NASB FINANCIAL INC
Form 10-Q
February 11, 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 December 31, 2012

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 February 4, 2013, was 7,867,614.

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Balance Sheets

	December 31, 2012 (Unaudited)	September 30, 2012
	(Dollars in thousands)	
ASSETS		
Cash and cash equivalents	$ 11,908	8,716
Securities:		
Available for sale, at fair value	266,326	214,190
Stock in Federal Home Loan Bank, at cost	8,097	7,073
Mortgage-backed securities:		
Available for sale, at fair value	524	554
Held to maturity, at cost	23,669	25,921
Loans receivable:		
Held for sale, at fair value	164,635	163,834
Held for investment, net	722,654	766,601
Allowance for loan losses	(27,853)	(31,829)
Total loans receivable, net	859,436	898,606
Accrued interest receivable	4,169	4,402
Foreclosed assets held for sale, net	15,314	17,040
Premises and equipment, net	15,248	15,272
Investment in LLCs	17,137	17,222
Deferred income tax asset, net	15,523	17,199
Other assets	15,173	14,631
	$ 1,252,524	1,240,826
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Customer deposit accounts	$ 864,827	870,946
Brokered deposit accounts	9,997	21,367
Advances from Federal Home Loan Bank	150,000	127,000
Subordinated debentures	25,774	25,774
Escrows	4,330	8,760
Income taxes payable	4,953	3,490
Accrued expenses and other liabilities	12,783	11,986
Total liabilities	1,072,664	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	16,657	16,657
Retained earnings	197,833	189,516
Treasury stock, at cost; 1,989,498 shares	(38,418)	(38,418)
Accumulated other comprehensive loss	2,309	2,269
Total stockholders equity	179,860	171,503

	$ 1,252,524	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 December 31, 2012	2011
	(Dollars in thousands, except share data)	
Interest on loans receivable	$ 12,334	15,893
Interest on mortgage-backed securities	294	499
Interest and dividends on securities	963	968
Other interest income	2	2
Total interest income	13,593	17,362
Interest on customer and brokered deposit accounts	1,749	2,479
Interest on advances from Federal Home Loan Bank	531	635
Interest on subordinated debentures	129	129
Other interest expense	3	
Total interest expense	2,412	3,243
Net interest income	11,181	14,119
Provision for loan losses	(4,000)	2,500
Net interest income after provision for loan losses	15,181	11,619
Other income (expense):		
Loan servicing fees, net	26	47
Customer service fees and charges	1,474	1,410
Provision for loss on real estate owned	(575)	(1,354)
Loss on sale of securities available for sale		(343)
Gain from loans receivable held for sale	16,106	11,271
Other expense	(534)	(482)
Total other income	16,497	10,549
General and administrative expenses:		
Compensation and fringe benefits	6,356	5,348
Commission-based mortgage banking compensation	5,813	3,701
Premises and equipment	1,322	1,191
Advertising and business promotion	1,163	1,011
Federal deposit insurance premiums	586	387
Other	2,915	2,499
Total general and administrative expenses	18,155	14,137
Income before income tax expense	13,523	8,031
Income tax expense	5,206	3,092
Net income	$ 8,317	4,939
Basic earnings per share	$ 1.06	0.63
Diluted earnings per share	$ 1.06	0.63

Basic weighted average shares outstanding	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 December 31,	
	2012	2011
	(Dollars in thousands)	
Net income	$ 8,317	4,939
Other comprehensive income (loss):		
Unrealized gain (loss) loss on available for sale securities, net of income taxes of $25 and $(113) at December 31, 2012 and 2011, respectively	40	(181)
Reclassification adjustment for loss included in net income, net of income taxes of $132 at December 31, 2011		211
Change in unrealized gain on available for sale securities, net of income taxes of $25 and $19 at December 31, 2012 and 2011, respectively	40	30
Comprehensive income	$ 8,357	4,969

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	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			8,317			8,317
Other comprehensive income, net of tax:						
Unrealized gain on securities available for sale					40	40
Total comprehensive income						8,357
Balance at December 31, 2012	$ 1,479	16,657	197,833	(38,418)	2,309	179,860

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

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Three months ended December 31,	
	2012	2011
	(Dollars in thousands)	
Cash flows from operating activities:		
Net income	$ 8,317	4,939
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	522	482
Amortization and accretion, net	212	(440)
Loss on sale of securities available for sale		343
Loss from investment in LLCs	90	13
Gain from loans receivable held for sale	(16,106)	(11,271)
Provision for loan losses	(4,000)	2,500
Provision for loss on real estate owned	575	1,354
Origination of loans receivable held for sale	(542,797)	(413,503)
Sale of loans receivable held for sale	558,103	424,076
Stock based compensation stock options		2
Changes in:		
Net fair value of loan-related commitments	300	635
Accrued interest receivable	233	288
Prepaid and accrued expenses, other liabilities, and income taxes payable	2,940	1,531
Net cash provided by operating activities	8,389	10,949
Cash flows from investing activities:		
Principal repayments of mortgage-backed securities:		
Held to maturity	2,248	3,366
Available for sale	28	53
Principal repayments of mortgage loans receivable held for investment	68,138	54,486
Principal repayments of other loans receivable	659	759
Principal repayments of investment securities available for sale		25,103
Loan origination - mortgage loans receivable held for investment	(24,930)	(19,019)
Loan origination - other loans receivable	(588)	(941)
Purchase of mortgage loans receivable held for investment	(647)	(378)
Proceeds from sale (purchase) of Federal Home Loan Bank stock	(1,024)	5,246
Purchase of investment securities available for sale	(52,525)	(5,468)
Proceeds from sale of investment securities available for sale		19,678
Proceeds from sale of real estate owned	2,772	2,506
Purchases of premises and equipment, net	(499)	(889)
Investment in LLCs	(5)	(3)
Other	(319)	(380)
Net cash provided by (used in) investing activities	(6,692)	84,119

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Three months ended December 31,		
		2012	2011
		(Dollars in thousands)	
Cash flows from financing activities:			
Net increase (decrease) in customer and brokered deposit accounts		(17,496)	72,895
Proceeds from advances from Federal Home Loan Bank		25,000	
Repayment on advances from Federal Home Loan Bank		(2,000)	(122,000)
Change in escrows		(4,431)	(5,297)
Proceeds from other borrowings		422	
Net cash provided by (used in) financing activities		1,495	(54,402)
Net increase in cash and cash equivalents		3,192	40,666
Cash and cash equivalents at beginning of the period		8,716	5,030
Cash and cash equivalents at end of period	$	11,908	45,696
Supplemental disclosure of cash flow information:			
Cash paid for income taxes (net of refunds)	$	2,093	
Cash paid for interest		2,378	3,332
Supplemental schedule of non-cash investing and financing activities:			
Conversion of loans receivable to real estate owned, net of specific reserves	$	1,826	6,483
Conversion of real estate owned to loans receivable			42

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

NASB Financial, Inc.

(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 8, 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 three month period ended December 31, 2012, 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 December 31, 2012, 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. Disclosure of these critical accounting policies is incorporated by reference under Item 8 Financial Statements and Supplementary Data in the Company s Annual Report on Form 10-K for the Company s year ended September 30, 2012.

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

(2) 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	
	12/31/12	12/31/11
Net income (in thousands)	$ 8,317	4,939
Average common shares outstanding	7,867,614	7,867,614
Average common share stock options outstanding		
Average diluted common shares	7,867,614	7,867,614
Earnings per share:		
Basic	$ 1.06	0.63
Diluted	1.06	0.63

At December 31, 2012 and 2011, options to purchase 47,538 shares 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.

(3) SECURITIES AVAILABLE FOR SALE

The following table presents a summary of securities available for sale at December 31, 2012. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Corporate debt securities	$ 69,464	3,310		72,774
U.S. government sponsored agency securities	192,710	580	166	193,124
Municipal securities	428			428
Total	$ 262,602	3,890	166	266,326

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 three month period ended December 31, 2012. During the three month period ended December 31, 2011, 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 December 31, 2012. 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	$ 60,307	166	$	
Total	$ 60,307	166	$	

The scheduled maturities of securities available for sale at December 31, 2012 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	$ 11,734	13		11,747
Due from one to five years	164,484	3,706	1	168,189
Due from five to ten years	35,095	147		35,242
Due after ten years	51,289	24	165	51,148
Total	$ 262,602	3,890	166	266,326

(4) MORTGAGE-BACKED SECURITIES AVAILABLE FOR SALE

The following table presents a summary of mortgage-backed securities available for sale at December 31, 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	$ 76	2		78
Pass-through certificates guaranteed by FNMA	adjustable rate	137	7		144
FHLMC participation certificates:					
Fixed rate		161	13		174
Adjustable rate		120	8		128
Total		$ 494	30		524

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 three month periods ended December 31, 2012 and 2011.

The scheduled maturities of mortgage-backed securities available for sale at December 31, 2012 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 five to ten years	$ 161	13		174
Due after ten years	333	17		350
Total	$ 494	30		524

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.

(5) MORTGAGE-BACKED SECURITIES HELD TO MATURITY

The following table presents a summary of mortgage-backed securities held to maturity at December 31, 2012. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
FHLMC participation certificates:				
Fixed rate	$ 35	3		38
FNMA pass-through certificates:				
Fixed rate	3			3
Balloon maturity and adjustable rate	23	1		24
Collateralized mortgage obligations	23,608	370	327	23,651
Total	$ 23,669	374	327	23,716

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

There were no sales of mortgage-backed securities held to maturity during the three month periods ended December 31, 2012 and 2011.

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 December 31, 2012. 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	$ 9,587	197	$ 1,345	130
Total	$ 9,587	197	$ 1,345	130

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 December 31, 2012, 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 December 31, 2012, 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 December 31, 2012, 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	$ 26	2		28
Due from five to ten years	1,115	2	28	1,089
Due after ten years	22,528	370	299	22,599
Total	$ 23,669	374	327	23,716

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.

(6) 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.

	12/31/12	9/30/12
HELD FOR INVESTMENT		
Mortgage loans:		
Permanent loans on:		
Residential properties	$ 329,436	331,310
Business properties	291,487	321,559
Partially guaranteed by VA or insured by FHA	4,447	3,950
Construction and development	97,684	110,718
Total mortgage loans	723,054	767,537
Commercial loans	14,986	17,570
Installment loans and lease financing to individuals	7,591	7,753
Total loans receivable held for investment	745,631	792,860
Less:		
Undisbursed loan funds	(18,013)	(21,014)
Unearned discounts and fees on loans, net of deferred costs	(4,964)	(5,245)
Net loans receivable held for investment	$ 722,654	766,601
HELD FOR SALE		
Mortgage loans:		
Permanent loans on:		
Residential properties	$ 164,635	163,834

Included in the loans receivable balances at December 31, 2012, are participating interests in mortgage loans and wholly-owned mortgage loans serviced by other institutions in the amount of $1.2 million. Loans and participations serviced for others amounted to approximately $27.4 million at December 31, 2012. 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 CEO or the EVP/Chief Credit Officer. 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 outside licensed appraiser, is required for 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 must be approved by the CEO and either the EVP/ Chief Credit Officer 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 $2.5 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 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 three month period ended December 31, 2012, the Bank renewed nineteen 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 must be approved by the CEO and either the EVP/ Chief Credit Officer 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 $2.5 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 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.

Allowance for Loan Losses

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 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 and the recorded investment in loans based on portfolio segment and impairment method at December 31, 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 October 1, 2012	$ 6,941		7,086	16,590	513	699	31,829
Provision for loan losses	1,956		166	(5,698)	(448)	24	(4,000)
Losses charged off	(464)		(69)	(40)		(86)	(659)
Recoveries	60		246	353		24	683
Balance at December 31, 2012	$ 8,493		7,429	11,205	65	661	27,853
Ending balance of allowance for loan losses related to loans at December 31, 2012:							
Individually evaluated for Impairment	$ 605		25	191			821
Collectively evaluated for Impairment	$ 7,888		7,404	11,014	65	661	27,032
Acquired with deteriorated credit quality	$ 21						21
Loans:							
Balance at December 31, 2012	$ 331,640	164,635	289,359	79,078	14,986	7,591	887,289
Ending balance:							
Loans individually evaluated for impairment	$ 23,398		19,806	39,560	13,751	62	96,577
Loans collectively evaluated for impairment	$ 308,242	164,635	269,553	39,518	1,235	7,529	790,712
Loans acquired with deteriorated credit quality	$ 3,956						3,956

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 December 31, 2011. 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 October 1, 2011	$ 6,663	12	13,201	41,863	7,682	845	70,266
Provision for loan losses	(731)	6	9,640	(3,967)	(2,577)	129	2,500
Losses charged off	(587)		(1,437)	(10,246)	(2,569)	(19)	(14,858)
Recoveries	37						37
Balance at December 31, 2011	$ 5,382	18	21,404	27,650	2,536	955	57,945
Ending balance of allowance for loan losses related to loans at December 31, 2011:							
Individually evaluated for Impairment	$ 1,742	18	7,011	16,927	335	660	26,693
Collectively evaluated for Impairment	$ 3,640		14,393	10,723	2,201	295	31,252
Acquired with deteriorated credit quality	$ 51						51
Loans:							
Balance at December 31, 2011	$ 325,417	116,133	378,585	144,434	73,970	9,185	1,047,724
Ending balance:							
Loans individually evaluated for impairment	$ 13,614	18	33,771	89,244	800	722	138,169
Loans collectively evaluated for impairment	$ 311,803	116,115	344,814	55,190	73,170	8,463	909,555
Loans acquired with deteriorated credit quality	$ 2,504						2,504

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 December 31, 2012. Dollar amounts are expressed in thousands.

	Residential	Residential Held For Sale	Commercial Real Estate	Construction & Development	Commercial	Installment	Total
Rating:							
Pass	$ 272,947	164,635	203,228	12,893		7,529	661,232
Pass Watch	24,253		57,868	20,048	1,235		103,404
Special Mention	229		4,749				4,978
Substandard	33,820		23,514	45,953	13,751	62	117,100
Doubtful	391			184			575
Loss							
Total	$ 331,640	164,635	289,359	79,078	14,986	7,591	887,289

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 December 31, 2012. Dollar amounts are expressed in thousands.

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Total Loans > 90 Days & Accruing
Residential	$ 2,064	1,131	7,738	10,933	320,707	331,640	156
Residential held for sale					164,635	164,635	
Commercial real estate	536		6,008	6,544	282,815	289,359	213
Construction & development		962	4,167	5,129	73,949	79,078	566
Commercial					14,986	14,986	
Installment	15		75	90	7,501	7,591	11
Total	$ 2,615	2,093	17,988	22,696	864,593	887,289	946

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	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Total Loans > 90 Days & Accruing
Residential	$ 1,727	1,439	16,430	19,596	312,724	332,320	5,183
Residential held for sale					163,834	163,834	
Commercial real estate	217	714	6,082	7,013	312,259	319,272	
Construction & development	567	633	5,487	6,687	83,002	89,689	1,931
Commercial					17,567	17,567	
Installment	181	67	64	312	7,441	7,753	
Total	$ 2,692	2,853	28,063	33,608	896,827	930,435	7,114

When a loan becomes 90 days past due, or when full payment of interest and principal is not expected, the Bank stops accruing interest and establishes a reserve for the unpaid interest accrued-to-date. In some instances, a loan may become 90 days past due if it has exceeded its maturity date but the Bank and borrower are still negotiating the terms of an extension agreement. In those instances, the Bank typically continues to accrue interest, provided the borrower has continued making interest payments after the maturity date and full payment of interest and principal is expected.

The following table presents the Company s loans meeting the regulatory definition of nonaccrual, which includes certain loans that are current and paying as agreed. This table does not include purchased impaired loans or troubled debt restructurings that are performing. Dollar amounts are expressed in thousands.

	12/31/12	9/30/12
Residential	$ 23,083	23,147
Residential held for sale		
Commercial real estate	14,711	20,952
Construction & development	23,220	30,606
Commercial		
Installment	62	62
Total	$ 61,076	74,767

As of December 31, 2012, $50.0 million (81.9%) of the loans classified as nonaccrual were current and paying as agreed.

During the quarter ended March 31, 2012, the Company s nonaccrual loans increased $41.4 million. This increase resulted from management s decision to move certain impaired collateral dependent loans secured by land development properties to nonaccrual, even though the majority of such loans were current and paying in accordance with their contractual terms. Due to the continued deterioration in the real estate markets, further declines in the value of collateral securing these loans are possible. In accordance with GAAP, such loans have been charged-down to the fair value of their underlying collateral, and therefore, the recorded investment in the loan is deemed fully collectable at December 31, 2012. Interest income is recognized on a cash-basis as payments are received.

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. A restructuring of debt is considered a TDR if, because of a debtor s financial difficulty, a creditor grants concessions that it would not otherwise consider. Loans modified in troubled debt restructurings are also considered impaired. Concessions granted in a TDR could include a reduction in interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection. 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.

During the quarter ended December 31, 2012, the Company modified five residential loans to a single borrower with a recorded investment of $2.8 million prior to modification, which were deemed to be TDRs. These modifications extended the maturity date for four years and did not result in a reduction in the contractual interest rate or a write-off of the principal balance. The loans were deemed collateral dependent, and the modification did not result in any measured impairment or specific allowances. In addition, the Company modified three residential loans to a single borrower with a total recorded investment of $421,000 prior to modification, which were deemed to be TDRs. These modifications, which required a combined $39,000 principal payment, extended the maturity date for three years and did not result in a reduction in the contractual interest rate. Prior to modification, the loans were deemed impaired and collateral dependent. Therefore, they were being carried at the fair value of the underlying collateral and no additional impairment of specific valuation allowances were required.

During the quarter ended December 31, 2012, the Company modified five construction and land development loans with a recorded investment of $3.7 million prior to modification which had previously been deemed TDRs and continued to be TDRs following the current modification. These modifications were the result of extensions, typically for a six-month period, and did not result in a reduction in the contractual interest rate or a write-off of the principal balance. Such loans are considered collateral dependent and were being carried at the fair value of the underlying collateral prior to modification. In addition, the Company modified three construction and land development loans with a recorded investment of $2.3 million prior to modification, which were deemed to be TDRs during the current period. These modifications were the result of extensions, typically for a six-month period, and did not result in a reduction in the contractual interest rate or a write-off of the principal balance. The loans were deemed collateral dependent, and the modification did not result in any measured impairment or specific allowances, based upon the fair value of the underlying collateral.

During the quarter ended December 31, 2012, the Company modified two commercial real estate loans with a recorded investment of $746,000 prior to modification, which were deemed to be TDRs. The modifications restructured the payment terms and did not result in a reduction in the contractual interest rate or a write-off of the principal balance. Prior to modification, such loans were considered impaired and collateral dependent. Therefore, they were being carried at the fair value of the underlying collateral and no additional impairment or specific valuation allowances were required. In addition, the Company agreed to modify one commercial loan with a recorded investment of $16.3 million prior to modification, which was deemed to be a TDR. The modification extended the maturity date by eighteen months and required a $2.5 million principal payment. The modification resulted in a measured impairment of $25,000, based upon the present value of the estimated future cash flows discounted at the loan s effective rate.

TDRs secured by residential properties with a recorded investment of $3.7 million, TDRs secured by commercial properties with a recorded investment of $698,000, and TDRs secured by land development properties with a recorded investment of $1.7 million defaulted during the period ended December 31, 2012. Management considers the level of defaults within the various portfolios when evaluating qualitative adjustments used to determine the adequacy of the Allowance for Loan and Lease Losses.

During the period ended December 31, 2011, the Company modified five land development loans, with a recorded investment of $3.2 million prior to modification, which had previously been deemed TDRs and continued to be TDRs following the current modification. These modifications were the result of extensions, typically for a six-month period, and did not result in a reduction in the contractual interest rate or a write-off of the principal balance. Such loans are considered collateral dependent, and the modifications resulted in specific loss allowances of $418,000, based upon the fair value of the collateral. Specific loss allowances are included in the calculation of estimated future loss ratios, which are applied to the various loan portfolios for purposes of estimating future losses.

TDRs secured by residential properties with a recorded investment of $3.1 million, TDRs secured by commercial properties with a recorded investment of $3.8 million, and TDRs secured by land development properties with a recorded investment of $4.7 million defaulted during the period ended December 31, 2011.

The following table presents the recorded balance of troubled debt restructurings. Dollar amounts are expressed in thousands.

	12/31/12	9/30/12
Troubled debt restructurings:		
Residential	$ 9,084	6,156
Residential held for sale		
Commercial real estate	14,168	17,384
Construction & development	38,303	39,844
Commercial	13,751	
Installment		
Total	$ 75,306	63,384
Performing troubled debt restructurings:		
Residential	$ 825	593
Residential held for sale		
Commercial real estate	3,553	3,812
Construction & development	16,340	11,521
Commercial	13,751	
Installment		
Total	$ 34,469	15,926

At December 31, 2012, the Bank had outstanding commitments of $235,000 to be advanced in connection with TDRs.

The following table presents impaired loans, including troubled debt restructurings, as of December 31, 2012. Dollar amounts are expressed in thousands.

	Recorded Balance	Unpaid Principal Balance	Specific Allowance	YTD Average Investment in Impaired Loans	Interest Income Recognized
Loans without a specific valuation allowance:					
Residential	$ 17,689	19,184		17,742	216
Residential held for sale					
Commercial real estate	19,806	28,384		20,023	462
Construction & development	35,988	40,109		37,170	553
Commercial					
Installment	62	519		70	5
Loans with a specific valuation allowance:					
Residential	$ 5,709	6,670	605	5,725	89
Residential held for sale					
Commercial real estate					
Construction & development	3,572	3,988	191	3,577	59
Commercial	13,751	13,751	25	15,417	280
Installment					
Total:					
Residential	$ 23,398	25,854	605	23,467	305
Residential held for sale					
Commercial real estate	19,806	28,384		20,023	462
Construction & development	39,560	44,097	191	40,747	612
Commercial	13,751	13,751	25	15,417	280
Installment	62	519		70	5

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The following table presents impaired loans, including troubled debt restructurings, as of September 30, 2012. Dollar amounts are expressed in thousands.

	Recorded Balance	Unpaid Principal Balance	Specific Allowance	YTD Average Investment in Impaired Loans	Interest Income Recognized
Loans without a specific valuation allowance:					
Residential	$ 16,849	19,394		18,252	776
Residential held for sale					
Commercial real estate	21,574	30,652		24,961	1,796
Construction & development	40,633	45,873		46,820	2,658
Commercial					
Installment	68	570		69	17
Loans with a specific valuation allowance:					
Residential	$ 4,836	4,910	974	4,836	260
Residential held for sale					
Commercial real estate	3,322	3,955	7	3,949	215
Construction & development	1,634	1,668	42	1,698	100
Commercial					
Installment					
Total:					
Residential	$ 21,685	24,304	974	23,088	1,036
Residential held for sale					
Commercial real estate	24,896	34,607	7	28,910	2,011
Construction & development	42,267	47,541	42	48,518	2,758
Commercial					
Installment	68	570		69	17

(7) FORECLOSED ASSETS HELD FOR SALE

The following table presents real estate owned and other repossessed property. Dollar amounts are expressed in thousands.

	12/31/12	9/30/12
Real estate acquired through (or deed in lieu of) foreclosure	$ 15,314	17,040
Less: allowance for losses		
Total	$ 15,314	17,040

Foreclosed assets held for sale are initially recorded at fair value as of the date of foreclosure less any estimated selling costs (the new basis) and are subsequently carried at the lower of the new basis or fair value less selling costs on the current measurement date. When foreclosed assets are acquired, any excess of the loan balance over the new basis of the foreclosed asset is charged to the allowance for loan losses. Subsequent adjustments for estimated losses are charged to operations when the fair value declines to an amount less than the carrying value. Costs and expenses related to major additions and improvements are capitalized, while maintenance and repairs that do not improve or extend the lives of the respective assets are expensed. Applicable gains and losses on the sale of real estate owned are realized when the asset is disposed of, depending on the adequacy of the down payment and other requirements.

With the adoption of the Call Report during the quarter ended March 31, 2012, the Bank was required to begin following regulatory guidance related to the Call Report requirements. One such requirement resulted in a change in the treatment of specific loss reserves for foreclosed assets held for sale. Previous Thrift Financial Report guidance allowed banks to reduce an asset s carrying value through a specific allowance when the fair value declined to an amount less than its carrying value. Call Report guidance requires that the carrying value of foreclosed assets held for sale be written down to fair value through a charge to earnings. During the quarter ended March 31, 2012, the Bank charged-off the previously established specific allowances on such assets of $9.4 million. This change had no impact on net foreclosed assets held for sale as presented in the consolidated balance sheet.

(8) SUBORDINATED DEBENTURES

On December 13, 2006, the Company, through its wholly-owned statutory trust, NASB Preferred Trust I (the Trust), issued $25 million of pooled Trust Preferred Securities. The Trust used the proceeds from the offering to purchase a like amount of the Company s subordinated debentures. The debentures, which have a variable rate of 1.65% over the 3-month LIBOR and a 30-year term, are the sole assets of the Trust. In exchange for the capital contributions made to the Trust by the Company upon formation, the Company owns all the common securities of the Trust.

In accordance with Financial Accounting Standards Board ASC 810-10, the Trust qualifies as a special purpose entity that is not required to be consolidated in the financial statements of the Company. The $25.0 million Trust Preferred Securities issued by the Trust will remain on the records of the Trust. The Trust Preferred Securities are included in Tier I capital for regulatory capital purposes.

The Trust Preferred Securities have a variable interest rate of 1.65% over the 3-month LIBOR, and are mandatorily redeemable upon the 30-year term of the debentures, or upon earlier redemption as provided in the Indenture. The debentures are callable, in whole or in part, after five years of the issuance date. The Company did not incur a placement or annual trustee fee related to the issuance. The securities are subordinate to all other debt of the Company and interest may be deferred up to five years.

On July 11, 2012, the Company notified security holders that it was exercising its right to defer the payment of interest on its Trust Preferred Securities for a period of up to five years.

(9) INCOME TAXES

The Company s federal and state income tax returns for fiscal years 2009 through 2011 remain subject to examination by the Internal Revenue Service and various state jurisdictions, based on the statute of limitations.

(10) SEGMENT INFORMATION

The Company has identified two principal operating segments for purposes of financial reporting: Banking and Mortgage Banking. These segments were determined based on the Company s internal financial accounting and reporting processes and are consistent with the information that is used to make operating decisions and to assess the Company s performance by the Company s key decision makers.

The Mortgage Banking segment originates mortgage loans for sale to investors and for the portfolio of the Banking segment. The Banking segment provides a full range of banking services through the Bank s branch network, exclusive of mortgage loan originations. A portion of the income presented in the Mortgage Banking segment is derived from sales of loans to the Banking segment based on a transfer pricing methodology that is designed to approximate economic reality. The Other and Eliminations segment includes financial information from the parent company plus inter-segment eliminations.

The following table presents financial information from the Company s operating segments for the periods indicated. Dollar amounts are expressed in thousands.

Three months ended December 31, 2012	Banking	Mortgage Banking	Other and Eliminations	Consolidated
Net interest income	$ 11,310		(129)	11,181
Provision for loan losses	(4,000)			(4,000)
Other income	50	17,021	(574)	16,497
General and administrative expenses	6,750	11,688	(283)	18,155
Income tax expense	3,315	2,053	(162)	5,206
Net income	$ 5,295	3,280	(258)	8,317

Three months ended December 31, 2011	Banking	Mortgage Banking	Other and Eliminations	Consolidated
Net interest income	$ 14,248		(129)	14,119
Provision for loan losses	2,500			2,500
Other income	(771)	11,685	(365)	10,549
General and administrative expenses	6,031	8,264	(158)	14,137
Income tax benefit	1,904	1,317	(129)	3,092
Net loss	$ 3,042	2,104	(207)	4,939

(11) DERIVATIVE INSTRUMENTS

The Company has commitments outstanding to extend credit that have not closed prior to the end of the period. As the Company enters into commitments to originate loans, it also enters into commitments to sell the loans in the secondary market on a best-efforts basis. Such commitments to originate loans held for sale are considered derivative instruments in accordance with GAAP, which requires the Company to recognize all derivative instruments in the balance sheet and to measure those instruments at fair value. As a result of marking to market commitments to originate loans, the Company recorded a decrease in other assets of $2.2 million, an increase in other liabilities of $623,000, and a decrease in other income of $2.9 million for the three month period ended December 31, 2012. The Company recorded a decrease in other assets of $662,000, a decrease in other liabilities of $535,000, and a decrease in other income of $127,000 for the three month period ended December 31, 2011.

Additionally, the Company has commitments to sell loans that have closed prior to the end of the period. Due to the mark to market adjustment on commitments to sell loans held for sale, the Company recorded an increase in other assets of $2.4 million, a decrease in other liabilities of $117,000, and an increase in other income of $2.6 million during the three month period ended December 31, 2012. The Company recorded a decrease in other assets of $669,000, a decrease in other liabilities of $161,000, and a decrease in other income of $508,000 during the three month period ended December 31, 2011.

The balance of derivative instruments related to commitments to originate and sell loans at December 31, 2012, is disclosed in Footnote 12, Fair Value Measurements.

(12) FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would likely be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. GAAP identifies three primary measurement techniques: the market approach, the income approach, and the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. The income approach uses valuations or techniques to convert future amounts, such as cash flows or earnings, to a single present amount. The cost approach is based on the amount that currently would be required to replace the service capability of an asset.

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GAAP establishes a fair value hierarchy and prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to observable inputs such as quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The maximization of observable inputs and the minimization of the use of unobservable inputs are required. Classification within the fair value hierarchy is based upon the objectivity of the inputs that are significant to the valuation of an asset or liability as of the measurement date. The three levels within the fair value hierarchy are characterized as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 Inputs other than quoted prices included with Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability; and inputs that are derived principally from, or corroborated by, observable market data by correlation or other means.

Level 3 Unobservable inputs for the asset or liability for which there is little, if any, market activity for the asset or liability at the measurement date. Unobservable inputs reflect the Company s own assumptions about what market participants would use to price the asset or liability. These inputs may include internally developed pricing models, discounted cash flow methodologies, as well as instruments for which the fair value determination requires significant management judgment.

The Company measures certain financial assets and liabilities at fair value in accordance with GAAP. These measurements involve various valuation techniques and assume that the transactions would occur between market participants in the most advantageous market for the Company.

The following is a summary of valuation techniques utilized by the Company for its significant financial assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy:

Available for sale securities

Securities available for sale consist of corporate debt, trust preferred, U. S. government sponsored agency, and municipal securities. Such securities are valued using market prices in an active market, if available. This measurement is classified as Level 1 within the hierarchy. Less frequently traded securities are valued using industry standard models which utilize various assumptions such as historical prices of the same or similar securities, and observation of market prices of securities of the same issuer, market prices of same-sector issuers, and fixed income indexes. Substantially all of these assumptions are observable in the marketplace or can be derived from observable data. These measurements are classified as Level 2 within the hierarchy.

At December 31, 2011, mortgage-backed securities available for sale, which consist of agency pass-through and participation certificates issued by GNMA, FNMA, and FHLMC, were valued by using broker-dealer quotes for similar assets in markets that are not active. Although the Company did not validate these quotes, they were reviewed by management for reasonableness in relation to current market conditions. Additionally, they were obtained from experienced brokers who had an established relationship with the Bank and deal regularly with these types of securities. The Company did not make any adjustment to the quotes received from broker-dealers. These measurements are classified as Level 2. At December 31, 2012, mortgage-backed securities available for sale were valued by using industry standard models which utilize various inputs and assumptions such as historical prices of benchmark securities, prepayment estimates, loan type, and year of origination. Substantially all of these assumptions are observable in the marketplace or can be derived from observable data. These measurements are classified as Level 2 within the hierarchy.

Loans held for sale

Loans held for sale are valued using quoted market prices for loans with similar characteristics. This measurement is classified as Level 2 within the hierarchy.

Commitments to Originate Loans and Forward Sales Commitments

Commitments to originate loans and forward sales commitments are valued using a valuation model which considers differences between current market interest rates and committed rates. The model also includes assumptions, which estimate fall-out percentages, for commitments to originate loans, and average lives. Fall-out percentages, which range from ten to forty percent, are estimated based upon the difference between current market rates and committed rates. Average lives are based upon estimates for similar types of loans. These measurements use significant unobservable inputs and are classified as Level 3 within the hierarchy.

The following table presents the fair value measurements of assets recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the measurements fall at December 31, 2012 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Securities, available for sale				
U.S. government sponsored agency securities	$ 193,124	156,850	36,274	
Corporate debt securities	72,774		72,774	
Municipal securities	428		428	
Mortgage-backed securities, available for sale				
Pass through certificates guaranteed by GNMA fixed rate	78		78	
Pass through certificates guaranteed by FNMA adjustable rate	144		144	
FHLMC participation certificates:				
Fixed rate	174		174	
Adjustable rate	128		128	
Loans held for sale	164,635		164,635	
Commitments to originate loans	323			323
Forward sales commitments	4,636			4,636
Total assets	$ 436,444	156,850	274,635	4,959
Liabilities:				
Commitments to originate loans	$ 1,135			1,135
Forward sales commitments	16			16
Total liabilities	$ 1,151			1,151

The following table presents the fair value measurements of assets recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the measurements fall at September 30, 2012 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Securities, available for sale				
U.S. government sponsored agency securities	$ 153,166	142,359	10,807	
Corporate debt securities				