NASB FINANCIAL INC
Form 10-Q
August 09, 2013

Securities and Exchange Commission

Washington, DC 20549

FORM 10-Q

x **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the period ended June 30, 2013

or

¨ **Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from _________ to _________

Commission File Number 0-24033

NASB Financial, Inc.

(Exact name of registrant as specified in its charter)

Missouri	**43-1805201**

(State or other jurisdiction of	**(IRS Employer**
incorporation or organization)	**Identification No.)**

12498 South 71 Highway, Grandview, Missouri 64030

(Address of principal executive offices) (Zip Code)

(816) 765-2200

(Registrant s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or non-accelerated filer, or a small reporting company. See definition of accelerated filer , large accelerated filer and small reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Small reporting Company	¨

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

The number of shares of Common Stock of the Registrant outstanding as of August 5, 2013, was 7,867,614.

PART I   FINANCIAL INFORMATION

Item 1. Financial Statements.

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Balance Sheets

	June 30, 2013 (Unaudited)	September 30, 2012
	(Dollars in thousands)	
ASSETS		
Cash and cash equivalents	$ 28,071	8,716
Securities:		
Available for sale, at fair value	239,716	214,190
Stock in Federal Home Loan Bank, at cost	5,929	7,073
Mortgage-backed securities:		
Available for sale, at fair value	475	554
Held to maturity, at cost	10,398	25,921
Loans receivable:		
Held for sale, at fair value	104,658	163,834
Held for investment, net	695,582	766,601
Allowance for loan losses	(20,650)	(31,829)
Total loans receivable, net	779,590	898,606
Accrued interest receivable	4,011	4,402
Foreclosed assets held for sale, net	13,007	17,040
Premises and equipment, net	11,920	11,637
Investment in LLCs	16,667	17,222
Deferred income tax asset, net	14,157	17,199
Income taxes receivable	1,187	
Other assets	17,277	18,266
	$ 1,142,405	1,240,826
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Customer deposit accounts	$ 801,348	870,946
Brokered deposit accounts		21,367
Advances from Federal Home Loan Bank	100,000	127,000
Subordinated debentures	25,774	25,774
Escrows	6,468	8,760
Income taxes payable		3,490
Accrued expenses and other liabilities	18,240	11,986
Total liabilities	951,830	1,069,323
Stockholders equity:		
Common stock of $0.15 par value: 20,000,000 shares authorized; 9,857,112 shares issued	1,479	1,479
Additional paid-in capital	16,613	16,657
Retained earnings	210,626	189,516
Treasury stock, at cost; 1,989,498 shares	(38,418)	(38,418)
Accumulated other comprehensive income	275	2,269

Total stockholders equity	190,575	171,503
	$ 1,142,405	1,240,826

See accompanying notes to condensed consolidated financial statements.

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statements of Operations (Unaudited)

	Three months ended June 30, 2013	Three months ended June 30, 2012	Nine months ended June 30, 2013	Nine months ended June 30, 2012
	(Dollars in thousands, except per share data)			
Interest on loans receivable	$ 10,880	13,654	34,954	43,817
Interest on mortgage-backed securities	103	415	484	1,377
Interest and dividends on securities	1,107	676	3,155	2,142
Other interest income	1	5	4	11
Total interest income	12,091	14,750	38,597	47,347
Interest on customer and brokered deposit accounts	1,179	2,241	4,288	7,155
Interest on advances from Federal Home Loan Bank	510	658	1,573	1,859
Interest on subordinated debentures	124	135	378	401
Other interest expense	5		13	
Total interest expense	1,818	3,034	6,252	9,415
Net interest income	10,273	11,716	32,345	37,932
Provision for loan losses		3,000	(9,600)	10,500
Net interest income after provision for loan losses	10,273	8,716	41,945	27,432
Other income (expense):				
Loan servicing fees, net	27	39	79	104
Customer service fees and charges	1,279	1,424	4,110	4,036
Provision for loss on real estate owned	(139)	(361)	(956)	(3,784)
Loss on sale of securities available for sale				(343)
Gain (loss) on sale of securities held to maturity		(32)	257	(32)
Gain from loans receivable held for sale	11,232	12,949	46,619	32,785
Impairment loss on investment in LLCs				(200)
Other income (expense)	(1,402)	1,542	(3,650)	1,833
Total other income	10,997	15,561	46,459	34,399
General and administrative expenses:				
Compensation and fringe benefits	6,954	5,633	19,812	16,454
Commission-based mortgage banking compensation	4,544	4,421	15,481	11,730
Premises and equipment	1,452	1,184	3,996	3,669
Advertising and business promotion	1,930	1,614	4,489	3,995
Federal deposit insurance premiums	589	361	1,839	1,148
Other	2,915	2,850	8,462	7,975
Total general and administrative expenses	18,384	16,063	54,079	44,971
Income before income tax expense	2,886	8,214	34,325	16,860
Income tax expense	1,111	3,159	13,215	6,491
Net income	$ 1,775	5,055	21,110	10,369
Basic earnings per share	$ 0.23	0.64	2.68	1.32

Diluted earnings per share	$ 0.23	0.64	2.68	1.32
Basic weighted average shares outstanding	7,867,614	7,867,614	7,867,614	7,867,614

See accompanying notes to condensed consolidated financial statements**.**

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

	Three months ended June 30, 2013	2012
	(Dollars in thousands)	
Net income	$ 1,775	5,055
Other comprehensive income (loss):		
Unrealized gain (loss) on available for sale securities, net of income tax benefit of $950 and $235 at June 30, 2013 and 2012, respectively	(1,518)	(375)
Reclassification adjustment for (gain) loss included in net income		
Change in unrealized gain (loss) on available for sale securities, net of income tax benefit of $950 and $235 at June 30, 2013 and 2012, respectively	(1,518)	(375)
Comprehensive income	$ 257	4,680

	Nine months ended June 30, 2013	2012
	(Dollars in thousands)	
Net income	$ 21,110	10,369
Other comprehensive income (loss):		
Unrealized gain (loss) on available for sale securities, net of income tax expense (benefit) of $(1,248) and $155 at June 30, 2013 and 2012, respectively	(1,994)	247
Reclassification adjustment for loss included in net income, net of income tax benefit of $132 at June 30, 2012		211
Change in unrealized gain (loss) on available for sale securities, net of income tax expense (benefit) of $(1,248) and $287 at June 30, 2013 and 2012, respectively	(1,994)	458
Comprehensive income	$ 19,116	10,827

See accompanying notes to condensed consolidated financial statements**.**

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statement of Stockholders Equity (Unaudited)

	Common stock	Additional paid-in capital	Retained earnings	Treasury stock	Accumulated other comprehensive Income (loss)	Total stockholders equity
			(Dollars in thousands)			
Balance at October 1, 2012	$ 1,479	16,657	189,516	(38,418)	2,269	171,503
Comprehensive income:						
Net income			21,110			21,110
Other comprehensive income, net of tax:						
Unrealized loss on securities available for sale					(1,994)	(1,994)
Total comprehensive income						19,116
Stock based compensation		(44)				(44)
Balance at June 30, 2013	$ 1,479	16,613	210,626	(38,418)	275	190,575

See accompanying notes to condensed consolidated financial statements**.**

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Nine months ended June 30,	
	2013	2012
	(Dollars in thousands)	
Cash flows from operating activities:		
Net income	$ 21,110	10,369
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,720	1,461
Amortization and accretion, net	621	(832)
Loss on sale of securities available for sale		343
(Gain) loss on sale of securities held to maturity	(257)	32
Loss from investment in LLCs	563	116
Impairment loss on investment in LLCs		200
Gain from loans receivable held for sale	(46,619)	(32,785)
Provision for loan losses	(9,600)	10,500
Provision for loss on real estate owned	956	3,784
Origination of loans receivable held for sale	(1,494,860)	(1,294,296)
Sale of loans receivable held for sale	1,600,655	1,318,653
Stock based compensation stock options	(44)	4
Changes in:		
Net fair value of loan-related commitments	3,299	(1,364)
Accrued interest receivable	391	456
Prepaid and accrued expenses, other liabilities, and income taxes payable	2,103	3,816
Net cash provided by operating activities	80,038	20,457
Cash flows from investing activities:		
Principal repayments of mortgage-backed securities:		
Held to maturity	4,851	9,654
Available for sale	68	118
Principal repayments of mortgage loans receivable held for investment	169,266	185,273
Principal repayments of other loans receivable	2,686	3,122
Principal repayments of investment securities available for sale	42,468	25,109
Loan origination - mortgage loans receivable held for investment	(108,088)	(62,045)
Loan origination - other loans receivable	(1,712)	(2,509)
Purchase of mortgage loans receivable held for investment	(647)	(709)
Proceeds from sale of Federal Home Loan Bank stock	1,145	5,454
Purchase of investment securities available for sale	(72,525)	(163,147)
Proceeds from sale of investment securities available for sale		19,678
Proceeds from sale of mortgage-backed securities held to maturity	10,800	859
Proceeds from sale of real estate owned	11,905	8,155
Purchases of premises and equipment, net	(957)	(2,203)
Investment in LLCs	(7)	(4)
Other	(91)	640
Net cash provided by investing activities	59,162	27,445

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Nine months ended June 30, 2013	2012
	(Dollars in thousands)	
Cash flows from financing activities:		
Net increase (decrease) in customer and brokered deposit accounts	(90,975)	55,794
Proceeds from advances from Federal Home Loan Bank	25,000	25,000
Repayment on advances from Federal Home Loan Bank	(52,000)	(122,000)
Change in escrows	(2,292)	(3,173)
Proceeds from other borrowings	422	
Net cash used in financing activities	(119,845)	(44,379)
Net increase in cash and cash equivalents	19,355	3,523
Cash and cash equivalents at beginning of the period	8,716	5,030
Cash and cash equivalents at end of period	$ 28,071	8,553
Supplemental disclosure of cash flow information:		
Cash paid for income taxes (net of refunds)	$ 13,602	4,642
Cash paid for interest	5,981	9,461
Supplemental schedule of non-cash investing and financing activities:		
Conversion of loans receivable to real estate owned, net of specific reserves	$ 9,335	15,974
Conversion of real estate owned to loans receivable	224	3,907

See accompanying notes to condensed consolidated financial statements**.**

(1) BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements include the accounts of NASB Financial, Inc. (the Company), its wholly-owned subsidiary, North American Savings Bank, F.S.B. (North American or the Bank), and the Bank s wholly-owned subsidiary, Nor-Am Service Corporation. All significant inter-company transactions have been eliminated in consolidation. The consolidated financial statements do not include the accounts of our wholly-owned statutory trust, NASB Preferred Trust I (the Trust). The Trust qualifies as a special purpose entity that is not required to be consolidated in the financial statements of NASB Financial, Inc. The Trust Preferred Securities issued by the Trust are included in Tier I capital for regulatory capital purposes. See Footnote 9, Subordinated Debentures.

The accompanying unaudited condensed consolidated financial statements are prepared in accordance with instructions to Form 10-Q and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (GAAP) for complete financial statements. All adjustments are of a normal and recurring nature, and, in the opinion of management, the statements include all adjustments considered necessary for fair presentation. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended September 30, 2012, filed with the Securities and Exchange Commission on December 14, 2012. Operating results for the nine month period ended June 30, 2013, are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2013. The condensed consolidated balance sheet of the Company as of September 30, 2012, has been derived from the audited balance sheet of the Company as of that date.

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowances for losses on loans, valuation of foreclosed assets held for sale, accruals for loan recourse provisions, and fair values of financial instruments, among other items. Management believes that these estimates are adequate; however, future additions to the allowance or changes in the estimates may be necessary based on changes in economic conditions.

The Company s critical accounting policies involving the more significant judgments and assumptions used in the preparation of the condensed consolidated financial statements as of June 30, 2013, have remained unchanged from September 30, 2012. These policies relate to the allowance for loan losses, the valuation of foreclosed assets held for sale, the valuation of derivative instruments, and the valuation of equity method investments.

Certain quarterly amounts for previous periods have been reclassified to conform to the current quarter s presentation.

(2) RECENTLY ISSUED ACCOUNTING STANDARDS

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, to improve the transparency of reporting reclassification out of accumulated other comprehensive income. The new standard is effective for fiscal years beginning after December 15, 2012, including interim periods within those years. The amendments should be prospectively applied. The amendments do not change the current requirement for reporting net income or other comprehensive income. The amendments require an organization to present on the face of the financial statements, or in the footnotes, the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income if the item reclassified is required to be reclassified to net income in its entirety in the same reporting period. Additionally, for other amounts that are not required to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required to provide additional detail about those amounts. Management does not believe that the adoption of this standard will have a material impact on the Company s consolidated financial statements.

(3) RECONCILIATION OF BASIC EARNINGS PER SHARE TO DILUTED EARNINGS PER SHARE

The following table presents a reconciliation of basic earnings per share to diluted earnings per share for the periods indicated.

	Three months ended		Nine months ended	
	6/30/13	6/30/12	6/30/13	6/30/12
Net income (in thousands)	$ 1,775	5,055	21,110	10,369
Average common shares outstanding	7,867,614	7,867,614	7,867,614	7,867,614
Average common share stock options outstanding				
Average diluted common shares	7,867,614	7,867,614	7,867,614	7,867,614
Earnings per share:				
Basic	$ 0.23	0.64	2.68	1.32
Diluted	$ 0.23	0.64	2.68	1.32

At June 30, 2013 and 2012, options to purchase 41,138 and 47,538 shares, respectively, of the Company s stock were outstanding. These options were not included in the calculation of diluted earnings per share because the option exercise price was greater than the average market price of the common shares for the period, thus making the options anti-dilutive.

(4) SECURITIES AVAILABLE FOR SALE

The following table presents a summary of securities available for sale at June 30, 2013. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Corporate debt securities	$ 67,471	2,117		69,588
U.S. government sponsored agency securities	171,398	222	1,914	169,706
Municipal securities	422			422
Total	$ 239,291	2,339	1,914	239,716

The following table presents a summary of securities available for sale at September 30, 2012. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Corporate debt securities	$ 57,983	3,035		61,018
U.S. government sponsored agency securities	152,546	624	4	153,166
Municipal securities	6			6
Total	$ 210,535	3,659	4	214,190

There were no sales of securities available for sale during the nine month period ended June 30, 2013. During the nine month period ended June 30, 2012, the Company realized gross gains of $227,000 and gross losses of $570,000 on the sale of securities available for sale.

The following table presents a summary of the fair value and gross unrealized losses of those securities available for sale which had unrealized losses at June 30, 2013. Dollar amounts are expressed in thousands.

	Less than 12 months		12 months or longer	
	Estimated fair value	Gross unrealized losses	Estimated fair value	Gross unrealized losses
U.S. government sponsored agency securities	$ 88,566	1,914	$	
Total	$ 88,566	1,914	$	

The scheduled maturities of securities available for sale at June 30, 2013 are presented in the following table. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Due in less than one year	$ 10,197	18		10,215
Due from one to five years	158,175	2,321	4	160,492
Due from five to ten years	10,420		18	10,402
Due after ten years	60,499		1,892	58,607
Total	$ 239,291	2,339	1,914	239,716

(5) MORTGAGE-BACKED SECURITIES AVAILABLE FOR SALE

The following table presents a summary of mortgage-backed securities available for sale at June 30, 2013. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Pass-through certificates guaranteed by GNMA fixed rate	$ 71	2		73
Pass-through certificates guaranteed by FNMA adjustable rate	130	7		137
FHLMC participation certificates:				
Fixed rate	138	7		145
Adjustable rate	114	6		120
Total	$ 453	22		475

The following table presents a summary of mortgage-backed securities available for sale at September 30, 2012. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Pass-through certificates guaranteed by GNMA fixed rate	$ 78	3		81
Pass-through certificates guaranteed by FNMA adjustable rate	143	9		152
FHLMC participation certificates:				
Fixed rate	176	14		190
Adjustable rate	123	8		131
Total	$ 520	34		554

There were no sales of mortgage-backed securities available for sale during the nine month periods ended June 30, 2013 and 2012.

The scheduled maturities of mortgage-backed securities available for sale at June 30, 2013 are presented in the following table. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Due from one to five years	$ 138	7		145
Due after ten years	315	15		330
Total	$ 453	22		475

Actual maturities and pay-downs of mortgage-backed securities available for sale will differ from scheduled maturities depending on the repayment characteristics and experience of the underlying financial instruments, on which borrowers have the right to prepay certain obligations.

(6) MORTGAGE-BACKED SECURITIES HELD TO MATURITY

The following table presents a summary of mortgage-backed securities held to maturity at June 30, 2013. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
FHLMC participation certificates:				
Fixed rate	$ 31	3		34
FNMA pass-through certificates:				
Fixed rate	2			2
Balloon maturity and adjustable rate	14			14
Collateralized mortgage obligations	10,351	186	29	10,508
Total	$ 10,398	189	29	10,558

The following table presents a summary of mortgage-backed securities held to maturity at September 30, 2012. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
FHLMC participation certificates:				
Fixed rate	$ 37	3		40
FNMA pass-through certificates:				
Fixed rate	3			3
Balloon maturity and adjustable rate	24	1		25
Collateralized mortgage obligations	25,857	390	198	26,049
Total	$ 25,921	394	198	26,117

During the nine month period ended June 30, 2013, the Bank recognized a gain of $295,000 and a loss of $38,000 on the sale of two mortgage backed securities which were classified as held to maturity. The securities had a combined amortized cost of $10.5 million at the time of sale. During the nine month period ended June 30, 2012, the Bank recognized a loss of $32,000 on the sale of a mortgage backed security which was classified as held to maturity. The security had an amortized cost of $891,000 at the time of sale. The decision was made to sell the securities after it was determined that there was a significant deterioration in the issuer s creditworthiness.

The following table presents a summary of the fair value and gross unrealized losses of those mortgage-backed securities held to maturity which had unrealized losses at June 30, 2013. Dollar amounts are expressed in thousands.

	Less than 12 months		12 months or longer	
	Estimated fair value	Gross unrealized losses	Estimated Fair Value	Gross unrealized losses
Collateralized mortgage obligations	$		$ 3,744	29
Total	$		$ 3,744	29

Management monitors the securities portfolio for impairment on an ongoing basis by evaluating market conditions and other relevant information, including external credit ratings, to determine whether or not a decline in value is other-than-temporary. When the fair value of a security is less than its amortized cost, an other-than-temporary impairment is considered to have occurred if the present value of expected cash flows is not sufficient to recover the entire amortized cost, or if the Company intends to, or will be required to, sell the security prior to the recovery of its amortized cost. The unrealized losses at June 30, 2013, are primarily the result of changes in market yields from the time of purchase. Management generally views changes in fair value caused by changes in interest rates as temporary. In addition, all scheduled payments for securities with unrealized losses at June 30, 2013, have been made, and it is anticipated that the Company will hold such securities to maturity and that the entire principal balance will be collected.

The scheduled maturities of mortgage-backed securities held to maturity at June 30, 2013, are presented in the following table. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Due from one to five years	$ 831	2	21	812
Due from five to ten years	24	1		25
Due after ten years	9,543	186	8	9,721

Total	$ 10,398	189	29	10,558

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Actual maturities and pay-downs of mortgage-backed securities held to maturity will differ from scheduled maturities depending on the repayment characteristics and experience of the underlying financial instruments, on which borrowers have the right to prepay certain obligations.

(7) LOANS RECEIVABLE

The Bank has traditionally concentrated its lending activities on mortgage loans secured by residential and business property and, to a lesser extent, development lending. Residential mortgage loans have either long-term fixed or adjustable rates. The Bank also has a portfolio of mortgage loans that are secured by multifamily, construction, development, and commercial real estate properties. The remaining part of North American s loan portfolio consists of non-mortgage commercial loans and installment loans.

The following table presents the Bank s total loans receivable. Dollar amounts are expressed in thousands.

	6/30/13	9/30/12
HELD FOR INVESTMENT		
Mortgage loans:		
Permanent loans on:		
Residential properties	$ 340,731	331,310
Business properties	269,141	321,559
Partially guaranteed by VA or insured by FHA	5,749	3,950
Construction and development	89,506	110,718
Total mortgage loans	705,127	767,537
Commercial loans	12,313	17,570
Installment loans and lease financing to individuals	6,322	7,753
Total loans receivable held for investment	723,762	792,860
Less:		
Undisbursed loan funds	(23,624)	(21,014)
Unearned discounts and fees on loans, net of deferred costs	(4,556)	(5,245)
Net loans receivable held for investment	$ 695,582	766,601
HELD FOR SALE		
Mortgage loans:		
Permanent loans on:		
Residential properties	$ 104,658	163,834

Included in the loans receivable balances at June 30, 2013, are participating interests in mortgage loans and wholly-owned mortgage loans serviced by other institutions in the amount of $1.1 million. Loans and participations serviced for others amounted to approximately $24.4 million at June 30, 2013. Loans serviced for others are not included in the accompanying condensed consolidated balance sheets.

Lending Practices and Underwriting Standards

Residential real estate loans - The Bank offers a range of residential loan programs, including programs offering loans guaranteed by the Veterans Administration (VA) and loans insured by the Federal Housing Administration (FHA). The Bank s residential loans come from several sources. The loans that the Bank originates are generally a result of direct solicitations of real estate brokers, builders, developers, or potential borrowers via the internet. North American periodically purchases real estate loans from other financial institutions or mortgage bankers.

The Bank s residential real estate loan underwriters are grouped into three different levels, based upon each underwriter s experience and proficiency. Underwriters within each level are authorized to approve loans up to prescribed dollar amounts. Any loan over $1 million must also be approved by either the Board Chairman, CEO or EVP/Residential Lending. Conventional residential real estate loans are underwritten using FNMA s Desktop Underwriter or FHLMC s Loan Prospector automated underwriting systems, which analyze credit history, employment and income information, qualifying ratios, asset reserves, and loan-to-value ratios. If a loan does not meet the automated underwriting standards, it is underwritten manually. Full documentation to support each applicant s credit history, income, and sufficient funds for closing is required on all loans. An appraisal report, performed in conformity with the Uniform Standards of Professional Appraisers Practice by an approved outside licensed appraiser, is required for substantially all loans. Typically, the Bank requires borrowers to purchase private mortgage insurance when the loan-to-value ratio exceeds 80%.

NASB originates Adjustable Rate Mortgages (ARMs), which fully amortize and typically have initial rates that are fixed for one to seven years before becoming adjustable. Such loans are underwritten based on the initial interest rate and the borrower s ability to repay based on the maximum first adjustment rate. Each underwriting decision takes into account the type of loan and the borrower s ability to pay at higher rates. While lifetime rate caps are taken into consideration, qualifying ratios may not be calculated at this level due to an extended number of years required to reach the fully-indexed rate. NASB does not originate any hybrid loans, such as payment option ARMs, nor does the Bank originate any subprime loans, generally defined as high risk or loans of substantially impaired quality.

At the time a potential borrower applies for a residential mortgage loan, it is designated as either a portfolio loan, which is held for investment and carried at amortized cost, or a loan held-for-sale in the secondary market and carried at fair value. All the loans on single family property that the Bank holds for sale conform to secondary market underwriting criteria established by various institutional investors. All loans originated, whether held for sale or held for investment, conform to internal underwriting guidelines, which consider, among other things, a property s value and the borrower s ability to repay the loan.

Construction and development loans - Construction and land development loans are made primarily to builders/developers, who construct properties for resale. The Bank s requirements for a construction loan are similar to those of a mortgage on an existing residence. In addition, the borrower must submit accurate plans, specifications, and cost projections of the property to be constructed. All construction and development loans are manually underwritten using NASB s internal underwriting standards. All construction and development loans require two approvals, from either the Board Chairman, CEO, or SVP/Construction Lending. Prior approval is required from the Bank s Board of Directors for newly originated construction and development loans with a proposed balance of $1.0 million or greater. The bank has adopted internal loan-to-value limits consistent with regulations, which are 65% for raw land, 75% for land development, and 85% for residential and non-residential construction. An appraisal report performed in conformity with the Uniform Standards of Professional Appraisers Practice by an approved outside licensed appraiser is required on all loans in excess of $250,000. Generally, the Bank will commit to an initial term of 12 to 18 months on construction loans, and an initial term of 24 to 48 months on land acquisition and development loans, with six month renewals thereafter. Interest rates on construction loans typically adjust daily and are tied to a predetermined index. NASB s staff regularly performs inspections of each property during its construction phase to help ensure adequate progress is achieved before making scheduled loan disbursements.

When construction and development loans mature, the Bank typically considers extensions for short, six-month term periods. This allows the Bank to more frequently evaluate the loan, including creditworthiness and current market conditions and, if management believes it s in the best interest of the Company, to modify the terms accordingly. This portfolio consists primarily of assets with rates tied to the prime rate and, in most cases, the conditions for loan renewal include an interest rate floor in accordance with the market conditions that exist at the time of renewal.

During the nine month period ended June 30, 2013, the Bank renewed fifty-seven loans within its construction and land development portfolio due to slower home and lot sales in the current economic environment. Such extensions were accounted for as Troubled Debt Restructurings (TDRs) if the restructuring was related to the borrower s financial difficulty, and if the Bank made concessions that it would not otherwise consider. In order to determine whether or not a renewal should be accounted for as a TDR, management reviewed the borrower s current financial information, including an analysis of income and liquidity in relation to debt service requirements. The large majority of these modifications did not result in a reduction in the contractual interest rate or a write-off of the principal balance (although the Bank does commonly require the borrower to make a principal reduction at renewal).

Commercial real estate loans - The Bank purchases and originates several different types of commercial real estate loans. Permanent multifamily mortgage loans on properties of 5 to 36 dwelling units have a 50% risk-weight for risk-based capital requirements if they have an initial loan-to-value ratio of not more than 80% and if their annual average occupancy rate exceeds 80%. All other performing commercial real estate loans have 100% risk-weights.

The Bank s commercial real estate loans are secured primarily by multi-family and nonresidential properties. Such loans are manually underwritten using NASB s internal underwriting standards, which evaluate the sources of repayment, including the ability of income producing property to generate sufficient cash flow to service the debt, the capacity of the borrower or guarantors to cover any shortfalls in operating income, and, as a last resort, the ability to liquidate the collateral in such a manner as to completely protect the Bank s investment. All commercial real estate loans require two approvals, from either the Board Chairman, CEO, or SVP/Commercial Lending. Prior approval is required from the Bank s Board of Directors for newly originated commercial loans with a proposed balance of $1.0 million or greater. Typically, loan-to-value ratios do not exceed 80%; however, exceptions may be made when it is determined that the safety of the loan is not compromised, and the rationale for exceeding this limit is clearly documented. An appraisal report performed in conformity with the Uniform Standards of Professional Appraisers Practice by an approved outside licensed appraiser is required on all loans in excess of $250,000. Interest rates on commercial loans may be either fixed or tied to a predetermined index and adjusted daily.

The Bank typically obtains full personal guarantees from the primary individuals involved in the transaction. Guarantor financial statements and tax returns are reviewed annually to determine their continuing ability to perform under such guarantees. The Bank typically pursues repayment from guarantors when the primary source of repayment is not sufficient to service the debt. However, the Bank may decide not to pursue a guarantor if, given the guarantor s financial condition, it is likely that the estimated legal fees would exceed the probable amount of any recovery. Although the Bank does not typically release guarantors from their obligation, the Bank may decide to delay the decision to pursue civil enforcement of a deficiency judgment.

At least once during each calendar year, a review is prepared for each borrower relationship in excess of $5 million and for each individual loan over $1 million. Collateral inspections are obtained on an annual basis for each loan over $1 million, and on a triennial basis for each loan between $500,000 and $1 million. Financial information, such as tax returns, is requested annually for all commercial real estate loans over $500,000, which is consistent with industry practice, and the Bank believes it has sufficient monitoring procedures in place to identify potential problem loans. A loan is deemed impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due in accordance with the contractual terms of the loan agreement. Any loans deemed impaired, regardless of their balance, are reviewed by management at the time of the impairment determination, and monitored on a quarterly basis thereafter, including calculation of specific valuation allowances, if applicable.

Installment Loans - These loans consist primarily of loans on savings accounts and consumer lines of credit that are secured by a customer s equity in their primary residence.

<u>Allowance for Loan Losses</u>

The Allowance for Loan and Lease Losses (ALLL) recognizes the inherent risks associated with lending activities for individually identified problem assets as well as the entire homogenous and non-homogenous loan portfolios. ALLLs are established by charges to the provision for loan losses and carried as contra assets. Management analyzes the adequacy of the allowance on a quarterly basis and appropriate provisions are made to maintain the ALLLs at adequate levels. At any given time, the ALLL should be sufficient to absorb at least all estimated credit losses on outstanding balances over the next twelve months. While management uses information currently available to determine these allowances, they can fluctuate based on changes in economic conditions and changes in the information available to management. Also, regulatory agencies review the Bank s allowances for loan loss as part of their examination, and they may require the Bank to recognize additional loss provisions, within their regulatory filings, based on the information available at the time of their examinations.

The ALLL is determined based upon two components. The first is made up of specific reserves for loans which have been deemed impaired in accordance with GAAP. The second component is made up of general reserves for loans that are not impaired. A loan becomes impaired when management believes it will be unable to collect all principal and interest due according to the contractual terms of the loan. Once a loan has been deemed impaired, the impairment must be measured by comparing the recorded investment in the loan to the present value of the estimated future cash flows discounted at the loan s effective rate, or to the fair value of the loan based on the loan s observable market price, or to the fair value of the collateral if the loan is collateral dependent. Prior to the quarter ended March 31, 2012, the Bank recorded a specific allowance equal to the amount of measured impairment.

In July 2011, the Office of Thrift Supervision (OTS) merged with and into the Office of the Comptroller of the Currency (OCC), and the OCC became the Bank s primary regulator. Beginning with the quarter ended March 31, 2012, the Bank was required to file a Consolidated Report of Condition and Income (Call Report) instead of the previously required Thrift Financial Report (TFR). With the adoption of the Call Report, the Bank was required to discontinue using specific valuation allowances on loans deemed impaired. The TFR had allowed any measured impairments to be carried as specific valuation allowances, whereas the Call Report required any measured impairments that are deemed confirmed losses to be charged-off and netted from their respective loan balances. For impaired loans that are collateral dependent, a confirmed loss is generally the amount by which the loan s recorded investment exceeds the fair value of its collateral. If a loan is considered uncollectible, the entire balance is deemed a confirmed loss and is fully charged-off. During the quarter ended March 31, 2012, the Bank charged-off against ALLL the aggregate confirmed losses of $23.3 million that were carried as specific valuation allowances in prior periods, and netted them against their respective loan balances for reporting purposes. This change had no impact on net loans receivable as presented in the consolidated balance sheet. In addition, this change did not materially impact the analysis of ALLL, which is described in more detail in the following paragraph, as specific valuation allowances were previously considered in the determination of historical loss ratios.

Loans that are not impaired are evaluated based upon the Bank s historical loss experience, as well as various subjective factors, to estimate potential unidentified losses within the various loan portfolios. These loans are categorized into pools based upon certain characteristics such as loan type, collateral type and repayment source. In addition to analyzing historical losses, the Bank also evaluates the following subjective factors for each loan pool to estimate future losses: changes in lending policies and procedures, changes in economic and business conditions, changes in the nature and volume of the portfolio, changes in management and other relevant staff, changes in the volume and severity of past due loans, changes in the quality of the Bank s loan review system, changes in the value of the underlying collateral for collateral dependent loans, changes in the level of lending concentrations, and changes in other external factors such as competition and legal and regulatory requirements. Historical loss ratios are adjusted accordingly, based upon the effect that the subjective factors have in estimated future losses. These adjusted ratios are applied to the balances of the loan pools to determine the adequacy of the ALLL each quarter. For purposes of calculating historical loss ratios, specific valuation allowances established prior to March 31, 2012, are considered charge-offs during the periods in which they are established.

The Bank does not routinely obtain updated appraisals for their collateral dependent loans that are not adversely classified. However, when analyzing the adequacy of its allowance for loan losses, the Bank considers potential changes in the value of the underlying collateral for such loans as one of the subjective factors used to estimate future losses in the various loan pools.

The following table presents the balance in the allowance for loan losses for the three and nine months ended June 30, 2013 and 2012. Dollar amounts are expressed in thousands.

	Residential	Residential Held For Sale	Commercial Real Estate	Construction & Development	Commercial	Installment	Total
Allowance for loan losses:							
Balance at April 1, 2013	$ 7,380		7,253	5,627	60	406	20,726
Provision for loan losses	886		(315)	(476)		(95)	
Losses charged off	(203)		(420)				(623)
Recoveries	307		174	21		45	547
Balance at June 30, 2013	$ 8,370		6,692	5,172	60	356	20,650
Balance at April 1, 2012	$ 6,941	3	13,881	15,169	651	152	36,797
Provision for loan losses	6,970	(3)	(5,165)	1,302	(89)	(15)	3,000
Losses charged off	(1,982)		(1,973)	(3,317)			(7,272)
Recoveries	20	2	1,662	588		19	2,291
Balance at June 30, 2012	$ 11,949	2	8,405	13,742	562	156	34,816
Balance at October 1, 2012	$ 6,941		7,086	16,590	513	699	31,829
Provision for loan losses	2,232		177	(11,129)	(453)	(427)	(9,600)
Losses charged off	(1,359)		(994)	(669)		(87)	(3,109)
Recoveries	556		423	380		171	1,530
Balance at June 30, 2013	$ 8,370		6,692	5,172	60	356	20,650
Balance at October 1, 2011	$ 6,663	12	13,201	41,863	7,682	845	70,266
Provision for loan losses	9,684	(12)	6,748	(1,359)	(4,551)	(10)	10,500
Losses charged off	(4,524)		(13,206)	(27,350)	(2,569)	(698)	(48,347)

Recoveries	126	2	1,663	588		19	2,397
Balance at June 30, 2012	$ 11,949	2	8,405	13,742	562	156	34,816

The following table presents the balance in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method at June 30, 2013. Dollar amounts are expressed in thousands.

	Residential	Residential Held For Sale	Commercial Real Estate	Construction & Development	Commercial	Installment	Total
Allowance for loan losses:							
Ending balance of allowance for loan losses related to loans at June 30, 2013:							
Individually evaluated for impairment	$ 712		137	4	25		878
Collectively evaluated for impairment	$ 7,658		6,555	5,168	35	356	19,772
Acquired with deteriorated credit quality *	$ 21						21
Loans:							
Balance at June 30, 2013	$ 344,333	104,658	267,312	65,302	12,313	6,322	800,240
Ending balance:							
Loans individually evaluated for impairment	$ 21,579		10,251	28,822	11,250	4	71,906
Loans collectively evaluated for impairment	$ 322,754	104,658	257,061	36,480	1,063	6,318	728,334
Loans acquired with deteriorated credit quality	$ 3,674						3,674

* Included in ending balance of allowance for loan losses related to loans individually evaluated for impairment at June 30, 2013.

The following table presents the balance in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method at September 30, 2012. Dollar amounts are expressed in thousands.

	Residential	Residential Held For Sale	Commercial Real Estate	Construction & Development	Commercial	Installment	Total
Allowance for loan losses:							
Ending balance of allowance for loan losses related to loans at September 30, 2012:							
Individually evaluated for impairment	$ 975		7	42			1,024
Collectively evaluated for impairment	$ 5,966		7,079	16,548	513	699	30,805
Acquired with deteriorated credit quality	$						
Loans:							
Balance at September 30, 2012	$ 332,320	163,834	319,272	89,689	17,567	7,753	930,435
Ending balance:							
Loans individually evaluated for impairment	$ 18,440		24,895	42,267		69	85,671
Loans collectively evaluated for impairment	$ 310,635	163,834	294,377	47,422	17,567	7,684	841,519

Loans acquired with deteriorated credit quality	$	3,245	3,245

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Classified Assets, Delinquencies, and Non-accrual Loans

Classified assets **-** In accordance with the Bank s asset classification system, problem assets are classified with risk ratings of either substandard, doubtful, or loss. An asset is considered substandard if it is inadequately protected by the borrower s ability to repay, or the value of collateral. Substandard assets include those characterized by a possibility that the institution will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have the same weaknesses of those classified as substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Assets classified as loss are considered uncollectible and of little value. Prior to the quarter ended March 31, 2012, the Bank established a specific valuation allowance for such assets. In conjunction with the adoption of the Call Report during the quarter ended March 31, 2012, such assets are charged-off against the ALLL at the time they are deemed to be a confirmed loss.

In addition to the risk rating categories for problem assets noted above, loans may be assigned a risk rating of pass, pass-watch, or special mention. The pass category includes loans with borrowers and/or collateral that is of average quality or better. Loans in this category are considered average risk and satisfactory repayment is expected. Assets classified as pass-watch are those in which the borrower has the capacity to perform according to the terms and repayment is expected. However, one or more elements of uncertainty exist. Assets classified as special mention have a potential weakness that deserves management s close attention. If left undetected, the potential weakness may result in deterioration of repayment prospects.

Each quarter, management reviews the problem loans in its portfolio to determine whether changes to the asset classifications or allowances are needed. The following table presents the credit risk profile of the Company s loan portfolio based on risk rating category as of June 30, 2013. Dollar amounts are expressed in thousands.

	Residential	Residential Held For Sale	Commercial Real Estate	Construction & Development	Commercial	Installment	Total
Rating:							
Pass	$ 291,695	104,658	196,528	13,855		6,293	613,029
Pass Watch	24,953		57,209	25,280	1,063		108,505
Special Mention	227		356				583
Substandard	26,940		13,082	26,167	11,250	29	77,468
Doubtful	518		137				655
Loss							
Total	$ 344,333	104,658	267,312	65,302	12,313	6,322	800,240

The following table presents the credit risk profile of the Company s loan portfolio based on risk rating category as of September 30, 2012. Dollar amounts are expressed in thousands.

	Residential	Residential Held For Sale	Commercial Real Estate	Construction & Development	Commercial	Installment	Total
Rating:							
Pass	$ 283,771	163,834	256,158	14,370	1,318	7,621	727,072
Pass Watch	11,076		28,439	19,054			58,569
Special Mention	4,689		323				5,012
Substandard	32,011		34,352	56,261	16,249	132	139,005
Doubtful	773			4			777
Loss							
Total	$ 332,320	163,834	319,272	89,689	17,567	7,753	930,435

The following table presents the Company s loan portfolio aging analysis as of June 30, 2013. Dollar amounts are expressed in thousands.

	30-59 Days Past Due	60-90 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Total Loans > 90 Days & Accruing
Residential	$ 4,665	603	6,514	11,782	332,551	344,333	
Residential held for sale					104,658	104,658	
Commercial real estate	1,930		515	2,445	264,867	267,312	
Construction & development	806		2,271	3,077	62,225	65,302	
Commercial					12,313	12,313	
Installment	58		25	83	6,239	6,322	
Total	$ 7,459	603	9,325	17,387	782,853	800,240	

The following table presents the Company s loan portfolio aging analysis as of September 30, 2012. Dollar amounts are expressed in thousands.

30-59 Days
Past Due