cumulative Convertible Nonparticipating Perpetual Preferred Stock (the Series B). The Series B preferred stock has a liquidation preference of $1,000 per share over shares of common stock. In the event of liquidation, the Series B preferred stock ranks *pari* passu with the Series A . The Series B preferred stock is entitled to cumulative dividends at a rate of 8.0% per annum when and as declared by the Company s board of directors quarterly in arrears on January 15, April 15, July 15 and October 15 of each year. Each share of Series B preferred stock is immediately convertible at the option of the holder into 111 shares of the Company s common stock, par value $0.01 per share Common Stock, which is equivalent to a conversion price of $9.00 per share of Common Stock. Under certain circumstances specified in the Certificate of Designation, the Company may require holders of Series B preferred stock to convert their shares into Common Stock. Generally, the Series B preferred stock has no voting rights and may be redeemed by the Company at a 5% premium starting in June of 2011, a 3% premium starting in June 2012 or a 2% premium anytime after June 2013.

During the year ended June 30, 2008, the Company issued $3,750 of Series B preferred stock representing 3,750 shares at a $1,000 face value. The Company declared dividends to holders of its Convertible Preferred Stock Series B totaling $3, for the year ended June 30, 2008. Subsequent to June 30, 2008, the Company issued another $1,040 of Series B preferred stock representing 1,040 shares.

12. STOCK-BASED COMPENSATION

The Company has two stock incentive plans, the 2004 Stock Incentive Plan (2004 Plan) and the 1999 Stock Option Plan (1999 Plan), which provide for the granting of non-qualified and incentive stock options, restricted stock and restricted stock units, stock appreciation rights and other awards to employees, directors and consultants.

1999 Stock Option Plan In July 1999, the Company s Board of Directors approved the 1999 Stock Option Plan and in August 2001, the Company s shareholders approved an amendment to the 1999 Plan such that 15% of the outstanding shares of the Company would always be available for grants under the 1999 Plan. The 1999 Plan is designed to encourage selected employees and directors

to improve operations and increase profits, to accept or continue employment or association with the Company through participation in the growth in the value of the common stock. The 1999 Plan provisions require that option exercise prices be not less than fair market value per share of common stock on the option grant date for incentive and nonqualified options. The options issued under the 1999 Plan generally vest in between three and five years. Option expiration dates are established by the plan administrator but may not be later than 10 years after the date of the grant.

In November 2007, the shareholders of the Company approved the termination of the 1999 Plan. No new option awards will be made under the 1999 Plan and the outstanding awards under the 1999 Plan will continue to be subject to the terms and conditions of the 1999 Plan.

2004 Stock Incentive Plan In October 2004, the Company s Board of Directors and the stockholders approved the 2004 Plan. In November 2007, the 2004 Plan was amended and approved by the Company s stockholders. The maximum number of shares of common stock available for issuance under the 2004 Plan is 14.8% of the Company s outstanding common stock measured from time to time. In addition, the number of shares of the Company s common stock reserved for issuance will also automatically increase by an additional 1.5% on the first day of each of four fiscal years starting July 1, 2007. At June 30, 2008, there were a maximum of 1,352,649 shares available for issuance under the limits of the 2004 Plan.

Stock Options Prior to July 1, 2005, the Company accounted for the Plans under the recognition and measurement provisions of APB Opinion No. 25 and related Interpretations, as permitted by SFAS No. 123. No stock option compensation cost was recognized in the income statements as all options granted had an exercise price equal to the market value of the underlying common stock on the grant date.

Effective July 1, 2005, the Company adopted the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment*, using the modified-prospective-transition method. Under this method, compensation cost recognized for the period includes compensation cost for all options granted prior to, but not yet vested as of July 1, 2005, and all options granted subsequent to January 1, 2005, based on the grant date fair value estimated in accordance with the provisions of Statements No. 123 and 123(R), respectively. Under this transition method, the Company was not required to restate its operating results for periods ending prior to July 1, 2005 for additional compensation cost associated with the change to fair value recognition.

The Company s income before income taxes and net income for the year ended June 30, 2008, 2007 and 2006 included stock option compensation cost of $478, $397 and $357 respectively. The total income tax benefit was $192, $162 and $143 for year ended June 30, 2008, 2007 and 2006, respectively. At June 30, 2008, unrecognized compensation expense related to non-vested grants aggregated to $312 and is expected to be recognized in future periods as follows:

	Stock Option Compensation Expense
For the fiscal year ended June 30,	
2008	$ 238
2009	67
2010	7
2011	
2012	
Total	$ 312

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The fair value of each option awarded under the Plans is estimated on the date of grant based on the Black- Scholes option pricing model. The weighted average grant-date fair value and the assumptions used in the valuations for each period are summarized as follows:

	Year Ended June 30,		
	2008	**2007**	**2006**
Weighted-average grant-date fair value per share		$ 3.95	$ 3.95
Assumptions used:			
Risk-free interest rates		4.75% to 5.0%	4.10% to 4.46%
Dividends		0%	0%
Volatility		31.87% to 32.45%	35.14% to 35.41%
Weighted-average expected life		6.0 to 6.25 years	6.0 to 6.25 years

A summary of stock option activity under the Plans during the period July 1, 2005 to June 30, 2008 is presented below:

	Number of Shares	**Weighted-Average Exercise Price Per Share**
Outstanding July 1, 2005	722,017	$ 6.11
Granted	247,900	$ 9.32
Exercised	(101,602)	$ 4.19
Cancelled	(52,246)	$ 9.86
Outstanding June 30, 2006	816,069	$ 7.08
Granted	160,000	$ 7.28
Exercised	(1,575)	$ 4.19
Cancelled	(37,500)	$ 8.94
Outstanding June 30, 2007	936,994	$ 7.05
Granted		
Exercised	(20,000)	$ 4.19
Cancelled	(10,750)	$ 9.32
Outstanding June 30, 2008	906,244	$ 7.09
Options exercisable June 30, 2006	518,500	$ 5.72
Options exercisable June 30, 2007	651,924	$ 6.51
Options exercisable June 30, 2008	804,496	$ 6.96

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The following table summarizes information as of June 30, 2008 concerning currently outstanding and exercisable options:

	Options Outstanding		Options Exercisable	
Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life (Years)	Number Exercisable	Weighted-Average Exercise Price
$ 4.19	360,583	1.6	360,583	$ 4.19
$ 6.76	20,000	8.3	8,333	$ 6.76
$ 7.35	134,600	8.1	85,148	$ 7.35
$ 8.50	15,000	7.4	12,917	$ 8.50
$ 9.20	7,500	7.1	7,083	$ 9.20
$ 9.50	184,000	7.1	154,010	$ 9.50
$ 10.00	183,561	4.9	175,422	$ 10.00
$ 11.00	1,000	4.0	1,000	$ 11.00
$ 7.09	906,244	4.6	804,496	$ 6.96

The aggregate intrinsic value of options outstanding and options exercisable under the Plans at June 30, 2008 were $1,172 and $1,163, respectively. The aggregate intrinsic value of options exercised during the years ended June 30, 2008, 2007 and 2006 was $64, $5 and $371, respectively.

Restricted Stock and Restricted Stock Units In July 2005, the Company s Board of Directors approved the first stock award under the 2004 Stock Incentive Plan. On July 25, 2005, 19,300 shares were awarded to directors and employees. Additional stock awards totaling 16,100 shares were granted to directors on July 24, 2006. The stock awards vest one-third on each one-year anniversary of the grant date and 17,032 shares were vested and issued as of June 30, 2008.

During the year ended June 30, 2008, the Company s Board of Directors granted 131,253 restricted stock units to employees and directors. The chief executive officer received 83,000 restricted stock units which vest ratably on each of the four fiscal year ends of the initial term in his employment contract. All other restricted stock unit awards granted during the year ended June 30, 2008, vest over three years, one-third on each anniversary date.

The Company s income before income taxes and net income for the years ended June 30, 2008, 2007 and 2006 included stock award expense of $299 and $92 and $52, respectively. The income tax benefit was $120, $37 and $21. The Company recognizes compensation expense based upon the grant-date fair value divided by the vesting and the service period between each vesting date. At June 30, 2008, unrecognized compensation expense related to non-vested awards aggregated to $758 and is expected to be recognized in future periods as follows:

	Stock Award Compensation Expense
For the fiscal year ended June 30,:	
2008	300
2009	260
2010	198
2011	
Total	$ 758

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The following table presents the status and changes in restricted stock grants from inception through June 30, 2008:

	Restricted Stock and restricted stock unit Shares	Weighted-Average Grant-Date Fair Value
Non-vested balance at July 1, 2005		
Granted	19,300	$ 9.50
Vested		
Forfeited	(1,800)	$ 9.50
Non-vested balance at June 30, 2006	17,500	$ 9.50
Granted	16,100	$ 7.35
Vested	(5,831)	
Forfeited		$ 9.50
Non-vested balance at June 30, 2007	27,769	$ 8.25
Granted	131,253	$ 6.98
Vested	(31,951)	$ 7.52
Non-vested balance at June 30, 2008	127,071	$ 7.13

2004 Employee Stock Purchase Plan In October 2004, the Company s Board of Directors and stockholders approved the 2004 Employee Stock Purchase Plan, which is intended to qualify as an Employee Stock Purchase Plan under Section 423 of the Internal Revenue Code. An aggregate of 500,000 shares of the Company s common stock has been reserved for issuance and will be available for purchase under the 2004 Employee Stock Purchase Plan. At June 30, 2008, there have been no shares issued under the 2004 Employee Stock Purchase Plan.

13. EARNINGS PER SHARE

Information used to calculate earnings per share for years ended June 30, 2008, 2007 and 2006, was as follows:

	2008	2007	2006
Net income	$ 4,196	$ 3,319	$ 3,266
Dividends on preferred stock	312	312	360
Net income attributable to common	$ 3,884	$ 3,007	$ 2,906
Weighted-average shares:			
Basic weighted-average number of common shares outstanding	8,261,100	8,283,098	8,340,973
Dilutive effect of stock options	113,509	122,117	175,305
Dilutive effect of stock awards	941		
Dilutive effect of preferred stock			
Dilutive weighted-average number of common shares outstanding	8,375,550	8,405,215	8,516,278

Net income per common share:			
Basic	$ 0.47	$ 0.36	$ 0.35
Diluted	$ 0.46	$ 0.36	$ 0.34

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Options and restricted stock grants of 693,254, 575,094 and 658,264 shares for the years ended June 30, 2008, 2007 and 2006, respectively, were not included in determining diluted earnings per share, as they were antidilutive.

14. COMMITMENTS AND CONTINGENCIES

Operating Leases The Company leases office space under an operating lease agreement scheduled to expire in October 2012. The Company pays property taxes, insurance and maintenance expenses related to this lease. Rent expense for the years ended June 30, 2008, 2007 and 2006 was $316, $315, and $316, respectively.

Pursuant to the terms of this non-cancelable lease agreement in effect at June 30, 2008, future minimum lease payments are as follows:

2009	323
2010	334
2011	344
2012	355
2013	122
	$ 1,478

15. OFF-BALANCE-SHEET ACTIVITIES

Credit-Related Financial Instruments The Company is a party to credit-related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments are commitments to extend credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company s exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments. At June 30, 2008 and 2007, the Company had commitments to originate or purchase loans and investment securities of $22,835 and $13,468.

Commitments to extend credit are agreements to lend to a customer so long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management s credit evaluation of the customer.

16. MINIMUM REGULATORY CAPITAL REQUIREMENTS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly 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 its assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The 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 tangible assets (as defined). As of June 30, 2008, the Bank met all capital adequacy requirements to which it is subject. As of June 30, 2008, the most recent filing date with the OTS, the Bank was categorized as well capitalized under the regulatory framework for prompt

corrective action. To be categorized as well capitalized, an institution must maintain

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minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since the notification that management believes have changed the Bank s categorization. The Bank s actual capital amounts and ratios as of June 30, 2008 and 2007 are presented in the following table:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
June 30, 2008	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Tier 1 Leverage (core) capital (to adjusted tangible assets)	$ 84,562	7.09%	$ 47,717	4.00%	$ 59,646	5.00%
Tier I capital (to risk-weighted assets)	84,562	13.95%	N/A	N/A	36,373	6.00%
Total capital (to risk-weighted assets)	87,272	14.40%	48,498	8.00%	60,622	10.00%
Tangible capital (to tangible assets)	84,562	7.09%	17,894	1.50%	N/A	N/A

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
June 30, 2007	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Tier 1 Leverage (core) capital (to adjusted tangible assets)	$ 74,854	7.90%	$ 37,922	4.00%	$ 47,402	5.00%
Tier I capital (to risk-weighted assets)	74,854	14.76%	N/A	N/A	30,420	6.00%
Total capital (to risk-weighted assets)	76,304	15.05%	40,561	8.00%	50,701	10.00%
Tangible capital (to tangible assets)	74,854	7.90%	14,221	1.50%	N/A	N/A

17. EMPLOYMENT AGREEMENTS AND EMPLOYEE BENEFIT PLANS

Employment Agreements In July 2003, the Company entered into employment agreements with three of the Company s executive officers. Under these agreements, if the Company terminates one or more of the executive officers for any reason other than cause, then the Company must (a) pay that officer normal compensation in effect through the date of termination; (b) pay that officer a severance payment equal to 12 times his then-current base monthly salary, payable at the option of the Board of Directors either in one lump sum or in 12 equal installments; and (c) continue group insurance benefits for that officer for one year from termination or until that officer commences work with a new employer providing group medical insurance benefits to that officer. In addition, if the executive officer s employment is terminated for any reason other than for cause, or that officer s employment is terminated due to death or disability, then all stock options currently held by such officer will fully vest as of the termination date. Each agreement automatically renews in one-year terms unless terminated by either Bank of Internet USA or the officer. In addition, each agreement specifies bonuses for each executive officer, which is contingent upon the Company s financial performance and the executive officer s continued employment with the Company. The Company incurred bonus expense of $55, $85, and $88 for the years ended June 30, 2008, 2007, and 2006, respectively, in connection with these executive officer bonuses.

On October 22, 2007, the Company executed an employment agreement (the Employment Agreement) with Gregory Garrabrants pursuant to which he was appointed to serve as the Company s Chief Executive Officer (CEO) effective immediately. The term of the Employment Agreement is from October 22, 2007 through October 22, 2011. Under the Employment Agreement, Mr. Garrabrants receives an annual base salary of $285,000, an annual short-term cash bonus, an initial restricted stock grant, an

annual restricted stock grant and medical and other benefits. Mr. Garrabrants will earn an annual short-term bonus of a minimum of $137,000 and $86,000 for fiscal 2008 and 2009, respectively, which will be paid in quarterly installments during the year. Mr. Garrabrants has the opportunity to earn as much as $171,000 (or 60% of his base pay at the time) as an annual short-term bonus based upon annual objectives set by the Board of Directors. Also under the terms of the Employment Agreement, Mr. Garrabrants is entitled to i) an initial restricted stock unit award of 83,000 shares, which vests one forth at each fiscal year-end for 2008-2011 and ii) an annual restricted stock unit award, starting at the end of fiscal 2008 and consisting of a minimum of 44,000 shares and 32,000 shares at the end of fiscal 2008 and 2009, respectively. The annual restricted stock unit award increases based upon the return on equity of the Company each year. Annual awards vest over three years from the grant date of each award after each fiscal year. The maximum annual restricted stock unit shares Mr. Garrabrants may be awarded in any year is 272,000 and the maximum aggregate number of shares for all restricted share awards under the Employment Agreement is 500,000 shares. Mr. Garrabrants will receive a relocation allowance not to exceed $95,000, net of income tax, and shall be entitled to the same paid vacation and fringe benefits including health and welfare benefits that all senior executives receive under the current Company policies. Upon termination of the Employment Agreement by the Company without cause or by Mr. Garrabrants for good reason (as such terms are defined in the Employment Agreement), Mr. Garrabrants will be entitled to (a) an amount in cash equal to two times his base salary, (b) a pro-rated portion of his annual short-term bonus, (c) accelerated vesting of his outstanding restricted stock unit awards, (d) at the Company s election, either a pro-rated portion of his annual restricted stock unit award based upon the Company s return on equity, or an equivalent amount in cash, and (e) continuation of health benefits for up to twelve months.

On October 22, 2007, the Company and its former CEO Mr. Gary Lewis Evans, executed an amendment to the July 1, 2003 Employment Agreement by and between Mr. Evans and Bank of Internet USA (the Amendment). The Amendment provides for the resignation of Mr. Evans from the office of CEO and appointed him Chief Operating Officer (COO) of the Company. During 2008, the Compensation Committee and the Board of Directors of the Company approved a further amendment to the July 1, 2003 employment contract of Mr. Evans to provide that the severance and vesting provisions of Mr. Evan s employment contract are the same whether he resigns or is terminated without cause. The amendment was made in connection with the resignation of Mr. Evans as a director of the Company and its subsidiary, Bank of Internet USA and supersedes any prior amendment. As a result of the amendment of Mr. Evans employment agreement, registrant incurred a one-time pretax compensation expense of $352,000 in the quarter ended March 31, 2008.

401(k) Plan The Company has a 401(k) Plan whereby substantially all of its employees participate in the Plan. Employees may contribute up to 15% of their compensation subject to certain limits based on federal tax laws. For the year ended June 30, 2008, 2007, and 2006 expense attributable to the plan amounted to $1, $1, and $2, respectively.

Deferred Compensation Plans Effective August 1, 2003, the Company adopted the Bank of Internet USA Nonqualified Deferred Compensation Plans (Deferred Compensation Plans) which cover designated key management employees and directors who elect to participate. The Deferred Compensation Plans allow eligible employees and directors to elect to defer up to 100% of their compensation, including commissions, bonuses and director fees. Although the Deferred Compensation Plans provide that the Company may make discretionary contributions to a participant s account, no such discretionary contributions have been made through the period ending June 30, 2008. Participant deferrals are fully vested at all times, and discretionary contributions, if any, will be subject to a vesting schedule specified by the Company. Participants in the Deferred Compensation Plans may elect to invest their accounts in either of two accounts: (1) which earns interest based upon the prime rate; or (2) which mirrors the performance of the book value of the Company s common stock. The Compensation Committee of the Board of Directors administrates the Deferred Compensation Plans. At June 30, 2008 and 2007, there was $640 and $438 deferred in connection with the Deferred Compensation Plans.

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18. FAIR VALUE OF FINANCIAL INSTRUMENTS

Carrying amount and estimated fair values of financial instruments at year-end were as follows:

	2008		2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	$ 16,264	$ 16,264	$ 39,708	$ 39,708
Investment securities available for sale	209,119	209,119	296,068	296,068
Investment securities held to maturity	300,895	304,604	61,902	61,334
Time deposits in financial institutions	1,980	1,980	12,082	12,082
Stock of the Federal Home Loan Bank	19,395	19,395	12,659	12,659
Loans held for investment net	631,413	632,661	507,906	506,099
Accrued interest receivable	5,740	5,740	6,013	6,013
Financial liabilities:				
Time deposits and savings	570,704	579,685	547,949	547,513
Securities sold under agreements to repurchase	130,000	134,062	90,000	89,173
Advances from the Federal Home Loan Bank	398,966	403,126	227,292	224,922
Junior subordinated debentures	5,155	5,155	5,155	5,155
Accrued interest payable	2,366	2,366	2,712	2,712

The methods and assumptions used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and cash equivalents, interest bearing deposits, Federal Home Loan Bank stock, accrued interest receivable and payable, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. The fair values for U.S. agency mortgage-backed securities and preferred stock available-for-sale and the fair values for U.S. Government agency debt securities held-to-maturity are obtained by the Company from quoted prices on active markets. As quoted prices from active markets are not available, the fair values of non-agency securities held to maturity are determined by the Company utilizing matrix pricing, which is a mathematical technique widely used in the industry to value securities based on the securities relationship to other benchmark quoted securities. The Company s pricing matrix for its portfolio of AAA non-agency mortgage-backed securities and its trust preferred collateralized debt securities uses actual and forecasted default rates, actual and forecasted loss severities, collateral seasoning and other individual characteristics of the specific loans comprising the loan pools as well as the structural subordination and overcollateralization characteristics of the securities to estimate future cash flows and select discount rates to calculate each security s fair value. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair values for impaired loans are estimated using discounted cash flow analysis or underlying collateral values. Fair value of loans held for sale is based on market quotes. Fair value of debt is based on current rates for similar financing. The fair value of off-balance-sheet items is not considered material.

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19. PARENT-ONLY CONDENSED FINANCIAL INFORMATION

The following BofI Holding, Inc. (Parent company only) financial information should be read in conjunction with the other notes to the consolidated financial statements:

CONDENSED BALANCE SHEETS

(Dollars in thousands)

	June 30	
	2008	**2007**
ASSETS		
Cash and cash equivalents	$ 2,366	$ 3,548
Other assets	302	319
Due from subsidiary	100	100
Investment in subsidiary	85,579	73,989
TOTAL	$ 88,347	$ 77,956
LIABILITIES AND STOCKHOLDERS EQUITY		
Junior subordinated debentures	$ 5,155	$ 5,155
Accrued interest payable	28	43
Accounts payable and accrued liabilities	82	8
Total liabilities	5,265	5,206
Stockholders equity	83,082	72,750
TOTAL	$ 88,347	$ 77,956

STATEMENTS OF INCOME

(Dollars in thousands)

	Year Ended June 30		
	2008	**2007**	**2006**
Interest income	$ 19	$ 30	$ 44
Interest expense	369	414	362
Net interest (expense) income	(350)	(384)	(318)
Non-interest income (loss)	(6)	(31)	37
Non-interest expense general and administrative	1,416	1,084	1,036
Loss before dividends from subsidiary and equity in undistributed income of subsidiary	(1,772)	(1,499)	(1,317)
Dividends from subsidiary	760	760	760
Equity in undistributed earnings of subsidiary	5,208	4,058	3,823
Net income	$ 4,196	$ 3,319	$ 3,266

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STATEMENT OF CASH FLOWS

(Dollars in thousands)

	Year Ended June 30		
	2008	**2007**	**2006**
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 4,196	$ 3,319	$ 3,266
Adjustments to reconcile net income to net cash used in operating activities:			
Stock-based compensation expense	776	491	409
Equity in undistributed earnings of subsidiary	(5,208)	(4,058)	(3,823)
Increase in other assets	17	107	(136)
Decrease in other liabilities	(6)	(9)	(222)
Net cash from operating activities	(225)	(150)	(506)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Investment in subsidiary	(4,500)	(5,000)	(7,000)
Net cash from investing activities	(4,500)	(5,000)	(7,000)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of convertible preferred stock Series B	3,750		
Proceeds from exercise of common stock options	91		
Tax benefit from exercise of common stock options	14	88	497
Purchase treasury shares		(1,103)	(1,325)
Cash dividends on convertible preferred stock	(312)	(312)	(360)
Net cash provided from financing activities	3,543	(1,327)	(1,188)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,182)	(6,477)	(8,694)
CASH AND CASH EQUIVALENTS Beginning of year	3,548	10,025	18,719
CASH AND CASH EQUIVALENTS End of year	$ 2,366	$ 3,548	$ 10,025

20. OTHER COMPREHENSIVE INCOME (LOSS)

Other comprehensive income (loss) components and related tax effects were as follows:

	Year Ended June 30		
	2008	**2007**	**2006**
Unrealized gain (loss) from securities:			
Net unrealized gain (loss) from available for sale securities	$ 3,850	$ 436	$ (1,485)
Reclassification of net gain from available for sale securities included in income	(711)	(403)	

Unrealized gain (loss), net of reclassification adjustments, before income tax	3,139	33	(1,485)
Income tax provision (benefit)	1,257	13	(594)
Other comprehensive income (loss)	$ 1,882	$ 20	$ (891)

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21. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

	Quarters Ended			
	June 30,	March 31,	December 31,	September 30,
2008				
Interest and dividend income	$ 18,534	$ 16,174	$ 14,971	$ 13,622
Interest expense	11,567	11,513	11,541	10,660
Net interest income	6,967	4,661	3,430	2,962
Provision for loan losses	1,122	835	264	5
Net interest income after provision for loan losses	5,845	3,826	3,166	2,957
Non-interest income	(425)	1,023	333	448
Non-interest expense	2,464	3,138	2,410	2,150
Income before income taxes	2,956	1,711	1,089	1,255
Income taxes	1,176	693	438	508
Net income	$ 1,780	$ 1,018	$ 651	$ 747
Net income attributable to common stock	$ 1,700	$ 940	$ 574	$ 670
Basic earnings per share	$ 0.21	$ 0.11	$ 0.07	$ 0.08
Diluted earnings per share	$ 0.20	$ 0.11	$ 0.07	$ 0.08
2007				
Interest and dividend income	$ 12,550	$ 11,333	$ 10,731	$ 9,972
Interest expense	9,511	8,463	8,228	7,536
Net interest income	3,039	2,870	2,503	2,436
Provision for loan losses	80	0	(80)	(25)
Net interest income after provision for loan losses	2,959	2,870	2,583	2,461
Non-interest income	209	226	378	367
Non-interest expense	1,656	1,603	1,613	1,578
Income before income taxes	1,512	1,493	1,348	1,250
Income taxes	608	631	541	504
Net income	$ 904	$ 862	$ 807	$ 746
Net income attributable to common stock	$ 827	$ 784	$ 728	$ 668
Basic earnings per share	$ 0.10	$ 0.09	$ 0.09	$ 0.08
Diluted earnings per share	$ 0.10	$ 0.09	$ 0.09	$ 0.08