TIMBERLAND BANCORP INC
Form 10-K
December 12, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended September 30, 2011 OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 0-23333

TIMBERLAND BANCORP, INC.

(Exact name of registrant as specified in its charter)

Washington	91-1863696
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
624 Simpson Avenue, Hoquiam, Washington	98550
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (360) 533-4747

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value $.01 per share	The Nasdaq Stock Market LLC
(Title of Each Class)	(Name of Each Exchange on Which Registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES _____ NO X

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 of Section 15(d) of the Act. YES _____ NO X

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. X

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer		Accelerated filer	
Non-accelerated filer		Smaller reporting company	X

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES NO X

As of November 30, 2011, the registrant had 7,045,036 shares of common stock issued and outstanding. The aggregate market value of the common stock held by nonaffiliates of the registrant, based on the closing sales price of the registrant's common stock as quoted on the NASDAQ Global Market on March 31, 2011, was $39.5 million (7,045,036 shares at $5.61). For purposes of this calculation, common stock held by officers and directors of the registrant and the Timberland Bank Employee Stock Ownership Plan and Trust are considered nonaffiliates.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of Definitive Proxy Statement for the 2012 Annual Meeting of Stockholders (Part III).

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PART I

Item 1. Business

General

Timberland Bancorp, Inc. ("Company"), a Washington corporation, was organized on September 8, 1997 for the purpose of becoming the holding company for Timberland Savings Bank, SSB ("Bank") upon the Bank's conversion from a Washington-chartered mutual savings bank to a Washington-chartered stock savings bank ("Conversion"). The Conversion was completed on January 12, 1998 through the sale and issuance of 13,225,000 shares of common stock by the Company. At September 30, 2011, on a consolidated basis, the Company had total assets of $738.2 million, total deposits of $592.7 million and total shareholders' equity of $86.2 million. The Company's business activities generally are limited to passive investment activities and oversight of its investment in the Bank. Accordingly, the information set forth in this report, including consolidated financial statements and related data, relates primarily to the Bank and its subsidiary.

The Bank was established in 1915 as "Southwest Washington Savings and Loan Association." In 1935, the Bank converted from a state-chartered mutual savings and loan association to a federally chartered mutual savings and loan association, and in 1972, changed its name to "Timberland Federal Savings and Loan Association." In 1990, the Bank converted to a federally chartered mutual savings bank under the name "Timberland Savings Bank, FSB." In 1991, the Bank converted to a Washington-chartered mutual savings bank and changed its name to "Timberland Savings Bank, SSB." On December 29, 2000, the Bank changed its name to "Timberland Bank." The Bank's deposits are insured up to applicable legal limits by the Federal Deposit Insurance Corporation ("FDIC"). The Bank has been a member of the Federal Home Loan Bank ("FHLB") System since 1937. The Bank is regulated by the Washington Department of Financial Institutions, Division of Banks ("Division" or "DFI") and the FDIC.

The Bank is a community-oriented bank which has traditionally offered a variety of savings products to its retail customers while concentrating its lending activities on real estate mortgage loans. Lending activities have historically been focused primarily on the origination of loans secured by real estate, including construction loans and land development, one- to four-family residential loans, multi-family loans, commercial real estate loans and land loans. The Bank originates adjustable-rate residential mortgage loans that do not qualify for sale in the secondary market under Federal Home Loan Mortgage Corporation ("Freddie Mac") guidelines. The Bank also originates commercial business loans and in 1998 established a business banking division to increase the origination of these loans. During the past several years, the Bank adjusted its lending strategy and began reducing its exposure to speculative construction and land development lending.

The Company maintains a website at www.timberlandbank.com. The information contained on that website is not included as a part of, or incorporated by reference into, this Annual Report on Form 10-K. Other than an investor's own internet access charges, the Company makes available free of charge through that website the Company's Annual Report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after these materials have been electronically filed with, or furnished to, the Securities and Exchange Commission ("SEC").

Corporate Overview

Participation in the Troubled Asset Relief Program ("TARP") Capital

Purchase Program ("CPP"). On December 23, 2008, as part of the TARP CPP established by the United States Department of the Treasury ("Treasury"), the Company sold to the Treasury 16,641 shares of Cumulative Perpetual Preferred Stock, Series A ("Series A Preferred Stock") and a warrant to purchase 370,889 shares of the Company's common stock, par value $0.01 per share, for an aggregate purchase price of $16.6 million in cash. For additional information regarding the TARP CPP transaction, see Item 1A, "Risk Factors - Risks specific to our participation in TARP."

Agreements with Banking Regulators. In December 2009, the FDIC determined that the Bank required supervisory attention and agreed to terms on a Memorandum of Understanding (the "Bank MOU") with the Bank. The terms of the Bank MOU restrict the Bank from certain activities, and require that the Bank obtain the prior written approval, or nonobjection, of the FDIC and/or the DFI to engage in certain activities.

In addition, on February 1, 2010, the Federal Reserve Bank of San Francisco ("FRB") determined that the Company required additional supervisory attention and entered into a Memorandum of Understanding with the Company (the "Company MOU"). Under the agreement, the Company must among other things obtain prior written approval, or non-objection, from the FRB to declare or pay any dividends, or make any other capital distributions; issue any trust preferred securities; or purchase or redeem any of its stock. The FRB has denied the Company's requests to pay dividends on its Series A Preferred Stock issued under the TARP CPP for the quarterly payments due for the last six quarters beginning with the payments due on May 15, 2010. If dividends on the Series A Preferred Stock are not paid for six quarters, whether or not consecutive, the Treasury has the right to appoint two members to the Board of Directors of the Company. There can be no assurances that our regulators will approve such payments or dividends in the future.

For additional information regarding the Bank MOU and Company MOU, see "Item 1A, Risk Factors - The Company and the Bank are required to comply with the terms of separate memoranda of understanding issued by their respective regulators and lack of compliance could result in additional regulatory actions."

Market Area

The Bank considers Grays Harbor, Pierce, Thurston, Kitsap, King and Lewis counties, Washington as its primary market areas. The Bank conducts operations from:

* its main office in Hoquiam (Grays Harbor County);
* five branch offices in Grays Harbor County (Ocean Shores, Montesano, Elma, and two branches in Aberdeen);
* five branch offices in Pierce County (Edgewood, Puyallup, Spanaway, Tacoma, and Gig Harbor);
* five branch offices in Thurston County (Olympia, Yelm, Tumwater, and two branches in Lacey);
* two branch offices in Kitsap County (Poulsbo and Silverdale);

* a branch office in King County (Auburn); and

* three branch offices in Lewis County (Winlock, Toledo and Chehalis).

For additional information, see "Item 2. Properties."

Hoquiam, with a population of approximately 9,000, is located in Grays Harbor County which is situated along Washington State's central Pacific coast. Hoquiam is located approximately 110 miles southwest of Seattle and 145 miles northwest of Portland, Oregon.

The Bank considers its primary market area to include six submarkets: primarily rural Grays Harbor County with its historical dependence on the timber and fishing industries; Pierce, Thurston and Kitsap counties with their dependence on state and federal government; King County with its broadly diversified economic base; and Lewis County with its dependence on retail trade, manufacturing, industrial services and local government. Each of these markets presents operating risks to the Bank. The Bank's expansion into Pierce, Thurston, Kitsap, King and Lewis counties represents the Bank's strategy to diversify its primary market area to become less reliant on the economy of Grays Harbor County.

Grays Harbor County has a population of 73,000 according to the U.S. Census Bureau 2010 estimates and a median family income of $56,600 according to 2011 estimates from the Department of Housing and Urban Development ("HUD"). The economic base in Grays Harbor County has been historically dependent on the timber and fishing industries. Other industries that support the economic base are tourism, agriculture, shipping, transportation and technology. According to the Washington State Employment Security Department, the unemployment rate in Grays Harbor County increased to 12.5% at September 30, 2011 from 11.4% at September 30, 2010. The median price of a resale home in Grays Harbor County for the quarter ended September 30, 2011 decreased 3.1% to $126,000 from $130,000 for the comparable prior year period. The number of home sales increased 20.8% for the quarter ended September 30, 2011 compared to the same quarter one year earlier. The Bank has six branches (including its home office) located throughout the county. The downturn in Grays Harbor County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

Pierce County is the second most populous county in the state and has a population of 795,000 according to the U.S. Census Bureau 2010 estimates. The county's median family income is $70,800 according to 2011 HUD estimates. The economy in Pierce County is diversified with the presence of military related government employment (Joint Base Lewis-McChord), transportation and shipping employment (Port of Tacoma), and aerospace related employment (Boeing). According to the Washington State Employment Security Department, the unemployment rate for the Pierce County area increased to 9.3% at September 30, 2011 from 8.7% at September 30, 2010. The median price of a resale home in Pierce County for the quarter ended September 30, 2011 decreased 12.5% to $192,500 from $220,000 for the comparable prior year period. The number of home sales increased 34.8% for the quarter ended September 30, 2011 compared to the same quarter one year earlier. The Bank has five branches in Pierce County and these branches have historically been responsible for a substantial portion of the Bank's construction lending activities. The downturn in Pierce County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

Thurston County has a population of 252,000 according to the U.S. Census Bureau 2010 estimates and a median family income of $74,000 according to 2011 HUD estimates. Thurston County is home of Washington State's capital (Olympia) and its economic base is largely driven by state government related employment. According to the Washington State Employment Security Department, the unemployment rate for the Thurston County area increased to 8.0% at September 30, 2011 from 7.2% in 2010. The median price of a resale home in Thurston County for the quarter ended September 30, 2011 decreased 3.2% to $223,600 from $231,000 for the same quarter one year earlier. The number of home sales decreased 0.6% for the quarter ended September 30, 2011 compared to the same quarter one year earlier. The Bank has five branches in Thurston County. This county has historically had a stable economic base primarily attributable to the state government presence; however the downturn in Thurston County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

Kitsap County has a population of 251,000 according to the U.S. Census Bureau 2010 estimates and a median family income of $74,500 according to 2011 HUD estimates. The Bank has two branches in Kitsap County. The economic base of Kitsap County is largely supported by military related government employment through the United States Navy. According to the Washington State Employment Security Department, the unemployment rate for the Kitsap County area increased to 7.5% at September 30, 2011 from 7.0% at September 30, 2010. The median price of a resale home in Kitsap County for the quarter ended September 30, 2011 increased 0.2% to $235,500 from $235,000, the same quarter one year earlier. The number of home sales increased 11.0% for the quarter ended September 30, 2011 compared to the same quarter one year earlier. The downturn in Kitsap County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

King County is the most populous county in the state and has a population of 1.9 million according to the U.S. Census Bureau 2010 estimates. The Bank has one branch in King County. The county's median family income is $86,800 according to 2011 HUD estimates. King County's economic base is diversified with many industries including shipping, transportation, aerospace (Boeing), computer technology and biotech industries. According to the Washington State Employment Security Department, the unemployment rate for the King County area decreased to 8.1% at September 30, 2011 from 8.4% at September 30, 2010. The median price of a resale home in King County for the quarter ended September 30, 2011 decreased 6.8% to $350,000 from $375,500, for the same quarter one year earlier. The

number of home sales increased 27.3% for the quarter ended September 30, 2011 compared to the same quarter one year earlier. The downturn in King County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

Lewis County has a population of 75,000 according to the U.S. Census Bureau 2010 estimates and a median family income of $56,600 according to 2011 HUD estimates. The economic base in Lewis County is supported by manufacturing, retail trade, local government and industrial services. According to the Washington State Employment Security Department, the unemployment rate in Lewis County increased to 12.1% at September 30, 2011 from 11.7% at September 30, 2010. The median price of a resale home in Lewis

County for the quarter ended September 30, 2011 decreased 12.6% to $141,100 from $161,500, for the same quarter one year earlier. The number of home sales increased 54.2% for the quarter ended September 30, 2011 compared to the same quarter one year earlier. The Bank currently has three branches located in Lewis County. The downturn in Lewis County's economy and the decline in real estate values since 2008 have had a negative effect on the Bank's profitability in this market area.

Lending Activities

General. Historically, the principal lending activity of the Bank has consisted of the origination of loans secured by first mortgages on owner-occupied, one- to four-family residences, loans secured by commercial real estate and loans for the construction of one- to four-family residences. During the past several years, the Bank adjusted its lending strategy and began reducing its exposure to speculative construction and land development lending. The Bank's net loans receivable, including loans held for sale, totaled $528.0 million at September 30, 2011, representing 71.5% of consolidated total assets, and at that date commercial real estate, construction and land development loans (including undisbursed loans in process), and land loans were $347.8 million, or 62.1%, of total loans. Construction and land development loans and commercial real estate loans typically have higher rates of return than one- to four-family loans; however, they also present a higher degree of risk. See "- Lending Activities - Commercial Real Estate Lending," "- Lending Activities - Construction and Land Development Lending" and "- Lending Activities - Land Lending."

The Bank's internal loan policy limits the maximum amount of loans to one borrower to 25% of its Tier 1 capital. At September 30, 2011, the maximum amount which the Bank could have lent to any one borrower and the borrower's related entities was approximately $18.6 million under this policy. At September 30, 2011, the largest amount outstanding to any one borrower and the borrower's related entities was $14.0 million. These loans were secured by commercial buildings located in Pierce and Kitsap counties. These loans were all performing according to the loan repayment terms at September 30, 2011. The next largest amount outstanding to any one borrower and the borrower's related entities was $10.3 million (including $1.5 million in undisbursed loans in process). These loans were secured by a condominium construction project, a commercial building, several one- to four-family properties, and several land parcels. All of the loans were secured by properties located in Grays Harbor County, except for one property located in Clark County and one property located in Clatsop County, Oregon. These loans were performing according to their loan repayment terms at September 30, 2011.

Loan Portfolio Analysis. The following table sets forth the composition of the Bank's loan portfolio by type of loan as of the dates indicated.

At September 30,								
2011		2010		2009		2008		
Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amoun
(Dollars in thousands)								

Mortgage Loans:									
One- to four-family(1)....	$114,680	20.47%	$121,014	21.65%	$110,556	18.58%	$112,299	18.35%	$102,
Multi-family..	30,982	5.53	32,267	5.77	25,638	4.31	25,927	4.24	35,
Commercial....	246,037	43.92	208,002	37.21	188,205	31.62	146,223	23.90	127,
Construction and land development..	52,484	9.37	69,271	12.39	139,728	23.48	186,344	30.46	186,
Land..........	49,236	8.79	62,999	11.27	65,642	11.03	60,701	9.92	60,
Total mortgage loans.......	493,419	88.08	493,553	88.29	529,769	89.02	531,494	86.87	512,
Consumer Loans:									
Home equity and second mortgage.....	36,008	6.43	38,418	6.87	41,746	7.01	48,690	7.96	47,
Other.........	8,240	1.47	9,086	1.62	9,827	1.66	10,635	1.73	10,
Total consumer loans.......	44,248	7.90	47,504	8.49	51,573	8.67	59,325	9.69	58,
Commercial business loans........	22,510	4.02	17,979	3.22	13,775	2.31	21,018	3.44	18,
Total loans..	560,177	100.00%	559,036	100.00%	595,117	100.00%	611,837	100.00%	588,
Less:									
Undisbursed portion of construction loans in process......	(18,265)		(17,952)		(31,298)		(43,353)		(65,
Deferred loan origination fees.........	(1,942)		(2,229)		(2,439)		(2,747)		(2,
Allowance for loan losses..	(11,946)		(11,264)		(14,172)		(8,050)		(4,
Total loans receivable, net...........	$528,024		$527,591		$547,208		$557,687		$515,

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(1) Includes loans held-for-sale of $4.0 million, $3.0 million, $630,000, $1.8 million and $757, September 30, 2011, 2010, 2009, 2008 and 2007, respectively.

Residential One- to Four-Family Lending. At September 30, 2011, $114.7 million, or 20.5%, of the Bank's loan portfolio consisted of loans secured by one- to four-family residences. The Bank originates both fixed-rate loans and adjustable-rate loans.

Generally, one- to four-family fixed-rate loans and five and seven year balloon reset loans (which are loans that are originated with a fixed interest rate for the initial five or seven years, and thereafter incur one interest

rate change in which the new rate remains in effect for the remainder of the loan term) are originated to meet the requirements for sale in the secondary market to Freddie Mac. From time to time, however, a portion of these fixed-rate loans, which include five and seven year balloon reset loans, may be retained in the loan portfolio to meet the Bank's asset/liability management objectives. The Bank uses an automated underwriting program, which preliminarily qualifies a loan as conforming to Freddie Mac underwriting standards when the loan is originated. At September 30, 2011, $53.7 million, or 46.8%, of the Bank's one- to four-family loan portfolio consisted of fixed-rate mortgage loans.

The Bank also offers adjustable-rate mortgage ("ARM") loans. All of the Bank's ARM loans are retained in its loan portfolio and not sold. The Bank offers several ARM products which adjust annually after an initial period ranging from one to five years and are typically subject to a limitation on the annual increase of 2% and an overall limitation of 6%. These ARM products generally are priced utilizing the weekly average yield on one year U.S. Treasury securities adjusted to a constant maturity of one year plus a margin of 2.88% to 4.00%. Loans tied to the prime rate or to the London Inter-Bank Offered Rate ("LIBOR") indices typically do not have periodic, or lifetime adjustment limits. Loans tied to these indices normally have margins ranging up to 3.5%. ARM loans held in the Bank's portfolio do not permit negative amortization of principal. Borrower demand for ARM loans versus fixed-rate mortgage loans is a function of the level of interest rates, the expectations of changes in the level of interest rates and the difference between the initial interest rates and fees charged for each type of loan. The relative amount of fixed-rate mortgage loans and

ARM loans that can be originated at any time is largely determined by the demand for each in a competitive environment. At September 30, 2011, $61.0 million, or 53.2%, of the Bank's one- to four- family loan portfolio consisted of ARM loans.

A portion of the Bank's ARM loans are "non-conforming" because they do not satisfy acreage limits, or various other requirements imposed by Freddie Mac. Some of these loans are also originated to meet the needs of borrowers who cannot otherwise satisfy Freddie Mac credit requirements because of personal and financial reasons (i.e., divorce, bankruptcy, length of time employed, etc.), and other aspects, which do not conform to Freddie Mac's guidelines. Such borrowers may have higher debt-to-income ratios, or the loans are secured by unique properties in rural markets for which there are no sales of comparable properties to support the value according to secondary market requirements. These loans are known as non-conforming loans and the Bank may require additional collateral or lower loan-to-value ratios to reduce the risk of these loans. The Bank believes that these loans satisfy a need in its local market area. As a result, subject to market conditions, the Bank intends to continue to originate these types of loans.

The retention of ARM loans in the Bank's loan portfolio helps reduce the Bank's exposure to changes in interest rates. There are, however, unquantifiable credit risks resulting from the potential of increased interest to be paid by the customer as a result of increases in interest rates. It is possible that during periods of rising interest rates the risk of default on ARM loans may increase as a result of repricing and the increased costs to the borrower. The Bank attempts to reduce the potential for delinquencies and defaults on ARM loans by qualifying the borrower based on the borrower's

ability to repay the ARM loan assuming that the maximum interest rate that could be charged at the first adjustment period remains constant during the loan term. Another consideration is that although ARM loans allow the Bank to increase the sensitivity of its asset base due to changes in the interest rates, the extent of this interest sensitivity is limited by the periodic and lifetime interest rate adjustment limits. Because of these considerations, the Bank has no assurance that yield increases on ARM loans will be sufficient to offset increases in the Bank's cost of funds.

While fixed-rate, single-family residential mortgage loans are normally originated with 15 to 30 year terms, these loans typically remain outstanding for substantially shorter periods because borrowers often prepay their loans in full upon sale of the property pledged as security or upon refinancing the original loan. In addition, substantially all mortgage loans in the Bank's loan portfolio contain due-on-sale clauses providing that the Bank may declare the unpaid amount due and payable upon the sale of the property securing the loan. Typically, the Bank enforces these due-on-sale clauses to the extent permitted by law and as business judgment dictates. Thus, average loan maturity is a function of, among other factors, the level of purchase and sale activity in the real estate market, prevailing interest rates and the interest rates received on outstanding loans.

The Bank requires that fire and extended coverage casualty insurance be maintained on all of its real estate secured loans and flood insurance, if appropriate.

The Bank's lending policies generally limit the maximum loan-to-value ratio on mortgage loans secured by owner-occupied properties to 95% of the lesser of the appraised value or the purchase price. However, the Bank usually obtains private mortgage insurance ("PMI") on the portion of the principal amount that exceeds 80% of the appraised value of the security property. The maximum loan-to-value ratio on mortgage loans secured by non-owner-occupied properties is generally 80% (90% for loans originated for sale in the secondary market to Freddie Mac). At September 30, 2011, nine single family loans totaling $2.2 million were not performing according to their terms. See "- Lending Activities - Non-performing Loans and Delinquencies."

Construction and Land Development Lending. Prompted by unfavorable economic conditions in its primary market area in the 1980s, the Bank sought to establish a market niche and, as a result, began originating construction loans outside of Grays Harbor County. In recent periods, construction lending activities have been primarily in the Pierce, King, Thurston, Grays Harbor, and Kitsap County markets although, as a result of the current economic environment, the Bank has sharply curtailed speculative construction and land development lending.

The Bank currently originates three types of residential construction loans: (i) custom construction loans, (ii) owner/builder construction loans and (iii) speculative construction loans (on a limited basis). The Bank believes that

its computer tracking system has enabled it to establish processing and disbursement procedures to meet the needs of these borrowers. The Bank also originates construction loans for the development of multi-family and commercial properties.

At September 30, 2011 and 2010, the composition of the Bank's construction and land development loan portfolio was as follows:

	At September 30,			
	2011		2010	
	Outstanding Balance	Percent of Total	Outstanding Balance	Percent of Total
	(Dollars in thousands)			
Custom and owner/builder construction..............	$26,205	49.93%	$30,945	44.67%
Speculative construction...	1,919	3.66	4,777	6.90
Multi-family (including condominium)..............	9,322	17.76	3,587	5.18
Land development...........	2,175	4.14	6,434	9.29
Commercial real estate.....	12,863	24.51	23,528	33.96
Total....................	$52,484	100.00%	$69,271	100.00%

Custom construction loans are made to home builders who, at the time of construction, have a signed contract with a home buyer who has a commitment to purchase the finished home. Custom construction loans are generally originated for a term of six to 12 months, with fixed interest rates currently ranging from 7.00% to 7.88% and with loan-to-value ratios of 80% of the appraised estimated value of the completed property or sales price, whichever is less.

Owner/builder construction loans are originated to home owners rather than home builders and are typically converted to or refinanced into permanent loans at the completion of construction. The construction phase of an owner/builder construction loan generally lasts up to 12 months with fixed interest rates currently ranging from 7.00% to 7.88%, and with loan-to-value ratios of 80% (or up to 95% with PMI) of the appraised estimated value of the completed property. At the completion of construction, the loan is converted to or refinanced into either a fixed-rate mortgage loan, which conforms to secondary market standards, or an ARM loan for retention in the Bank's portfolio. At September 30, 2011, custom and owner/builder construction loans totaled $26.2 million, or 49.9%, of the total construction and land development loan portfolio. At September 30, 2011, the largest outstanding custom and owner/builder construction loan had an outstanding balance of $980,000 (including $905,000 of undisbursed loans in process) and was performing according to its repayment terms.

Speculative construction loans are made to home builders and are termed "speculative" because the home builder does not have, at the time of loan origination, a signed contract with a home buyer who has a commitment for permanent financing with either the Bank or another lender for the finished home. The home buyer may be identified either during or after the construction period, with the risk that the builder will have to debt service the speculative construction loan and finance real estate taxes and other carrying costs of the completed home for a significant time after the completion of construction until the home buyer is identified and a sale is consummated. Historically, the Bank has originated loans to approximately 50 builders located in the Bank's primary market area, each of which generally would have one to eight speculative loans outstanding from the Bank during a 12 month period. Rather than originating lines of credit to home builders to construct several homes at once, the Bank generally originates and underwrites

a separate loan for each home. Speculative construction loans are generally originated for a term of 12 months, with current rates ranging from 4.75% to 6.50%, and with a loan-to-value ratio of no more than 80% of the appraised estimated value of the completed property. The Bank is currently originating speculative construction loans on a limited basis. At September 30, 2011, speculative construction loans totaled $1.9 million, or 3.7%, of the total construction and land development loan portfolio. At September 30, 2011, the Bank had two borrowers each with aggregate outstanding speculative loan balances of more than $500,000. The largest aggregate outstanding balance to one borrower for speculative construction loans totaled $861,000 (including $277,000 of undisbursed loans in process), all of which were

performing according to the loan repayment terms. The largest outstanding balance for a single speculative loan was $700,000 and was performing according to its restructured terms. At September 30, 2011, all speculative construction loans were performing according to their original or restructured terms. See "- Lending Activities - Non-performing Loans and Delinquencies."

The Bank historically originated loans to real estate developers with whom it had established relationships for the purpose of developing residential subdivisions (i.e., installing roads, sewers, water and other utilities) (generally with ten to 50 lots). The Bank is not currently originating any new land development loans. At September 30, 2011, the Bank had nine land development loans totaling $2.2 million, or 4.1% of construction and land development loans receivable. Land development loans are secured by a lien on the property and typically made for a period of two to five years with fixed or variable interest rates, and are made with loan-to-value ratios generally not exceeding 75%. Land development loans are generally structured so that the Bank is repaid in full upon the sale by the borrower of approximately 80% of the subdivision lots. A majority of the Bank's land development loans are secured by property located in its primary market area. In addition, in the case of a corporate borrower, the Bank also generally obtains personal guarantees from corporate principals and reviews their personal financial statements. At September 30, 2011, the Bank had seven land development loans totaling $1.9 million that were not performing according to their terms. The non-performing loans consisted of:

* Four loans totaling $756,000 secured by land development projects in King County;
* One loan with a balance of $837,000 secured by a land development project in Lewis County;
* One loan with a balance of $225,000 secured by a land development project in Pierce County; and
* One loan with a balance of $63,000 secured by a land development project in Grays Harbor County.

Land development loans secured by land under development involve greater risks than one- to four-family residential mortgage loans because these loans are advanced upon the predicted future value of the developed property upon completion. If the estimate of the future value proves to be inaccurate, in the event of default and foreclosure the Bank may be confronted with a property the value of which is insufficient to assure full repayment. The Bank has historically attempted to minimize this risk by generally limiting the maximum loan-to-value ratio on land loans to 75% of the estimated developed value of the secured property. The Bank is not currently originating any new land development loans.

The Bank also provides construction financing for multi-family and commercial properties. At September 30, 2011, these loans amounted to $22.2 million, or 42.3% of construction and land development loans. These loans are secured by condominiums, apartment buildings, mini-storage facilities, office buildings, hotels and retail rental space predominantly located in the Bank's primary market area. At September 30, 2011, the largest outstanding multi-family construction loan was secured by an apartment building project in Thurston County and had a balance of $6.5 million (including $2.5 million of undisbursed loans in process) and was performing according to its terms. At September 30, 2011, the largest outstanding commercial real estate construction loan had a balance of $6.1 million (including $4.4 million of undisbursed loans in process). This loan was secured by a medical office building being constructed in Thurston County and was performing according to its terms.

All construction loans must be approved by a member of one of the Bank's Loan Committees or the Bank's Board of Directors, or in the case of one- to four-family construction loans meeting Freddie Mac guidelines, by a qualified Bank underwriter. See "- Lending Activities - Loan Solicitation and Processing." Prior to preliminary approval of any construction loan application, an independent fee appraiser inspects the site and the Bank reviews the existing or proposed improvements, identifies the market for the proposed project and analyzes the pro forma data and assumptions on the project. In the case of a speculative or custom construction loan, the Bank reviews the experience and expertise of the builder. After preliminary approval has been given, the application is processed, which includes obtaining credit reports, financial statements and tax returns on the borrowers and guarantors, an independent appraisal of the project, and any other expert reports necessary to evaluate the proposed project. In the event of cost overruns, the Bank generally requires that the borrower increase the funds available for construction by depositing its own funds into a secured savings account, the proceeds of which are used to pay construction costs.

Loan disbursements during the construction period are made to the builder, materials supplier or subcontractor, based on a line item budget. Periodic on-site inspections are made by qualified independent inspectors to document the reasonableness of draw requests. For most builders, the Bank disburses loan funds by providing vouchers to borrowers, which when used by the borrower to purchase supplies are submitted by the supplier to the Bank for payment.

The Bank regularly monitors construction loan disbursements using an internal monitoring system which the Bank believes reduces many of the risks inherent with construction lending.

The Bank originates construction loan applications primarily through customer referrals, contacts in the business community and occasionally real estate brokers seeking financing for their clients.

Construction lending affords the Bank the opportunity to achieve higher interest rates and fees with shorter terms to maturity than does its single-family permanent mortgage lending. Construction lending, however, is generally considered to involve a higher degree of risk than single-family permanent mortgage lending because of the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost of

the project. The nature of these loans is such that they are generally more difficult to evaluate and monitor. If the estimate of construction cost proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the project. If the estimate of value upon completion proves to be inaccurate, the Bank may be confronted with a project whose value is insufficient to assure full repayment and it may incur a loss. Projects may also be jeopardized by disagreements between borrowers and builders and by the failure of builders to pay subcontractors. Loans to builders to construct homes for which no purchaser has been identified carry more risk because the payoff for the loan depends on the builder's ability to sell the property prior to the time that the construction loan is due. The Bank has sought to address these risks by adhering to strict underwriting policies, disbursement procedures, and monitoring practices. The Bank's construction loans are primarily secured by properties in its primary market area, and changes in the local and state economies and real estate markets have adversely affected the Bank's construction loan portfolio.

Multi-Family Lending. At September 30, 2011, the Bank had $31.0 million, or 5.5% of the Bank's total loan portfolio, secured by multi-family dwelling units (more than four units) located primarily in the Bank's primary market area. Multi-family loans are generally originated with variable rates of interest ranging from 2.00% to 3.50% over the one-year constant maturity U.S. Treasury Bill Index or a matched term FHLB advance, with principal and interest payments fully amortizing over terms of up to 30 years. At September 30, 2011 the Bank's largest multi-family loan had an outstanding principal balance of $3.5 million and was secured by an apartment building located in the Bank's primary market area. At September 30, 2011, this loan was performing according to its terms. At September 30, 2011, one multi-family loan with a balance of $1.4 million was not performing according to its repayment terms. See "- Lending Activities - Non-performing Loans and Delinquencies."

The maximum loan-to-value ratio for multi-family loans is generally limited to not more than 80%. The Bank generally requests its multi-family loan borrowers with loan balances in excess of $750,000 to submit financial statements and rent rolls on the properties securing such loans. The Bank also inspects such properties annually. The Bank generally imposes a minimum debt coverage ratio of approximately 1.20 for loans secured by multi-family properties.

Multi-family mortgage lending affords the Bank an opportunity to receive interest at rates higher than those generally available from one- to four-family residential lending. However, loans secured by multi-family properties usually are greater in amount, more difficult to evaluate and monitor and, therefore, involve a greater degree of risk than one- to four-family residential mortgage loans. Because payments on loans secured by multi-family properties are often dependent on the successful operation and management of the properties, repayment of such loans may be affected by adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks by scrutinizing the financial condition of the borrower, the quality of the collateral and the management of the property securing the loan. If the borrower is other than an individual, the Bank also generally obtains personal guarantees from the principals based on a review of personal financial statements.

Commercial Real Estate Lending. Commercial real estate loans totaled $246.0 million, or 43.9% of the total loan portfolio at September 30, 2011. The Bank originates commercial real estate loans generally at variable interest

rates and these loans are secured by properties, such as restaurants, motels, mini-storage facilities, office buildings and retail/wholesale facilities, located in the Bank's primary market area. At September 30, 2011, the largest commercial real estate loan was secured by an office building in Pierce County and had a balance of $6.2 million and was performing according to its terms. At September 30, 2011, eight commercial real estate loans totaling $6.6 million were not performing according to their terms. See "- Lending Activities - Non-performing Loans and Delinquencies."

The Bank typically requires appraisals of properties securing commercial real estate loans. For loans that are less than $250,000, the Bank may use the tax assessed value and a property inspection in lieu of an appraisal. Appraisals are performed by independent appraisers designated by the Bank, all of which are reviewed by management. The Bank considers the quality and location of the real estate, the credit history of the borrower, the cash flow of the project and the quality of management involved with the property. The Bank generally imposes a minimum debt coverage ratio of approximately 1.20 for originated loans secured by income producing commercial properties. Loan-to-value ratios on commercial real estate loans are generally limited to not more than 80%. If the borrower is other than an individual, the Bank also generally obtains personal guarantees from the principals based on a review of personal financial statements.

Commercial real estate lending affords the Bank an opportunity to receive interest at rates higher than those generally available from one- to four-family residential lending. However, loans secured by such properties usually are greater in amount, more difficult to evaluate and monitor and, therefore, involve a greater degree of risk than one- to four-family residential mortgage loans. Because payments on loans secured by commercial properties often depend upon the successful operation and management of the properties, repayment of these loans may be affected by adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks by generally limiting the maximum loan-to-value ratio to 80% and scrutinizing the financial condition of the borrower, the quality of the collateral and the management of the property securing the loan. The Bank also requests annual financial information and rent rolls on the subject property from the borrowers on loans over $750,000.

Land Lending. The Bank has historically originated loans for the acquisition of land upon which the purchaser can then build or make improvements necessary to build or to sell as improved lots. Currently the Bank is not offering land loans to new customers and is attempting to decrease its land loan portfolio. At September 30, 2011, land loans totaled $49.2 million, or 8.8% of the Bank's total loan portfolio as compared to $63.0 million, or 11.3% of the Bank's total loan portfolio at September 30, 2010. Land loans originated by the Bank generally have maturities of five to ten years. The largest land loan had an outstanding balance of $4.1 million at September 30, 2011 and was performing according to its repayment terms. At September 30, 2011, 31 land loans totaling $8.9 million were not performing according to their terms. See "- Lending Activities - Non-performing Loans and Delinquencies."

Loans secured by undeveloped land or improved lots involve greater risks than one- to four-family residential mortgage loans because these loans are more difficult to evaluate. If the estimate of value proves to be inaccurate, in the event of default and foreclosure the Bank may be confronted with a property the value of which is insufficient to assure full repayment. The

Bank attempts to minimize this risk by generally limiting the maximum loan-to-value ratio on land loans to 75%.

Consumer Lending. Consumer loans generally have shorter terms to maturity and higher interest rates than mortgage loans. Consumer loans include home equity lines of credit, second mortgage loans, savings account loans, automobile loans, boat loans, motorcycle loans, recreational vehicle loans and unsecured loans. Consumer loans are made with both fixed and variable interest rates and with varying terms. At September 30, 2011, consumer loans amounted to $44.2 million, or 7.9%, of the total loan portfolio.

At September 30, 2011, the largest component of the consumer loan portfolio consisted of second mortgage loans and home equity lines of credit, which totaled $36.0 million, or 6.4%, of the total loan portfolio. Home equity lines of credit and second mortgage loans are made for purposes such as the improvement of residential properties, debt consolidation and education expenses, among others. The majority of these loans are made to existing customers and are secured by a first or second mortgage on residential property. The loan-to-value ratio is typically 80% or less, when taking into account both the first and second mortgage loans. Second mortgage loans typically carry fixed interest rates with a fixed payment over a term between five and 15 years. Home equity lines of credit are generally made at interest

rates tied to the prime rate or the 26 week Treasury Bill. Second mortgage loans and home equity lines of credit have greater credit risk than one- to four-family residential mortgage loans because they are secured by mortgages subordinated to the existing first mortgage on the property, which may or may not be held by the Bank.

Consumer loans entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans. The Bank believes that these risks are not as prevalent in the case of the Bank's consumer loan portfolio because a large percentage of the portfolio consists of second mortgage loans and home equity lines of credit that are underwritten in a manner such that they result in credit risk that is substantially similar to one- to four-family residential mortgage loans. At September 30, 2011, five consumer loans totaling $367,000 were delinquent in excess of 90 days. See "- Lending Activities - Non-performing Loans and Delinquencies."

Commercial Business Lending. Commercial business loans totaled $22.5 million, or 4.0% of the loan portfolio at September 30, 2011. Commercial business loans are generally secured by business equipment, accounts receivable, inventory or other property and are made at variable rates of interest equal to a negotiated margin above the prime rate. The Bank also

generally obtains personal guarantees from the principals based on a review of personal financial statements. The largest commercial business loan had an outstanding balance of $2.0 million at September 30, 2011 and was performing according to its terms. At September 30, 2011, three commercial business loans totaling $44,000 were not performing according to their repayment terms. See "- Lending Activities - Non-performing Loans and Delinquencies."

Commercial business lending generally involves greater risk than residential mortgage lending and involves risks that are different from those associated with residential and commercial real estate lending. Real estate lending is generally considered to be collateral based lending with loan amounts based on predetermined loan to collateral values and liquidation of the underlying real estate collateral is viewed as the primary source of repayment in the event of borrower default. Although commercial business loans are often collateralized by equipment, inventory, accounts receivable or other business assets, the liquidation of collateral in the event of a borrower default is often an insufficient source of repayment because accounts receivable may be uncollectible and inventories and equipment may be obsolete or of limited use, among other things. Accordingly, the repayment of a commercial business loan depends primarily on the creditworthiness of the borrower (and any guarantors), while liquidation of collateral is a secondary and often insufficient source of repayment.

Loan Maturity. The following table sets forth certain information at September 30, 2011 regarding the dollar amount of loans maturing in the Bank's portfolio based on their contractual terms to maturity, but does not include scheduled payments or potential prepayments. Loans having no stated maturity and overdrafts are reported as due in one year or less.

	Within 1 Year	After 1 Year Through 3 Years	After 3 Years Through 5 Years	After 5 Years Through 10 Years	After 10 Years	Total
			(In thousands)			
Mortgage loans:						
One- to four-family (1).........	$ 6,375	$ 6,769	$ 1,780	$ 10,909	$ 88,847	$114,680
Multi-family........	7,274	941	547	21,650	570	30,982
Commercial..........	7,829	24,026	34,738	172,812	6,632	246,037
Construction and land development(2).....	45,529	187	6,768	--	--	52,484
Land................	15,797	21,004	7,594	2,778	2,063	49,236
Consumer loans:						
Home equity and second mortgage....	7,771	2,068	2,302	7,179	16,688	36,008
Other...............	3,099	725	429	695	3,292	8,240
Commercial business loans...............	11,154	1,303	1,975	6,214	1,864	22,510
Total...............	$104,828	$57,023	$56,133	$222,237	$119,956	560,177
Less:						
Undisbursed portion of construction						

loans in process...	(18,265)
Deferred loan origination fees...	(1,942)
Allowance for loan losses............	(11,946)
Loans receivable, net...............	$528,024

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(1) Includes $4.0 million of loans held-for-sale.
(2) Includes construction/permanent loans that convert to permanent mortgage loans once construction is completed.

The following table sets forth the dollar amount of all loans due after one year from September 30, 2011, which have fixed interest rates and have floating or adjustable interest rates.

	Fixed Rates	Floating or Adjustable Rates	Total
		(In thousands)	
Mortgage loans:			
One- to four-family(1)............	$ 51,222	$ 57,083	$108,305
Multi-family......................	1,551	22,157	23,708
Commercial........................	47,489	190,719	238,208
Construction and land development..	6,955	--	6,955
Land..............................	20,217	13,222	33,439
Consumer loans:			
Home equity and second mortgage....	16,651	11,586	28,237
Other.............................	4,920	221	5,141
Commercial business loans..........	5,401	5,955	11,356
Total............................	$154,406	$300,943	$455,349

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(1) Includes loans held-for-sale.

Scheduled contractual principal repayments of loans do not reflect the actual life of these assets. The average life of loans is substantially less than their contractual terms because of prepayments. In addition, due-on-sale clauses on loans generally give the Bank the right to declare loans immediately due and payable in the event, among other things, that the borrower sells the real property subject to the mortgage and the loan is not repaid. The average life of mortgage loans tends to increase, however, when current mortgage loan interest rates are substantially higher than interest rates on existing mortgage loans and, conversely, decrease when interest rates on existing mortgage loans are substantially higher than current mortgage loan interest rates.

Loan Solicitation and Processing. Loan originations are obtained from a variety of sources, including walk-in customers, and referrals from builders and realtors. Upon receipt of a loan application from a prospective borrower, a credit report and other data are obtained to verify specific information

relating to the loan applicant's employment, income and credit standing. An appraisal of the real estate offered as collateral generally is undertaken by a certified appraiser retained by the Bank.

Loan applications are initiated by loan officers and are required to be approved by an authorized loan underwriter, one of the Bank's Loan Committees or the Bank's Board of Directors. The Bank's Consumer Loan Committee consists of three underwriters, each of whom can approve one- to four-family mortgage loans and other consumer loans up to and including the current Freddie Mac single-family limit. Certain consumer loans up to and including $25,000 may be approved by individual loan officers and the Bank's Consumer Lending Department Manager may approve consumer loans up to and including $75,000. The Bank's Regional Manager of Commercial Lending has individual lending authority for loans up to and including $250,000, excluding speculative construction loans and unsecured loans. The Bank's Commercial Loan Committee, which consists of the Bank's President, Chief Credit Administrator, Executive Vice President of Commercial Lending, Executive Vice President of Community Lending, and Regional Manager of Commercial Lending, may approve commercial real estate loans and commercial business loans up to and including $1.5 million. The Bank's President, Chief Credit Administrator, Executive Vice President of Commercial Lending and Executive Vice President of Community Lending also have individual lending authority for loans up to and including $750,000. The Bank's Board Loan Committee, which consists of two rotating non-employee Directors and the Bank's President, may approve loans up to and including $3.0 million. Loans in excess of $3.0 million, as well as loans of any amount granted to a single borrower whose aggregate loans exceed $3.0 million, must be approved by the Bank's Board of Directors.

Loan Originations, Purchases and Sales. During the years ended September 30, 2011 and 2010, the Bank's total gross loan originations were $160.2 million and $182.5 million, respectively. Periodically, the Bank purchases participation interests in construction and land development loans, commercial real estate loans, and multi-family loans, secured by properties generally located in Washington State, from other lenders. These purchases are underwritten to the Bank's underwriting guidelines and are without recourse to the seller other than for fraud. There were no loan participation interests purchased during the years ended September 30, 2011 and 2010. During the year ended September 30, 2009, the Bank purchased loan participation interests of $1.6 million. The Bank also periodically purchases contracts secured by one- to four-family residencies from individuals. During the year ended September 30, 2011, the Bank purchased contracts totaling $187,000. See "- Lending Activities - Construction and Land Development Lending" and "- Lending Activities - Multi-Family Lending."

Consistent with its asset/liability management strategy, the Bank's policy generally is to retain in its portfolio all ARM loans originated and to sell fixed rate one- to four-family mortgage loans in the secondary market to Freddie Mac; however, from time to time, a portion of fixed-rate loans may be retained in the Bank's portfolio to meet its asset-liability objectives. Loans sold in the secondary market are generally sold on a servicing retained basis. At September 30, 2011, the Bank's loan servicing portfolio, which is not included in the Company's consolidated financial statements, totaled $298.9 million.

The Bank also periodically sells participation interests in construction and land development loans, commercial real estate loans, and land loans to other lenders. These sales are usually made to avoid concentrations in a particular loan type or concentrations to a particular borrower. The Bank did not sell any loan participation interests to other lenders during the years ended September 30, 2011, 2010 and 2009.

The following table shows total loans originated, purchased, sold and repaid during the periods indicated.

	Year Ended September 30,		
	2011	2010	2009
	(In thousands)		
Loans originated:			
Mortgage loans:			
One- to four-family	$ 57,620	$ 72,015	$ 165,972
Multi-family	2,009	7,772	1,036
Commercial	38,262	27,248	43,821
Construction and land development	40,724	35,369	56,287
Land	3,793	11,712	6,519
Consumer	7,424	10,286	14,080
Commercial business loans	10,325	18,130	7,601
Total loans originated	160,157	182,532	295,316
Loans purchased:			
Mortgage loans:			
One- to four-family	187	50	--
Commercial	-	--	1,606
Total loans purchased	187	50	1,606
Total loans originated and purchased	160,344	182,582	296,922
Loans sold:			
Whole loans sold	(62,480)	(68,330)	(162,913)
Total loans sold	(62,480)	(68,330)	(162,913)
Loan principal repayments	(96,723)	(150,333)	(150,729)
Other items, net	(708)	16,464	6,241
Net increase (decrease) in loans receivable	$ 433	$ (19,617)	$(10,479)

Loan Origination Fees. The Bank receives loan origination fees on many of its mortgage loans and commercial business loans. Loan fees are a percentage of the loan which are charged to the borrower for funding the loan. The amount of fees charged by the Bank is generally up to 2.0% of the loan amount. Current accounting principles generally accepted in the United States of America require fees received and certain loan origination costs for originating loans to be deferred and amortized into interest income over the contractual life of the loan. Net deferred fees or costs associated with loans that are prepaid are recognized as income at the time of prepayment. Unamortized deferred loan origination fees totaled $1.9 million at September 30, 2011.

Non-performing Loans and Delinquencies. The Bank assesses late fees or penalty charges on delinquent loans of approximately 5% of the monthly loan payment amount. A majority of loan payments are due on the first day of the month; however, the borrower is given a 15 day grace period to make the loan payment. When a mortgage loan borrower fails to make a required payment when

due, the Bank institutes collection procedures. A notice is mailed to the borrower 16 days after the date the payment is due. Attempts to contact the borrower by telephone generally begin on or before the 30th day of delinquency. If a satisfactory response is not obtained, continuous follow-up contacts are attempted until the loan has been brought current. Before the 90th day of delinquency, attempts are made to establish (i) the cause of the delinquency, (ii) whether the cause is temporary, (iii) the attitude of the borrower toward the debt, and (iv) a mutually satisfactory arrangement for curing the default.

If the borrower is chronically delinquent and all reasonable means of obtaining payment on time have been exhausted, foreclosure is initiated according to the terms of the security instrument and applicable law. Interest income on loans in foreclosure is reduced by the full amount of accrued and uncollected interest.

When a consumer loan borrower or commercial business borrower fails to make a required payment on a loan by the payment due date, the Bank institutes similar collection procedures as for its mortgage loan borrowers. Loans becoming 90 days or more past due are placed on non-accrual status, with any accrued interest reversed against interest income, unless they are well secured and in the process of collection.

The Bank's Board of Directors is informed monthly as to the status of loans that are delinquent by more than 30 days, and the status of all foreclosed and repossessed property owned by the Bank.

The following table sets forth information with respect to the Company's non-performing assets at the dates indicated.

	At September 30,				
	2011	2010	2009	2008	2007
Loans accounted for on a non-accrual basis:	(Dollars in thousands)				
Mortgage loans:					
One- to four-family...	$ 2,150	$ 3,691	$ 1,343	$ 300	$ 252
Commercial............	6,571	7,252	5,004	714	90
Construction and land development....	3,522	7,609	17,594	9,840	1,000
Land..................	8,935	5,460	5,023	726	28
Consumer loans..........	367	806	258	160	--
Commercial business loans................	44	46	65	250	120
Total.............	21,589	24,864	29,287	11,990	1,490
Accruing loans which are contractually past due 90 days or more.......	1,754	1,325	796	--	--
Total of non-accrual and 90 days past due loans............	23,343	26,189	30,083	11,990	1,490

Non-accrual investment securities............	2,796	3,390	477	--	--
Other real estate owned and other repossessed assets................	10,811	11,519	8,185	511	--
Total non-performing assets (1)..........	$ 36,950	$ 41,098	$ 38,745	$ 12,501	$ 1,490
Troubled debt restructured loans on accrual status (2)............	$ 18,166	$ 8,995	$ --	$ 272	$ --
Non-accrual and 90 days or more past due loans as a percentage of loans receivable, net.	4.32%	4.86%	5.36%	2.12%	0.29%
Non-accrual and 90 days or more past due loans as a percentage of total assets..........	3.16%	3.53%	4.28%	1.76%	0.23%
Non-performing assets as a percentage of total assets..........	5.01%	5.53%	5.52%	1.83%	0.23%
Loans receivable, net (3)...............	$539,970	$538,855	$561,380	$565,737	$520,138
Total assets	$738,224	$742,687	$701,676	$681,883	$644,848

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(1) Does not include troubled debt restructured loans on accrual status.
(2) Does not include troubled debt restructured loans totaling $7.4 million, $7.4 million and $9.5 million reported as non-accrual loans at September 30, 2011, 2010 and 2009, respectively.
(3) Includes loans held-for-sale and is before the allowance for loan losses.

The Bank's non-accrual loans decreased by $3.3 million to $21.6 million at September 30, 2011 from $24.9 million at September 30, 2010, primarily as a result of a $4.1 million decrease in construction and land development loans on non-accrual status, a $1.5 million decrease in one- to four-family loans on non-accrual status, a $681,000 decrease in commercial real estate loans on non-accrual status and a $439,000 decrease in consumer loans on non-accrual status. These decreases were partially offset by a $3.5 million increase in land loans on non-accrual status. The largest

non-performing loan was secured by a mini-storage facility in King County and had a balance of $2.6 million at September 30, 2011. A discussion of our largest non-performing loans is set forth below under "Asset Classification."

Additional interest income which would have been recorded for the year ended September 30, 2011 had non-accruing loans been current in accordance

with their original terms totaled $3.5 million.

Other Real Estate Owned and Other Repossessed Assets. Real estate acquired by the Bank as a result of foreclosure or by deed-in-lieu of foreclosure is classified as other real estate owned ("OREO") until sold. When property is acquired, it is recorded at the estimated fair market value less estimated costs to sell. At September 30, 2011, the Bank had $10.8 million of OREO and other repossessed assets consisting of 46 individual properties and four other repossessed assets, a decrease of $708,000 from $11.5 million at September 30, 2010. The OREO properties consisted of two condominium projects totaling $3.5 million, 28 land parcels totaling $3.3 million, 11 single family homes totaling $1.9 million, three commercial real estate properties totaling $1.2 million and two land development projects totaling $794,000. The largest OREO property was a condominium project with a balance of $2.6 million.

Restructured Loans. Under accounting principles generally accepted in the United States of America, the Bank is required to account for certain loan modifications or restructurings as "troubled debt restructurings." In general, the modification or restructuring of a debt constitutes a troubled debt restructuring if the Bank for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrowers that the Bank would not otherwise consider. Debt restructuring or loan modifications for a borrower does not necessarily always constitute troubled debt restructuring, however, and troubled debt restructurings do not necessarily result in non-accrual loans. The Bank had restructured loans totaling $25.5 million at September 30, 2011, of which $7.4 million were on non-accrual status.

Impaired Loans. A loan is considered impaired when it is probable the Bank will be unable to collect all contractual principal and interest payments due in accordance with the original or modified terms of the loan agreement. To determine specific valuation allowances, impaired loans are measured based on the estimated fair value of the collateral less estimated cost to sell if the loan is considered collateral dependent. Impaired loans not considered to be collateral dependent are measured based on the present value of expected future cash flows.

The categories of non-accrual loans and impaired loans overlap, although they are not coextensive. The Bank considers all circumstances regarding the loan and borrower on an individual basis when determining whether an impaired loan should be placed on non-accrual status, such as the financial strength of the borrower, the collateral value, reasons for delay, payment record, the amount past due and the number of days past due. At September 30, 2011, the Bank had $48.5 million in impaired loans. For additional information on impaired loans, see Note 4 of the Notes to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Other Loans of Concern. Loans not reflected in the table above as non-performing, but where known information about possible credit problems of borrowers causes management to have doubts as to the ability of the borrower to comply with present repayment terms and that may result in disclosure of such loans as non-performing assets in the future are commonly referred to as "other loans of concern" or "potential problem loans." The amount included in potential problem loans results from an evaluation, on a loan-by-loan basis, of loans classified as "substandard" and "special mention," as those terms are defined under "Asset Classification" below. The amount of potential problem loans was $62.5 million at September 30, 2011 and $43.7 million at September 30, 2010. The vast majority of these loans are collateralized by real estate. See "- Asset Classification" below for additional information regarding our problem loans.

Asset Classification. Applicable regulations require that each insured institution review and classify its assets on a regular basis. In addition, in connection with examinations of insured institutions, regulatory examiners have authority to identify problem assets and, if appropriate, require them to be classified. There are three classifications for problem assets: substandard, doubtful and loss. Substandard loans are classified as those loans that are inadequately protected by the current net worth, and paying capacity of the obligor, or of the collateral pledged. Assets classified as substandard have a well-defined weakness, or weaknesses that jeopardize the repayment of the debt. If the weakness,

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or weaknesses are not corrected there is the distinct possibility that some loss will be sustained. Doubtful assets have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. An asset classified as loss is considered uncollectible and of such little value that continuance as an asset of the Bank is not warranted. When the Bank classifies problem assets as either substandard or doubtful, it is required to establish allowances for loan losses in an amount deemed prudent by management. These allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities and the risks associated with particular problem assets. When the Bank classifies problem assets as loss, it charges off the balance of the asset against the allowance for loan losses. Assets which do not currently expose the Bank to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated as special mention. The Bank's determination of the classification of its assets and the amount of its valuation allowances is subject to review by the FDIC and the Division which can require the establishment of additional loss allowances.

The aggregate amounts of the Bank's classified and special mention loans (as determined by the Bank), and of the Bank's allowances for loan losses at the dates indicated, were as follows:

	At September 30,		
	2011	2010	2009
	(In thousands)		
Loss	$ --	$ --	$ --
Doubtful	--	--	--
Substandard(1)(2)	56,980	56,796	63,188
Special mention(1)	27,419	13,070	21,711
Total classified and special mention loans	$84,399	$69,866	$84,899
Allowance for loan losses	$11,946	$11,264	$14,172

(1) For further information concerning the change in classified assets, see "-Lending Activities - Non-performing Loans and Delinquencies."
(2) Includes non-performing loans.

The Bank's classified and special mention loans increased by $14.5 million from September 30, 2010 to $84.4 million at September 30, 2011, primarily as a result of a $14.3 million increase in loans classified as special mention.

Special mention loans are defined as those credits deemed by management to have some potential weakness that deserve management's close attention. If left uncorrected these potential weaknesses may result in the deterioration of the payment prospects of the loan. Assets in this category are not adversely classified and currently do not expose the Bank to sufficient risk to warrant a substandard classification. Thirty-one individual loans comprised $25.6 million, or 93.3%, of the $27.4 million in loans classified as special mention. They include eight multi-family loans totaling $10.4 million, seven commercial real estate loans totaling $6.3 million, eight land loans totaling $4.8 million, six one- to four-family loans totaling $2.6 million, one multi-family construction loan with a balance of $752,000 and one speculative single-family construction loan with a balance of $700,000. All of these loans were current and paying in accordance with their required loan repayment terms at September 30, 2011, except three loans totaling $2.8 million that were 60 days past due.

The aggregate amount of loans classified as substandard at September 30, 2011 increased by $184,000 to $57.0 million from $56.8 million at September 30, 2010. At September 30, 2011, 134 loans were classified as substandard compared to 146 at September 30, 2010.

Of the $57.0 million in loans classified as substandard at September 30, 2011, $21.6 million were on non-accrual status and $1.8 million were past due 90 days or more and still accruing. Troubled debt restructured loans

totaling $20.1 million were classified as substandard at September 30, 2011, with $7.4 million in troubled debt restructured loans on non-accrual status and $12.7 million in troubled debt restructured loans on accrual status. The largest loan classified as substandard at September 30, 2011 had a balance of $4.7 million and was secured by a mini-storage facility in Pierce County. This loan was performing according to its loan repayment terms at September 30, 2011. The next largest loan classified as substandard at September 30, 2011 had a balance of $4.6 million and was secured by a mini-storage facility in Pierce County and was 60 days past due at September 30, 2011.

Allowance for Loan Losses. The allowance for loan losses is maintained to cover estimated losses in the loan portfolio. The Bank has established a comprehensive methodology for the determination of provisions for loan losses that takes into consideration the need for an overall general valuation allowance. The Bank's methodology for assessing the adequacy of its allowance for loan losses is based on its historic loss experience for various loan segments; adjusted for changes in economic conditions, delinquency rates, and other factors. Using these loss estimate factors, management develops a range of probable loss for each loan category. Certain individual loans for which full collectibility may not be assured are evaluated individually with loss exposure based on estimated discounted cash flows or net realizable collateral values. The total estimated range of loss based on these two components of the analysis is compared to the loan loss allowance balance. Based on this review, management will adjust the allowance as necessary to maintain directional consistency with trends in the loan portfolio.

In originating loans, the Bank recognizes that losses will be experienced and that the risk of loss will vary with, among other things, the type of loan being made, the creditworthiness of the borrower over the term of the loan, general economic conditions and, in the case of a secured loan, the quality of the security for the loan. The Bank increases its allowance for loan losses by charging provisions for loan losses against the Bank's income.

The Board of Directors reviews the adequacy of the allowance for loan losses at least quarterly based on management's assessment of current economic conditions, past loss and collection experience, and risk characteristics of the loan portfolio.

At September 30, 2011, the Bank's allowance for loan losses totaled $11.9 million. The Bank's allowance for loan losses as a percentage of total loans receivable and non-performing loans increased to 2.21% and 51.2%, respectively, at September 30, 2011 from 2.09% and 43.0%, respectively, at September 30, 2010.

Management believes that the amount maintained in the allowance is adequate to absorb probable losses in the portfolio. Although management believes that it uses the best information available to make its determinations, future adjustments to the allowance for loan losses may be necessary and results of operations could be significantly and adversely affected if circumstances differ substantially from the assumptions used in making the determinations.

While the Bank believes it has established its existing allowance for loan losses in accordance with accounting principles generally accepted in the United States of America, there can be no assurance that regulators, in reviewing the Bank's loan portfolio, will not request the Bank to increase significantly its allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that substantial increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses may adversely affect the Bank's financial condition and results of operations.

The following table sets forth an analysis of the Bank's allowance for loan losses for the periods indicated.

	Year Ended September 30,				
	2011	2010	2009	2008	2007
	(Dollars in thousands)				
Allowance at beginning of year.......	$11,264	$14,172	$ 8,050	$4,797	$4,122
Provision for loan losses...........	6,758	10,550	10,734	3,900	686
Allocated to loan commitments........	-	--	(169)	-	--
Recoveries:					
Mortgage loans:					
One- to four-family................	151	-	--	--	--
Multi-family.......................	41	-	--	--	--
Commercial.........................	--	13	-	--	--
Construction.......................	109	104	-	--	--

Land..............................	46	153	83	-	--
Consumer loans:					
Home equity and second mortgage.....	42	86	-	--	--
Other..............................	2	6	5	1	1
Commercial business loans...........	1	-	-	-	--
Total recoveries..................	392	362	88	1	1
Charge-offs:					
Mortgage loans:					
One- to four-family................	543	200	46	-	--
Construction.......................	3,972	8,012	3,108	648	--
Commercial.........................	47	1,888	235	-	--
Land..............................	1,704	3,285	705	-	--
Consumer loans:					
Home equity and second mortgage.....	150	399	162	-	--
Other..............................	30	36	25	-	12
Commercial business loans...........	22	-	250	-	--
Total charge-offs..................	6,468	13,820	4,531	648	12
Net charge-offs....................	6,076	13,458	4,443	647	11
Allowance at end of year...........	$11,946	$11,264	$14,172	$8,050	$4,797
Allowance for loan losses as a percentage of total loans receivable (net)(1) outstanding at the end of the year..........................	2.21%	2.09%	2.52%	1.42%	0.92%
Net charge-offs as a percentage of average loans outstanding during the year....................	1.13%	2.45%	0.79%	0.12%	0.00%
Allowance for loan losses as a percentage of non-performing loans at end of year.....................	51.2%	43.01%	47.11%	67.14%	321.95%

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(1) Total loans receivable (net) includes loans held for sale and is before the allowance for loan losses.

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The following table sets forth the allocation of the allowance for loan losses by loan catego
dates indicated.

	At September 30,				
	2011	2010	2009	2008	
	Percent of Loans in Category	Percent of Loans in Category	Percent of Loans in Category	Percent of Loans in Category	

	Amount	to Total Loans	Amount	to Total Loans	Amount	to Total Loans	Amount	to Total Loans	Amount
					(Dollars in thousands)				
Mortgage loans:									
One- to four-family..	$ 760	20.47%	$ 530	21.65%	$ 616	18.58%	$ 476	18.35%	$ 39
Multi-family..	1,076	5.53	392	5.77	431	4.31	248	4.24	20
Commercial....	4,035	43.92	3,173	37.21	2,719	31.63	1,521	23.90	1,36
Construction and land development..	1,618	9.37	1,626	12.39	5,132	23.48	3,254	30.46	1,04
Land..........	2,795	8.79	3,709	11.27	3,348	11.03	1,435	9.92	54
Non-mortgage loans:									
Consumer loans........	875	7.90	461	8.49	1,216	8.66	457	9.69	41
Commercial business loans........	787	4.02	1,373	3.22	710	2.31	659	3.44	82
Total allowance for loan losses......	$11,946	100.0%	$11,264	100.00%	$14,172	100.00%	$8,050	100.00%	$4,79

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Investment Activities

The investment policies of the Company are established and monitored by the Board of Directors. The policies are designed primarily to provide and maintain liquidity, to generate a favorable return on investments without incurring undue interest rate and credit risk, and to compliment the Bank's lending activities. These policies dictate the criteria for classifying securities as either available-for-sale or held-to-maturity. The policies permit investment in various types of liquid assets permissible under applicable regulations, which includes U.S. Treasury obligations, securities of various federal agencies, certain certificates of deposit of insured banks, banker's acceptances, federal funds, mortgage-backed securities, and mutual funds. The Company's investment policy also permits investment in equity securities in certain financial service companies.

At September 30, 2011, the Company's investment portfolio totaled $10.9 million, primarily consisting of $5.7 million of mortgage-backed securities available-for-sale, $1.0 million of mutual funds available-for-sale, and $4.1 million of mortgaged-backed securities held-to-maturity. The Company does not maintain a trading account for any investments. This compares with a total investment portfolio of $16.2 million at September 30, 2010, primarily consisting of $10.1 million of mortgage-backed securities available-for-sale, $988,000 of mutual funds available-for-sale, and $5.0 million of mortgaged-backed securities held-to-maturity. The composition of the portfolios by type of security, at each respective date is presented in the following table.

	At September 30,					
	2011		2010		2009	
	Recorded Value	Percent of Total	Recorded Value	Percent of Total	Recorded Value	Percent of Total
	(Dollars in thousands)					
Held-to-Maturity:						
U.S. agency securities..	$ 27	0.25%	$ 28	0.17%	$ 27	0.13%
Mortgage-backed securities..	4,118	37.91	5,038	31.13	7,060	34.34
Available-for-Sale (at fair value):						
Mortgage-backed securities..	5,717	52.63	10,131	62.59	12,503	60.82
Mutual funds.	1,000	9.21	988	6.11	968	4.71
Total portfolio....	$10,862	100.0%	$16,185	100.00%	$20,558	100.00%

The following table sets forth the maturities and weighted average yields of the investment an mortgage-backed securities in the Company's investment securities portfolio at September 30, 2011 funds, which by their nature do not have maturities, are classified in the one year or less categ

	One Year or Less		After One to Five Years		After Five to Ten Years		After Year
	Amount	Yield	Amount	Yield	Amount	Yield	Amount
	(Dollars in thousands)						
Held-to-Maturity:							
U.S. agency securities........	$ -	--%	$ 13	3.25%	$ 14	3.98%	$ -
Mortgage-backed securities........	-	--	10	4.70	24	3.16	4,084
Available-for-Sale:							
Mortgage-backed securities........	1	4.40	-	--	117	5.90	5,599

Mutual funds.......	1,000	2.82	-	-	--	-	--
Total portfolio....	$1,001	2.82%	$ 23	3.85%	$ 155	5.28%	$9,683

There were no securities which had an aggregate book value in excess of 10% of the Company's total equity at September 30, 2011. At September 30, 2011, the Company had $3.4 million of private label mortgage-backed securities of which $2.8 million was on non-accrual status. The private label mortgage-backed securities were acquired from the in-kind redemption of the Company's investment in the AMF family of mutual funds in June 2008. For additional information regarding investment securities, see "Item 1A, Risk Factors - Other-than-temporary impairment charges in our investment securities portfolio could result in additional losses" and Note 3 of the Notes to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Deposit Activities and Other Sources of Funds

General. Deposits and loan repayments are the major sources of the Bank's funds for lending and other investment purposes. Scheduled loan repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are influenced significantly by general interest rates and money market conditions. Borrowings through the FHLB-Seattle and the FRB may be used to compensate for reductions in the availability of funds from other sources.

Deposit Accounts. Substantially all of the Bank's depositors are residents of Washington. Deposits are attracted from within the Bank's market area through the offering of a broad selection of deposit instruments, including money market deposit accounts, checking accounts, regular savings accounts and certificates of deposit. Deposit account terms vary, according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors. In determining the terms of its deposit accounts, the Bank considers current market interest rates, profitability to the Bank, matching deposit and loan products and its customer preferences and concerns. The Bank actively seeks consumer and commercial checking accounts through checking account acquisition marketing programs. At September 30, 2011, the Bank had 37.1% of total deposits in non-interest bearing accounts and NOW checking accounts.

At September 30, 2011 the Bank had $86.3 million of jumbo certificates of deposit of $100,000 or more. The Bank had no brokered certificates of deposits at September 30, 2011. The Bank believes that its jumbo certificates of deposit, which represented 14.6% of total deposits at September 30, 2011, present similar interest rate risk compared to its other deposits.

The following table sets forth information concerning the Bank's deposits at September 30, 2011.

	Weighted	Percentage

Category	Average Interest Rate	Amount	of Total Deposits
		(In thousands)	
Non-interest bearing....................	--%	$ 64,494	10.88%
Negotiable order of withdrawal ("NOW") checking...........	0.90	155,299	26.20
Savings................................	0.62	83,636	14.11
Money market...........................	0.75	61,028	10.30
Subtotal..............................	0.80	364,457	61.49
Certificates of Deposit(1)			
Maturing within 1 year.................	1.19	157,161	26.52
Maturing after 1 year but within 2 years	1.44	39,793	6.71
Maturing after 2 years but within 5 years	2.54	30,641	5.17
Maturing after 5 years.................	2.10	626	0.11
Total certificates of deposit.........	1.42	228,221	38.51
Total deposits.......................	1.04	$592,678	100.0%

(1) Based on remaining maturity of certificates.

The following table indicates the amount of the Bank's jumbo certificates of deposit by time remaining until maturity as of September 30, 2011. Jumbo certificates of deposit have principal balances of $100,000 or more and the rates paid on these accounts are generally negotiable.

Maturity Period	Amount
	(In thousands)
Three months or less...................	$15,767
Over three through six months...........	16,027
Over six through twelve months..........	26,067
Over twelve months.....................	28,461
Total................................	$86,322

Deposit Flow. The following table sets forth the balances of deposits in the various types o offered by the Bank at the dates indicated.

	At September 30,		
	2011	2010	2
	Percent	Percent	

	Amount	of Total	Increase (Decrease)	Amount	of Total	Increase (Decrease)	Amount
				(Dollars in thousands)			
Non-interest-bearing...	$ 64,494	10.88%	$ 5,739	$ 58,755	10.15%	$ 8,460	$ 50,29
NOW checking..........	155,299	26.20	1,995	153,304	26.48	35,947	117,35
Savings...............	83,636	14.11	16,188	67,448	11.65	8,839	58,60
Money market..........	61,028	10.30	5,305	55,723	9.63	(6,755)	62,47
Certificates of deposit which mature:							
Within 1 year........	157,161	26.52	(20,750)	177,911	30.74	(4,374)	182,28
After 1 year, but within 2 years......	39,793	6.71	(3,239)	43,032	7.43	20,445	22,58
After 2 years, but within 5 years......	30,641	5.17	8,255	22,386	3.87	10,652	11,73
Certificates maturing thereafter..........	626	0.11	316	310	0.05	(6)	31
Total.................	$592,678	100.0%	$13,809	$578,869	100.00%	$73,208	$505,66

Certificates of Deposit by Rates. The following table sets forth the certificates of deposit in the Bank classified by rates as of the dates indicated.

	At September 30,		
	2011	2010	2009
	(In thousands)		
0.00 - 1.99%................	$193,790	$194,142	$ 59,466
2.00 - 3.99%................	33,345	48,059	146,513
4.00 - 5.99%................	1,086	1,374	10,569
6.00% - and over............	--	64	374
Total.......................	$228,221	$243,639	$216,922

Certificates of Deposit by Maturities. The following table sets forth the amount and maturities of certificates of deposit at September 30, 2011.

	Amount Due				
	Less Than One Year	One to Two Years	After Two to Five Years	After Five Years	Total
	(In thousands)				
0.00 - 1.99%..........	$153,898	$34,972	$ 4,771	$149	$193,790
2.00 - 3.99%..........	2,603	4,553	25,712	477	33,345

4.00 - 5.99%..........	660	268	158	--	1,086
6.00% and over.........	--	--	--	--	--
Total..................	$157,161	$39,793	$30,641	$626	$228,221

Deposit Activities. The following table sets forth the deposit activities of the Bank for the periods indicated.

	Year September 30,		
	2011	2010	2009
	(In thousands)		
Beginning balance..................	$578,869	$505,661	$498,572
Net deposits (withdrawals) before interest credited................	7,673	65,401	(2,383)
Interest credited..................	6,136	7,807	9,472
Net increase in deposits...........	13,809	73,208	7,089
Ending balance.....................	$592,678	$578,869	$505,661

Borrowings. Deposits and loan repayments are generally the primary source of funds for the Bank's lending and investment activities and for general business purposes. The Bank has the ability to use advances from the FHLB-Seattle to supplement its supply of lendable funds and to meet deposit withdrawal requirements. The FHLB-Seattle functions as a central reserve bank providing credit for member financial institutions. As a member of the FHLB-Seattle, the Bank is required to own capital stock in the FHLB-Seattle and is authorized to apply for advances on the security of such stock and certain mortgage loans and other assets (principally securities which are obligations of, or guaranteed by, the United States government) provided certain creditworthiness standards have been met. Advances are made pursuant to several different credit programs. Each credit program has its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based on the financial condition of the member institution and the adequacy of collateral pledged to secure the credit. At September 30, 2011, the Bank maintained an uncommitted credit facility with the FHLB-Seattle that provided for immediately available advances up to an aggregate amount of 30% of the Bank's total assets, limited by available collateral, under which $55.0 million was outstanding.

The Bank also utilizes overnight repurchase agreements with customers. These overnight repurchase agreements are classified as other borrowings and totaled $729,000 at September 30, 2011. The Bank also maintains a short-term borrowing line with the FRB with total credit based on eligible collateral. At September 30, 2011, the Bank had no outstanding balance and $58.7 million in unused borrowing capacity on this borrowing line.

The following table sets forth certain information regarding borrowings including repurchase agreements by the Bank at the end of and during the periods indicated:

	At or For the Year September 30,		
	2011	2010	2009
	(Dollars in thousands)		
Average total borrowings...........	$55,511	$ 78,402	$ 97,393
Weighted average rate paid on total borrowings.................	4.32%	4.03%	4.14%
Total borrowings outstanding at end of period...................	$55,729	$ 75,622	$105,777

The following table sets forth certain information regarding short-term borrowings including repurchase agreements by the Bank at the end of and during the periods indicated. Borrowings are considered short-term when the original maturity is less than one year.

	At or For the Year September 30,		
	2011	2010	2009
	(Dollars in thousands)		
Maximum amount outstanding at any month end:			
FHLB advances...................	$ --	$ --	$ --
Repurchase agreements...........	729	750	844
Pacific Coast Bankers' Bank ("PCBB") borrowings......	--	--	--
FRB borrowings..................	--	10,000	10,000
Average outstanding during period:			
FHLB advances...................	$ --	$ --	$ 15
Repurchase agreements...........	511	539	624
PCBB borrowings.................	--	--	6
FRB borrowings..................	--	384	27
Total average outstanding during period...........................	$ 511	$ 923	$ 672
Weighted average rate paid during period:			
FHLB advances...................	--%	--%	0.71%
Repurchase agreements...........	0.05	0.05	0.08
PCBB borrowings.................	--	--	1.48
FRB borrowings..................	--	0.66	0.50
Total weighted average rate paid during period...............	0.05	0.30	0.12

(table continued on following page)

At or For the
Year September 30,

	2011	2010	2009
	(Dollars in thousands)		
Outstanding at end of period:			
FHLB advances..................	$ --	$ --	$ --
Repurchase agreements..........	729	622	777
PCBB borrowings................	--	--	--
FRB borrowings.................	--	--	10,000
Total outstanding at end of period.	$ 729	$ 622	$ 10,777
Weighted average rate at end of period:			
FHLB advances..................	--%	--%	--%
Repurchase agreements..........	0.05	0.05	0.05
PCBB borrowings................	--	--	--
FRB borrowings.................	--	--	0.50
Total weighted average rate at end of period..................	0.05	0.05	0.50

Bank Owned Life Insurance

The Bank has purchased life insurance policies covering certain officers. These policies are recorded at their cash surrender value, net of any cash surrender charges. Increases in cash surrender value, net of policy premiums, and proceeds from death benefits are recorded in non-interest income. At September 30, 2011, the cash surrender value of bank owned life insurance ("BOLI") was $15.9 million.

Regulation of the Bank

General. The Bank, as a state-chartered savings bank, is subject to regulation and oversight by the Division and the applicable provisions of Washington law and regulations of the Division adopted thereunder. The Bank also is subject to regulation and examination by the FDIC, which insures the deposits of the Bank to the maximum extent permitted by law, and requirements established by the Federal Reserve. State law and regulations govern the Bank's ability to take deposits and pay interest thereon, to make loans on or invest in residential and other real estate, to make consumer loans, to invest in securities, to offer various banking services to its customers, and to establish branch offices. Under state law, savings banks in Washington also generally have all of the powers that federal savings banks have under federal laws and regulations. The Bank is subject to periodic examination and reporting requirements by and of the Division and the FDIC.

In December 2009, the FDIC and the Division agreed to terms on the Bank MOU informal supervisory agreement. The terms of the Bank MOU restrict the Bank from certain activities, and require that the Bank obtain the prior written approval, or non-objection, of the FDIC and/or the DFI to engage in certain activities. In addition, on February 1, 2010, the FRB determined that the Company required additional supervisory attention and entered into the Company MOU. Under the Company MOU, the Company must among other things obtain prior written approval, or non-objection, from the FRB to declare or pay any dividends, or make any other capital distributions; issue any trust preferred securities; or purchase or redeem any of its stock. The FRB has denied the Company's requests to pay dividends on its Series A Preferred Stock issued under the CPP for the quarterly payments due for the last six quarters beginning with the payments due on May 15, 2010. Since dividends on the Series A Preferred Stock have not been paid for more than six quarters, the Treasury has the right to appoint two members to the Board of Directors of the

Company. See "- Risks specific to our participation in TARP." There can be no assurances that the FRB will approve such payments or dividends in the future. For additional information regarding the Bank MOU and the Company MOU, see "Item 1A, Risk Factors - The Company and the Bank are required to comply with the terms of separate memorandums

of understanding issued by their respective regulators and lack of compliance could result in additional regulatory actions." and "- Risks specific to our participation in TARP."

New Legislation. On July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act implements far-reaching changes across the financial regulatory landscape, including provisions that, among other things, has or will:

* Centralize responsibility for consumer financial protection by creating a new agency within the Federal Reserve Board, the Bureau of Consumer Financial Protection, with broad rulemaking, supervision and enforcement authority for a wide range of consumer protection laws that would apply to all banks and thrifts. Smaller financial institutions, including the Bank, will be subject to the supervision and enforcement of their primary federal banking regulator with respect to the federal consumer financial protection laws.

* Require the federal banking regulators to promulgate new capital regulations and seek to make their capital requirements countercyclical, so that capital requirements increase in times of economic expansion and decrease in times of economic contraction.

* Provide for new disclosure and other requirements relating to executive compensation and corporate governance.

* Make permanent the $250,000 limit for federal deposit insurance and provide unlimited federal deposit insurance until January 1, 2013 for non interest-bearing demand transaction accounts at all insured depository institutions.

* Effective July 21, 2011, repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

* Require all depository institution holding companies to serve as a source of financial strength to their depository institution subsidiaries in the event such subsidiaries suffer from financial distress.

Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Company and the financial services industry more generally. The elimination of the prohibition on the payment of interest on demand deposits could materially increase our interest expense, depending on our competitors' responses. Provisions in the legislation that require revisions to the capital requirements of the Company and the Bank could require the Company and the Bank to seek additional sources of capital in the future.

Insurance of Accounts and Regulation by the FDIC. The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund ("DIF") of the FDIC. Deposits are insured up to the applicable limits by the FDIC, backed by the full faith and credit of the United States Government. As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of and to require reporting by FDIC insured institutions. It also may prohibit any FDIC insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious risk to the insurance fund. The FDIC also has the authority to initiate enforcement actions against savings institutions and may terminate the deposit insurance if it determines that the institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

In addition to the regular quarterly assessments, due to losses and projected losses attributed to failed institutions, the FDIC imposed a special assessment of five basis points on the amount of each depository institution's assets reduced by the amount of its Tier 1 capital (not to exceed 10 basis points of its assessment base for regularly quarterly premiums) as of June 30, 2009, which was collected on September 30, 2009.

As a result of a decline in the reserve ratio (the ratio of the DIF to estimated insured deposits) and concerns about expected failure costs and available liquid assets in the DIF, the FDIC adopted a rule requiring each insured institution to prepay on December 30, 2009 the estimated amount of its quarterly assessments for the fourth quarter of 2009 and all quarters through the end of 2012 (in addition to the regular quarterly assessment for the third quarter which was due on December 30, 2009). The prepaid amount is recorded as an asset with a zero risk weight and the Bank will continue to record quarterly expenses for deposit insurance. For purposes of calculating the prepaid amount, assessments were measured at the Bank's assessment rate as of September 30, 2009, with a uniform increase of 3 basis points effective January 1, 2011, and were based on the Bank's assessment base for the third quarter of 2009, with deposit growth assumed quarterly at annual rate of 5%. If events cause actual assessments during the prepayment period to vary from the prepaid amount, the Bank will pay excess assessments in cash or receive a rebate of prepaid amounts not exhausted after collection of assessments due on June 30, 2013, as applicable. Collection of the prepayment does not preclude the FDIC from changing assessment rates or revising the risk-based assessment system in the future. In December 2009, the Bank paid the prepaid assessment of $4.4 million; and as of September 30, 2011, the remaining prepaid balance was $2.1 million.

As required by the Dodd-Frank Act, the FDIC adopted rules effective April 1, 2011, under which insurance premium assessments are based on an institution's total assets minus its tangible equity (defined as Tier 1 capital) instead of its deposits. Under these rules, an institution with total assets of less than $10 billion will be assigned to a Risk Category as described above and a range of initial base assessment rates will apply to each category, subject to adjustment downward based on unsecured debt issued by the institution and, except for an institution in Risk Category I, adjustment upward if the institution's brokered deposits exceed 10% of its domestic deposits, to produce total base assessment rates. Total base assessment rates range from 2.5 to 9 basis points for Risk Category I, nine to 24 basis points for Risk Category II, 18 to 33 basis points for Risk Category III and 30 to 45 basis points for Risk Category IV, all subject to further

adjustment upward if the institution holds more than a de minimis amount of unsecured debt issued by another FDIC-insured institution. The FDIC may increase or decrease its rates by 2.0 basis points without further rulemaking. In an emergency, the FDIC may also impose a special assessment.

The Dodd-Frank Act establishes 1.35% as the minimum reserve ratio. The FDIC has adopted a plan under which it will meet this ratio by September 30, 2020, the deadline imposed by the Dodd-Frank Act. The Dodd-Frank Act requires the FDIC to offset the effect on institutions with assets less than $10 billion of the increase in the statutory minimum reserve ratio to 1.35% from the former statutory minimum of 1.15%. The FDIC has not yet announced how it will implement this offset. In addition to the statutory minimum ratio the FDIC must designate a reserve ratio, known as the designated reserve ratio ("DRR"), which may exceed the statutory minimum. The FDIC has established 2.0% as the DRR. In addition, all institutions with deposits insured by the FDIC are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation, an agency of the Federal government established to fund the costs of failed thrifts in the 1980s. These assessments, which may be revised based upon the level of DIF deposits, will continue until the bonds mature in the years 2017 through 2019. For the quarterly period ended September 30, 2011, the Financing Corporation assessment equaled 0.680 basis points for each $100 in domestic deposits. These assessments, which may be revised based upon the level of DIF deposits, will continue until the bonds mature in the years 2017 through 2019.

Under the Dodd-Frank Act, beginning on January 1, 2011, all non-interest bearing transaction accounts and interest on lawyers trust accounts ("IOLTA") qualify for unlimited deposit insurance by the FDIC through December 31, 2012. NOW accounts, which were previously fully insured under the Transaction Account Guarantee Program, are no longer eligible for an unlimited guarantee due to the expiration of this program on December 31, 2010. NOW accounts, along with all other deposits maintained at the Bank, are now insured by the FDIC up to $250,000 per account owner.

As insurer, the FDIC is authorized to conduct examinations of and to require reporting by FDIC-insured institutions. It also may prohibit any FDIC-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious threat to the DIF. The FDIC also has the authority to take enforcement actions against banks and savings associations.

The Dodd-Frank Act contains a number of provisions that will affect the capital requirements applicable to the Company and the Bank. In addition, on September 12, 2010, the Basel Committee adopted the Basel III capital rules. These rules, which will be phased in over a period of years, set new standards for common equity, tier 1 and total capital, determined on a risk-weighted basis. The impact on the Company and the Bank of the Basel III rules cannot be determined at this time. For additional information, see "- Capital Requirements - Possible Changes to Capital Requirements Resulting from Basel III" set forth below.

A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of the Bank. There can be no prediction as to what insurance assessment rates will be in the future. Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an

unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. Management of the Bank is not aware of any practice, condition or violation that might lead to termination of the Bank's deposit insurance.

The FDIC may terminate the deposit insurance of any insured depository institution, including the Bank, if it determines after a hearing that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance, if the institution meets certain criteria. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the FDIC. Management of the Bank is not aware of any practice, condition or violation that might lead to termination of the Bank's deposit insurance.

Prompt Corrective Action. Federal statutes establish a supervisory framework based on five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. An institution's category depends upon where its capital levels are in relation to relevant capital measures, which include a risk-based capital measure, a leverage ratio capital measure and certain other factors. The federal banking agencies have adopted regulations that implement this statutory framework. Under these regulations, an institution is deemed to be well capitalized if its ratio of total capital to risk-weighted assets is 10% or more, its ratio of core capital to risk-weighted assets is 6% or more, its ratio of core capital to adjusted total assets (leverage ratio) is 5% or more, and it is not subject to any federal supervisory order or directive to meet a specific capital level. In order to be adequately capitalized, an institution must have a total risk-based capital ratio of not less than 8%, a Tier 1 risk-based capital ratio of not less than 4%, and a leverage ratio of not less than 4%. Any institution which is neither well capitalized nor adequately capitalized is considered undercapitalized.

Undercapitalized institutions are subject to certain prompt corrective action requirements, regulatory controls and restrictions which become more extensive as an institution becomes more severely undercapitalized. Failure by institutions to comply with applicable capital requirements would, if unremedied, result in progressively more severe restrictions on their respective activities and lead to enforcement actions, including, but not limited to, the issuance of a capital directive to ensure the maintenance of required capital levels and, ultimately, the appointment of the FDIC as receiver or conservator. Banking regulators will take prompt corrective action with respect to depository institutions that do not meet minimum capital requirements. Additionally, approval of any regulatory application filed for their review may be dependent on compliance with capital requirements.

At September 30, 2011, the Bank was categorized as "well capitalized" under the prompt corrective action regulations of the FDIC. For additional information on capital requirements, see Note 18 of the Notes to the Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplemental Data."

Capital Requirements. Federally insured savings institutions, such as the Bank, are required to maintain a minimum level of regulatory capital. FDIC regulations recognize two types, or tiers, of capital: core ("Tier 1") capital and supplementary ("Tier 2") capital. Tier 1 capital generally includes common shareholders' equity and noncumulative perpetual preferred stock, less most intangible assets. Tier 2 capital, which is limited to 100%

of Tier 1 capital, includes such items as qualifying general loan loss reserves, cumulative perpetual preferred stock, mandatory convertible debt,

term subordinated debt and limited life preferred stock; however, the amount of term subordinated debt and intermediate term preferred stock (original maturity of at least five years but less than 20 years) that may be included in Tier 2 capital is limited to 50% of Tier 1 capital.

The FDIC currently measures an institution's capital using a leverage limit together with certain risk-based ratios. The FDIC's minimum leverage capital requirement specifies a minimum ratio of Tier 1 capital to average total assets. Most banks are required to maintain a minimum leverage ratio of at least 4% to 5% of total assets. At September 30, 2011, the Bank had a Tier 1 leverage capital ratio of 10.3%. The FDIC retains the right to require a particular institution to maintain a higher capital level based on the its particular risk profile.

FDIC regulations also establish a measure of capital adequacy based on ratios of qualifying capital to risk-weighted assets. Assets are placed in one of four categories and given a percentage weight based on the relative risk of that category. In addition, certain off-balance-sheet items are converted to balance-sheet credit equivalent amounts, and each amount is then assigned to one of the four categories. Under the guidelines, the ratio of total capital (Tier 1 capital plus Tier 2 capital) to risk-weighted assets must be at least 8%, and the ratio of Tier 1 capital to risk-weighted assets must be at least 4%. In evaluating the adequacy of a bank's capital, the FDIC may also consider other factors that may affect a bank's financial condition. Such factors may include interest rate risk exposure, liquidity, funding and market risks, the quality and level of earnings, concentration of credit risk, risks arising from nontraditional activities, loan and investment quality, the effectiveness of loan and investment policies, and management's ability to monitor and control financial operating risks. At September 30, 2011, the Bank's ratio of total capital to risk-weighted assets was 15.3% and the ratio of Tier 1 capital to risk-weighted assets was 14.0%.

The Division requires that net worth equal at least 5% of total assets. Intangible assets must be deducted from net worth and assets when computing compliance with this requirement. At September 30, 2011, the Bank had a net worth of 10.1% of total assets.

The table below sets forth the Bank's capital position relative to its FDIC capital requirements at September 30, 2011. The definitions of the terms used in the table are those provided in the capital regulations issued by the FDIC and reflect the higher Tier 1 leverage capital ratio that the Bank is required to comply with in connection with the Bank MOU. For additional information regarding the MOU, see "Item 1A, Risk Factors - The Company and the Bank are required to comply with the terms of separate memoranda of understanding issued by their respective regulators and lack of compliance could result in additional regulatory actions."

	At September 30, 2011	
	Amount	Percent of Adjusted Total Assets (1)

	(Dollars in thousands)	
Tier 1 (leverage) capital	$74,588	10.3%
Tier 1 (leverage) capital requirement (2)	72,662	10.0
Excess	$ 1,926	0.3%
Tier 1 risk adjusted capital	$74,588	14.0%
Tier 1 risk adjusted capital requirement	31,951	6.0
Excess	$42,637	8.0%
Total risk-based capital	$81,310	15.3%
Total risk-based capital requirement	53,251	10.0
Excess	$28,059	5.3%

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(1) For the Tier 1 (leverage) capital and Washington regulatory capital calculations, percent of total average assets of $726.6 million. For the Tier 1 risk-based capital and total risk-based capital calculations, percent of total risk-weighted assets of $532.5 million.

(2) As a Washington-chartered savings bank, the Bank is subject to the capital requirements of the FDIC and the Division. The FDIC requires state-chartered savings banks, including the Bank, to have a minimum leverage ratio of Tier 1 capital to total assets of at least 3%, provided, however, that all institutions, other than those (i) receiving the highest rating during the examination process and (ii) not anticipating any significant growth, are required to maintain a ratio of 1% to 2% above the stated minimum, with an absolute total capital to risk-weighted assets of at least 8%. Under the MOU, the Bank is required to maintain at least a 10.0% Tier 1 leverage capital ratio.

Events beyond the control of the Bank, such as a downturn in the economy in areas where the Bank has most of its loans, could adversely affect future earnings and, consequently, the ability of the Bank to meet its capital requirements under the MOU. See "Item 1A, Risk Factors - The Company and the Bank are required to comply with the terms of separate memoranda of understanding issued by their respective regulators and lack of compliance could result in additional regulatory actions."

Possible Changes to Capital Requirements Resulting from Basel III. In December 2010 and January 2011, the Basel Committee on Banking Supervision published the final texts of reforms on capital and liquidity generally referred to as "Basel III." Although Basel III is intended to be implemented by participating countries for large, internationally active banks, its provisions are likely to be considered by United States banking regulators in developing new regulations applicable to other banks in the United States, including the Bank.

For banks in the United States, among the most significant provisions of Basel III concerning capital are the following:

* A minimum ratio of common equity to risk-weighted assets reaching 4.5%, plus an additional 2.5% as a capital conservation buffer, by 2019 after a phase-in period.

* A minimum ratio of Tier 1 capital to risk-weighted assets reaching 6.0% by 2019 after a phase-in period.

* A minimum ratio of total capital to risk-weighted assets, plus the additional 2.5% capital conservation buffer, reaching 10.5% by 2019 after a phase-in period.

* An additional countercyclical capital buffer to be imposed by applicable national banking regulators periodically at their discretion, with advance notice.

* Restrictions on capital distributions and discretionary bonuses applicable when capital ratios fall within the buffer zone.

* Deduction from common equity of deferred tax assets that depend on future profitability to be realized.

* Increased capital requirements for counterparty credit risk relating to OTC derivatives, repos and securities financing activities.

* For capital instruments issued on or after January 13, 2013 (other than common equity), a loss-absorbency requirement such that the instrument must be written off or converted to common equity if a trigger event occurs, either pursuant to applicable law or at the direction of the banking regulator. A trigger event is an event under which the banking entity would become nonviable without the write-off or conversion, or without an injection of capital from the public sector. The issuer must maintain authorization to issue the requisite shares of common equity if conversion were required.

The Basel III provisions on liquidity include complex criteria establishing a liquidity coverage ratio ("LCR") and net stable funding ratio ("NSFR"). The purpose of the LCR is to ensure that a bank maintains adequate unencumbered, high quality liquid assets to meet its liquidity needs for 30 days under a severe liquidity stress scenario. The purpose of the NSFR is to promote more medium and long-term funding of assets and activities, using a one-year horizon. Although Basel III is described as a "final text," it is subject to the resolution of certain issues and to further guidance and modification, as well as to adoption by United States banking regulators, including decisions as to whether and to what extent it will apply to United States banks that are not large, internationally active banks.

Federal Home Loan Bank System. The Bank is a member of the FHLB-Seattle, which is one of 12 regional FHLBs that administer the home financing credit function of savings institutions. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from proceeds derived from the sale of

consolidated obligations of the FHLB System. It makes loans or advances to members in accordance with policies and procedures, established by the Board of Directors of the FHLB, which are subject to the oversight of the Federal Housing Finance Board. All advances from the FHLB are required to be fully

secured by sufficient collateral as determined by the FHLB. In addition, all long-term advances are required to provide funds for residential home financing. See "Business - Deposit Activities and Other Sources of Funds Borrowings."

As a member, the Bank is required to purchase and maintain stock in the FHLB-Seattle. At September 30, 2011, the Bank had $5.7 million in FHLB stock, which was in compliance with this requirement. The Bank did not receive any dividends from the FHLB-Seattle for the year ended September 30, 2011. Subsequent to December 31, 2008, the FHLB-Seattle announced that it was below its regulatory risk-based capital requirement and it is now precluded from paying dividends or repurchasing capital stock. The FHLB-Seattle is not anticipated to resume dividend payments until its financial results improve. The FHLB-Seattle has not indicated when dividend payments may resume. For additional information, see Item 1A, "Risk Factors - Our investment in Federal Home Loan Bank of Seattle stock may become impaired."

The FHLBs continue to contribute to low- and moderately-priced housing programs through direct loans or interest subsidies on advances targeted for community investment and low- and moderate-income housing projects. These contributions have affected adversely the level of FHLB dividends paid and could continue to do so in the future. These contributions could also have an adverse effect on the value of FHLB stock in the future. A reduction in value of the Bank's FHLB stock may result in a corresponding reduction in its capital.

Standards for Safety and Soundness. The federal banking regulatory agencies have prescribed, by regulation, guidelines for all insured depository institutions relating to: internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, and compensation, fees and benefits. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. Each insured depository institution must implement a comprehensive written information security program that includes administrative, technical, and physical safeguards appropriate to the institution's size and complexity and the nature and scope of its activities. The information security program also must be designed to ensure the security and confidentiality of customer information, protect against any unanticipated threats or hazards to the security or integrity of such information, protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer, and ensure the proper disposal of customer and consumer information. Each insured depository institution must also develop and implement a risk-based response program to address incidents of unauthorized access to customer information in customer information systems. If the FDIC determines that the Bank fails to meet any standard prescribed by the guidelines, the agency may require the Bank to submit to the agency an acceptable plan to achieve compliance with the standard. FDIC regulations establish deadlines for the submission and review of such safety and soundness compliance plans. Management of the Bank is not aware of any conditions relating to these safety and soundness standards which would require submission of a plan of compliance.

Real Estate Lending Standards. FDIC regulations require the Bank to adopt and maintain written policies that establish appropriate limits and standards for real estate loans. These standards, which must be consistent with safe and sound banking practices, must establish loan portfolio diversification standards, prudent underwriting standards (including loan-to-value ratio limits) that are clear and measurable, loan administration procedures, and documentation, approval and reporting requirements. The Bank is obligated to monitor conditions in its real estate markets to ensure that

its standards continue to be appropriate for current market conditions. The Bank's Board of Directors is required to review and approve the Bank's standards at least annually. The FDIC has published guidelines for compliance with these regulations, including supervisory limitations on loan-to-value ratios for different categories of real estate loans. Under the guidelines, the aggregate amount of all loans in excess of the supervisory loan-to-value ratios should not exceed 100% of total capital, and the total of all loans for commercial, agricultural, multifamily or other non-one- to four-family residential properties in excess of the supervisory loan-to-value ratios should not exceed 30% of total capital. Loans in excess of the supervisory loan-to-value ratio limitations must be identified in the Bank's records and reported at least quarterly to the Bank's Board of Directors. The Bank is in compliance with the record and reporting requirements. As of September 30, 2011, the Bank's aggregate loans in excess of the supervisory loan-to-value ratios

were 29% of total capital and the Bank's loans on commercial, agricultural, multifamily or other non-one- to four-family residential properties in excess of the supervisory loan-to-value ratios were 25% of total capital.

Activities and Investments of Insured State-Chartered Financial Institutions. Federal law generally limits the activities and equity investments of FDIC-insured, state-chartered banks to those that are permissible for national banks. An insured state bank is not prohibited from, among other things, (i) acquiring or retaining a majority interest in a subsidiary, (ii) investing as a limited partner in a partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank's total assets, (iii) acquiring up to 10% of the voting stock of a company that solely provides or reinsures directors', trustees' and officers' liability insurance coverage or bankers' blanket bond group insurance coverage for insured depository institutions, (iv) acting as agent for a customer in many capacities, and (v) acquiring or retaining the voting shares of a depository institution if certain requirements are met.

Washington state has enacted a law regarding financial institution parity. Primarily, the law affords Washington-chartered commercial banks the same powers as Washington-chartered savings banks. In order for a bank to exercise these powers, it must provide 30 days notice to the Director of the Washington Division of Financial Institutions and the Director must authorize the requested activity. In addition, the law provides that Washington-chartered commercial banks may exercise any of the powers that the Federal Reserve has determined to be closely related to the business of banking and the powers of national banks, subject to the approval of the Director in certain situations. Finally, the law provides additional flexibility for Washington-chartered commercial and savings banks with respect to interest rates on loans and other extensions of credit. Specifically, they may charge the maximum interest rate allowable for loans and other extensions of credit by federally-chartered financial institutions to Washington residents.

Environmental Issues Associated With Real Estate Lending. The Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), is a federal statute that generally imposes strict liability on all prior and present "owners and operators" of sites containing hazardous waste. However, Congress acted to protect secured creditors by providing

that the term "owner and operator" excludes a person whose ownership is limited to protecting its security interest in the site. Since the enactment of the CERCLA, this "secured creditor exemption" has been the subject of judicial interpretations which have left open the possibility that lenders could be liable for cleanup costs on contaminated property that they hold as collateral for a loan.

To the extent that legal uncertainty exists in this area, all creditors, including the Bank, that have made loans secured by properties with potential hazardous waste contamination (such as petroleum contamination) could be subject to liability for cleanup costs, which costs often substantially exceed the value of the collateral property.

Federal Reserve System. The Federal Reserve Board requires that all depository institutions maintain reserves on transaction accounts or non-personal time deposits. These reserves may be in the form of cash or non-interest-bearing deposits with the regional Federal Reserve Bank. Negotiable order of withdrawal accounts and other types of accounts that permit payments or transfers to third parties fall within the definition of transaction accounts and are subject to reserve requirements, as are any non-personal time deposits at a savings bank. As of September 30, 2011, the Bank's deposit with the Federal Reserve and vault cash exceeded its Regulation D reserve requirements.

Affiliate Transactions. The Company and the Bank are separate and distinct legal entities. Federal laws strictly limit the ability of banks to engage in certain transactions with their affiliates, including their bank holding companies. Transactions deemed to be a "covered transaction" under Section 23A of the Federal Reserve Act and between a subsidiary bank and its parent company or the nonbank subsidiaries of the bank holding company are limited to 10% of the bank subsidiary's capital and surplus and, with respect to the parent company and all such nonbank subsidiaries, to an aggregate of 20% of the bank subsidiary's capital and surplus. Further, covered transactions that are loans and extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also requires that covered transactions and certain other transactions listed in Section 23B of the Federal Reserve Act between a bank and its affiliates be on terms as favorable to the bank as transactions with non-affiliates.

Community Reinvestment Act. Banks are also subject to the provisions of the Community Reinvestment Act of 1977, which requires the appropriate federal bank regulatory agency to assess a bank's record in meeting the credit needs of the community serviced by the bank, including low and moderate income neighborhoods. The regulatory agency's assessment of the bank's record is made available to the public. Further, an assessment is required of any bank which has applied to establish a new branch office that will accept deposits, relocate an existing office or merge or consolidate with, or acquire the assets or assume the liabilities of, a federally regulated financial institution. The Bank received a "satisfactory" rating during its most recent examination.

Dividends. Dividends from the Bank constitute the major source of funds for dividends which may be paid by the Company shareholders. The amount of dividends payable by the Bank to the Company depends upon the Bank's earnings and capital position, and is limited by federal and state laws, regulations and policies. According to Washington law, the Bank may not declare or pay a

cash dividend on its capital stock if it would cause its net worth to be reduced below (i) the amount required for liquidation accounts or (ii) the net worth requirements, if any, imposed by the Director of the Division. In addition, dividends on the Bank's capital stock may not be paid in an aggregate amount greater than the aggregate retained earnings of the Bank, without the approval of the Director of the Division.

The amount of dividends actually paid during any one period will be strongly affected by the Bank's management policy of maintaining a strong capital position. Federal law further provides that no insured depository institution may pay a cash dividend if it would cause the institution to be "undercapitalized," as defined in the prompt corrective action regulations. Moreover, the federal bank regulatory agencies also have the general authority to limit the dividends paid by insured banks if such payments should be deemed to constitute an unsafe and unsound practice.

Other Consumer Protection Laws and Regulations. The Bank is subject to a broad array of federal and state consumer protection laws and regulations that govern almost every aspect of its business relationships with consumers. While the list set forth below is not exhaustive, these include the Truth-in-Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Right to Financial Privacy Act, the Home Ownership and Equity Protection Act, the Consumer Leasing Act, the Fair Credit Billing Act, the Homeowners Protection Act, the Check Clearing for the 21st Century Act, laws governing flood insurance, laws governing consumer protections in connection with the sale of insurance, federal and state laws prohibiting unfair and deceptive business practices, and various regulations that implement some or all of the foregoing. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans, collecting loans, and providing other services. Failure to comply with these laws and regulations can subject the Bank to various penalties, including but not limited to, enforcement actions, injunctions, fines, civil liability, criminal penalties, punitive damages, and the loss of certain contractual rights.

Regulation of the Company

General. The Company, as the sole shareholder of the Bank, is a bank holding company and is registered as such with the Federal Reserve. Bank holding companies are subject to comprehensive regulation by the Federal Reserve under the Bank Holding Company Act of 1956, as amended ("BHCA"), and the regulations of the Federal Reserve. As a bank holding company, the Company is required to file with the Federal Reserve annual reports and such additional information as the Federal Reserve may require and will be subject to regular examinations by the Federal Reserve. The Federal Reserve also has extensive enforcement authority over bank holding companies, including, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to require that a holding company divest subsidiaries (including its bank subsidiaries). In general, enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices.

The Bank Holding Company Act. Under the BHCA, the Company is supervised by the Federal Reserve. The Federal Reserve has a policy that a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, the Federal Reserve provides that bank holding companies should serve as a source of strength to its subsidiary banks by

being prepared to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity, and should maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligation to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice or a violation of the Federal Reserve's regulations or both.

The Company is required to file quarterly and periodic reports with the Federal Reserve and provide additional information as the Federal Reserve may require. The Federal Reserve may examine the Company, and any of its subsidiaries, and charge the Company for the cost of the examination.

The Company and any subsidiaries that it may control are considered "affiliates" within the meaning of the Federal Reserve Act, and transactions between our bank subsidiary and affiliates are subject to numerous restrictions. With some exceptions, the Company and its subsidiaries, are prohibited from tying the provision of various services, such as extensions of credit, to other services offered by the Company, or its affiliates.

Acquisitions. The BHCA prohibits a bank holding company, with certain exceptions, from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank or bank holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. Under the BHCA, the Federal Reserve is authorized to approve the ownership of shares by a bank holding company in any company, the activities of which the Federal Reserve has determined to be so closely related to the business of banking or managing or controlling banks as to be a proper incident thereto. The list of activities determined by regulation to be closely related to banking within the meaning of the BHCA includes, among other things: operating a savings institution, mortgage company, finance company, credit card company or factoring company; performing certain data processing operations; providing certain investment and financial advice; underwriting and acting as an insurance agent for certain types of credit-related insurance; leasing property on a full-payout, non-operating basis; selling money orders, travelers' checks and U.S. Savings Bonds; real estate and personal property appraising; providing tax planning and preparation services; and, subject to certain limitations, providing securities brokerage services for customers.

Interstate Banking. The Federal Reserve may approve an application of a bank holding company to acquire control of, or acquire all or substantially all of the assets of, a bank located in a state other than such holding company's home state, without regard to whether the transaction is prohibited by the laws of any state except with respect to the acquisition of a bank that has not been in existence for the minimum time period, not exceeding five years, specified by the law of the host state. The Federal Reserve may not approve an application if the applicant controls or would control more than 10% of the insured deposits in the United States or 30% or more of the deposits in the target bank's home state or in any state in which the target bank maintains a branch. Federal law does not affect the authority of states to limit the percentage of total insured deposits in the state that may be held or controlled by a bank holding company to the extent such limitation

does not discriminate against out-of-state banks or bank holding companies. Individual states may also waive the 30% state-wide concentration limit contained in the federal law.

The federal banking agencies are authorized to approve interstate merger transactions without regard to whether such transaction is prohibited by the law of any state, unless the home state of one of the banks adopted a law prior to June 1, 1997 which applies equally to all out-of-state banks and expressly prohibits merger transactions involving out-of-state banks. Interstate acquisitions of branches will be permitted only if the law of the state in which the branch is located permits such acquisitions. Interstate mergers and branch acquisitions will also be subject to the nationwide and statewide insured deposit concentration amounts described above.

Dividends. The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve's view that a bank holding company should pay cash dividends only to the extent that the company's net income for the past year is sufficient to cover both the cash dividends and a rate of earning retention that is consistent with the company's capital needs, asset quality and overall financial condition, and that it is inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Under the terms of the Bank MOU, the Bank may not pay dividends to the Company without the prior consent of the FDIC and

the Division. In addition, the FRB has denied the Company's request to pay cash dividends on its common stock since May 2010. In addition, the FRB has denied the Company's requests to pay dividends on its Series A Preferred Stock issued under the CPP for the quarterly payments due for the last six quarters beginning with the payments due on May 15, 2010. The Company's ability to pay dividends with respect to common stock is subject to obtaining approval from the FRB and the Treasury and is further restricted until the dividend obligations under the Series A Preferred Stock are brought current.

Stock Repurchases. Bank holding companies, except for certain "well-capitalized" and highly rated bank holding companies, are required to give the Federal Reserve prior written notice of any purchase or redemption of its outstanding equity securities if the consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of their consolidated net worth. The Federal Reserve may disapprove a purchase or redemption if it determines that the proposal would constitute an unsafe or unsound practice or would violate any law, regulation, Federal Reserve order, or any condition imposed by, or written agreement with, the Federal Reserve.

Capital Requirements. The Federal Reserve has established capital adequacy guidelines for bank holding companies that generally parallel the capital requirements of the FDIC for the Bank. The Federal Reserve regulations provide that capital standards will be applied on a consolidated basis in the case of a bank holding company with $500 million or more in total consolidated assets.

The Company's total risk based capital must equal 8% of risk-weighted assets and one half of the 8%, or 4%, must consist of Tier 1 (core) capital and its Tier 1 (core) capital must equal 4% of total assets. As of September

30, 2011, the Company's total risk based capital was 16.5% of risk-weighted assets, its risk based capital of Tier 1 (core) capital was 15.2% of risk-weighted assets and its Tier 1 (core) capital was 11.1% of average assets.

Sarbanes-Oxley Act of 2002. As a public company, the Company is subject to the Sarbanes-Oxley Act of 2002, which implements a broad range of corporate governance and accounting measures for public companies designed to promote honesty and transparency in corporate America and better protect investors from corporate wrongdoing. The Sarbanes-Oxley Act of 2002 was signed into law on July 30, 2002 in response to public concerns regarding corporate accountability in connection with several accounting scandals. The stated goals of the Sarbanes-Oxley Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

The Sarbanes-Oxley Act includes very specific additional disclosure requirements and new corporate governance rules, requires the Securities and Exchange Commission and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of certain issues by the SEC and the Comptroller General.

Taxation

Federal Taxation

General. The Company and the Bank report their operations on a fiscal year basis using the accrual method of accounting and are subject to federal income taxation in the same manner as other corporations with some exceptions, including particularly the Bank's allowance for loan losses discussed below. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to the Bank or the Company.

Allowance for Loan Losses. Historically, savings institutions such as the Bank which met certain definitional tests primarily related to their assets and the nature of their business ("qualifying thrift") were permitted to establish an allowance for loan losses and to make annual additions thereto, which may have been deducted in arriving at their taxable income.

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Distributions. To the extent that the Bank makes "nondividend distributions" to the Company, such distributions will be considered to result in distributions from the balance of its allowance for loan losses as of December 31, 1987 (or a lesser amount if the Bank's loan portfolio decreased since December 31, 1987) and then from the supplemental allowance for loan losses ("Excess Distributions"), and an amount based on the Excess Distributions will be included in the Bank's taxable income. Nondividend distributions include distributions in excess of the Bank's current and accumulated earnings and profits, distributions in redemption of stock and distributions in partial or complete liquidation. However, dividends paid out of the Bank's current or accumulated earnings and profits, as calculated for federal income tax purposes, will not be considered to result in a distribution from the Bank's allowance for loan losses. The amount of additional taxable income created from an Excess Distribution is an amount that, when reduced by the tax attributable to the income, is equal to the

amount of the distribution. Thus, if the Bank makes a "nondividend distribution," then approximately one and one-half times the Excess Distribution would be includable in gross income for federal income tax purposes, assuming a 34% corporate income tax rate (exclusive of state and local taxes). See "- Regulation of the Bank - Dividends" for limits on the payment of dividends by the Bank. The Bank does not intend to pay dividends that would result in a recapture of any portion of its tax allowance for loan losses.

Corporate Alternative Minimum Tax. The Code imposes a tax on alternative minimum taxable income ("AMTI") at a rate of 20%. In addition, only 90% of AMTI can be offset by net operating loss carryovers. AMTI is increased by an amount equal to 75% of the amount by which the Bank's adjusted current earnings exceeds its AMTI (determined without regard to this preference and prior to reduction for net operating losses).

Dividends-Received Deduction. The Company may exclude from its income 100% of dividends received from the Bank as a member of the same affiliated group of corporations. The corporate dividends-received deduction is generally 70% in the case of dividends received from unaffiliated corporations with which the Company and the Bank will not file a consolidated tax return, except that if the Company or the Bank owns more than 20% of the stock of a corporation distributing a dividend, then 80% of any dividends received may be deducted.

Audits. The Company is no longer subject to United States federal tax examination by tax authorities for years ended on or before September 30, 2007.

Washington Taxation. The Bank is subject to a business and occupation tax imposed under Washington law at the rate of 1.50% of gross receipts. Interest received on loans secured by mortgages or deeds of trust on residential properties is exempt from such tax.

Competition

The Bank operates in an intensely competitive market for the attraction of deposits (generally its primary source of lendable funds) and in the origination of loans. Historically, its most direct competition for deposits has come from large commercial banks, thrift institutions and credit unions in its primary market area. In times of high interest rates, the Bank experiences additional significant competition for investors' funds from short-term money market securities and other corporate and government securities. The Bank's competition for loans comes principally from mortgage bankers, commercial banks and other thrift institutions. Such competition for deposits and the origination of loans may limit the Bank's future growth and earnings prospects.

Subsidiary Activities

The Bank has one wholly-owned subsidiary, Timberland Service Corporation ("Timberland Service"), whose primary function is to act as the Bank's escrow department and offer non-deposit investment services.

Personnel

As of September 30, 2011, the Bank had 247 full-time employees and 23 part-time and on-call employees. The employees are not represented by a collective bargaining unit and the Bank believes its relationship with its employees is good.

Executive Officers of the Registrant

The following table sets forth certain information with respect to the executive officers of the Company and the Bank.

Executive Officers of the Company and Bank

Name	Age at September 30, 2011	Position: Company	Position: Bank
Michael R. Sand	57	President and Chief Executive Officer	President and Chief Executive Officer
Dean J. Brydon	44	Executive Vice President, Chief Financial Officer and Secretary	Executive Vice President, Chief Financial Officer and Secretary
Robert A. Drugge	60	Executive Vice President	Executive Vice President and Business Banking Division Manager
John P. Norawong	46	Executive Vice President	Executive Vice President and Community Banking Division Manager
Michael J. Scott	65		Executive Vice President and Chief Credit Administrator
Marci A. Basich	42	Senior Vice President and Treasurer	Senior Vice President and Treasurer
Kathie M. Bailey	59	Senior Vice President	Senior Vice President and Chief Operations Officer
Jonathan A. Fischer	37	Senior Vice President and Chief Risk Officer	Senior Vice President and Chief Risk Officer

Biographical Information.

Michael R. Sand has been affiliated with the Bank since 1977 and has served as President of the Bank and the Company since January 23, 2003. On September 30, 2003, he was appointed as Chief Executive Officer of the Bank and Company. Prior to appointment as President and Chief Executive Officer, Mr. Sand had served as Executive Vice President and Secretary of the Bank since 1993 and as Executive Vice President and Secretary of the Company since its formation in 1997.

Dean J. Brydon has been affiliated with the Bank since 1994 and has

served as the Chief Financial Officer of the Company and the Bank since January 2000 and Secretary of the Company and Bank since January 2004. Mr. Brydon is a Certified Public Accountant.

Robert A. Drugge has been affiliated with the Bank since April 2006 and has served as Executive Vice President and Business Banking Manager since September 2006. Prior to joining Timberland, Mr. Drugge was employed at Bank of America as a senior officer and most recently served as Senior Vice President and Commercial Banking

Manager. Mr. Drugge began his banking career at Seafirst in 1974, which was acquired by Bank America Corp. and became known as Bank of America.

John P. Norawong has been affiliated with the Bank since July 2006 and has served as Executive Vice President and Community Banking Division Manager since September 2006. Prior to joining Timberland, Mr. Norawong served as Senior Vice President and Commercial Bank Manager at United Commercial Bank from February 2006 to July 2006, and as Vice President and Senior Vice President at Key Bank from 1999 through 2006.

Michael J. Scott has been affiliated with the Bank since January 2008 and has served as Chief Credit Administrator. Prior to joining Timberland, Mr. Scott was employed by Bank of America where he was a Senior Vice President and Senior Credit Products Officer in both Seattle and Tacoma, Washington. He began his banking career at Seafirst in 1973, which was acquired by Bank America Corp. and became known as Bank of America.

Marci A. Basich has been affiliated with the Bank since 1999 and has served as Treasurer of the Company and the Bank since January 2002. Ms. Basich is a Certified Public Accountant.

Kathie M. Bailey has been affiliated with the Bank since 1984 and has served as Senior Vice President and Chief Operations Officer since 2003.

Jonathan A. Fischer has been affiliated with the Bank since October 1997 and has served as the Chief Risk Officer since October 2010. Mr. Fischer has served as the Compliance Officer, Community Reinvestment Act Officer, and Privacy Officer since January 2000. Mr. Fischer has been the Bank's Bank Secrecy Act Officer since November 2007.

Item 1A. Risk Factors

We assume and manage a certain degree of risk in order to conduct our business strategy. In addition to the risk factors described below, other risks and uncertainties not specifically mentioned, or that are currently known to, or deemed to be immaterial by management, also may materially and adversely affect our financial position, results of operations and/or cash flows. Before making an investment decision, you should carefully consider

the risks described below together with all of the other information included in this Form 10-K. If any of the circumstances described in the following risk factors actually occur to a significant degree, the value of our common stock could decline, and you could lose all or part of your investment.

The Company and the Bank are required to comply with the terms of separate memoranda of understanding issued by their respective regulators and lack of compliance could result in additional regulatory actions.

In December 2009, the FDIC and the Division determined that the Bank required additional supervisory attention and on December 29, 2009 entered into the Bank MOU. Under the terms of the Bank MOU, the Bank, without the prior written approval, or nonobjection, of the FDIC and/or the DFI, may not:

* appoint any new director or senior executive officer or change the responsibilities of any current senior executive officers;
* pay cash dividends to its holding company, Timberland Bancorp, Inc.; or
* engage in any transactions that would materially change the balance sheet composition including growth in total assets of five percent or more or significant changes in funding sources, such as by increasing brokered deposits.

Other material provisions of the Bank MOU require the Bank to:

* maintain Tier 1 Capital of not less than 10.0% of the Bank's adjusted total assets pursuant to Part 325 of the FDIC Rules and Regulations, and maintain capital ratios above "well capitalized" thresholds as defined under Section 325.103 of the FDIC Rules and Regulations;
* maintain a fully funded allowance for loan and lease losses, the adequacy of which shall be deemed to be satisfactory to the FDIC and the DFI;
* formulate and implement a written profit plan acceptable to the FDIC and the DFI;
* eliminate from its books all assets classified "Loss" that have not been previously collected or charged-off;
* reduce the dollar volume by 50% of the assets classified "Substandard" and "Doubtful" at April 30, 2009;
* develop a written plan for reducing the aggregate amount of its acquisition, development and construction loans; and
* revise, adopt and fully implement a written liquidity and funds management policy.

In addition on February 1, 2010, the FRB determined that the Company required additional supervisory attention and entered into the Company MOU. Under the terms of the Company MOU, the Company, without prior written approval, or non-objection, of the FRB, may not:

* appoint any new director or senior executive officer or change the responsibilities of any current senior executive officers;
* receive dividends or any other form of payment or distribution representing a reduction in capital from the Bank;
* declare or pay any dividends, or make any other capital distributions;
* incur, renew, increase, or guarantee any debt;
* issue any trust preferred securities; or
* purchase or redeem any of its stock.

The Bank MOU and the Company MOU will remain in effect until stayed, modified, terminated or suspended by the FDIC and the Division or FRB, as the case may be. If either the Company or the Bank is found not in compliance

with their respective MOU, it could be subject to various remedies, including among others, the power to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation or practice, to direct an increase in capital, to restrict growth, to remove officers and/or directors, and to assess civil monetary penalties. Management of the Company and the Bank have been taking action and implementing programs to comply with the requirements of the Company MOU and the Bank MOU, respectively. Compliance will be determined by the FDIC, Division and FRB. Any of these regulators may determine in their sole discretion that the issues raised by the Company MOU or the Bank MOU have not been addressed satisfactorily, or that any current or past actions, violations or deficiencies could be the subject of further regulatory enforcement actions. Such enforcement actions could involve penalties or further limitations on the Company's business and negatively affect its ability to implement its business plan, pay dividends on its common stock or the value of its common stock, as well as its financial condition and result of operations.

As of September 30, 2011, the FRB has denied the Company's requests to pay dividends on its Series A Preferred Stock issued under the CPP for the quarterly payments due for the last six quarters beginning with the payments due on May 15, 2010. There can be no assurance that our regulators will approve such payments or dividends in the future. The Company may not declare or pay dividends on its common stock or, with certain exceptions, repurchase common stock without first having paid all cumulative preferred dividends that are due. If dividends on the Series A Preferred Stock are not paid for six quarters, whether or not consecutive, the Treasury has the right to appoint two members to the Board of Directors of the Company. See "- Risks specific to our participation in TARP."

Financial reform legislation enacted by Congress will, among other things, tighten capital standards, create a new Consumer Financial Protection Bureau and result in new laws and regulations that are expected to increase our costs of operations.

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). This new law will significantly change the current bank regulatory structure and affect the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years.

Among the many requirements in the Dodd-Frank Act for new banking regulations is a requirement for new capital regulations to be adopted within 18 months. These regulations must be at least as stringent as, and may call for higher levels of capital than, current regulations. In addition, the banking regulators are required to seek to make capital requirements for banks and bank holding companies, countercyclical so that capital requirements increase in times of economic expansion and decrease in times of economic contraction.

Certain provisions of the Dodd-Frank Act are expected to have a near term impact on the Company. For example, effective one year after the date of enactment, the Dodd-Frank Act eliminated the federal prohibitions on paying

interest on demand deposits, thus allowing businesses to have interest bearing checking accounts. Depending on competitive responses, this significant change to existing law could have an adverse impact on the Company's interest expense and deposit balances.

The Dodd-Frank Act also broadens the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor and non-interest-bearing transaction accounts and IOLTA accounts have unlimited deposit insurance through December 31, 2012.

The Dodd-Frank Act requires publicly traded companies to give stockholders a non-binding vote on executive compensation and so-called "golden parachute" payments and authorizes the Securities and Exchange Commission to promulgate rules that would allow stockholders to nominate their own candidates using a company's proxy materials.

The legislation also directs the federal banking regulators to issue rules prohibiting incentive compensation that encourages inappropriate risks. The legislation also directs the Federal Reserve Board to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded or not.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Financial institutions with $10 billion or less in assets, such as Timberland Bank, will continue to be examined for compliance with the consumer laws by their primary bank regulators.

Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Bank. However, it is expected that at a minimum compliance with this law and implementing regulations will increase our operating and compliance costs and could increase our interest expense. Any additional changes in our regulation and oversight, whether in the form of new laws, rules and regulations could make compliance more difficult or expensive or otherwise materially adversely affect our business, financial condition or prospects.

The current weak economic conditions in the market areas we serve may continue to adversely impact our earnings and could increase the credit risk associated with our loan portfolio.

Substantially all of our loans are to businesses and individuals in the state of Washington. A continuing decline in the economies of our local market areas of Grays Harbor, Pierce, Thurston, King, Kitsap and Lewis counties in which we operate, and which we consider to be our primary market areas, could have a material adverse effect on our business, financial condition, results of operations and prospects. In particular, Washington has experienced

substantial home price declines and increased foreclosures and has experienced above average unemployment rates.

A further deterioration in economic conditions in the market areas we serve could result in the following consequences, any of which could have a materially adverse impact on our business, financial condition and results of operations:

* loan delinquencies, problem assets and foreclosures may increase;
* demand for our products and services may decline possibly resulting in a decrease in our total loans or assets;
* collateral for loans made may decline further in value, in turn reducing customers' borrowing power, reducing the value of assets and collateral associated with existing loans;
* the amount of our low-cost or non-interest bearing deposits may decrease; and
* the price of our common stock may decrease.

Our real estate construction and land development loans expose us to significant risks.

We make real estate construction loans to individuals and builders, primarily for the construction of residential properties. We originate these loans whether or not the collateral property underlying the loan is under contract for sale. At September 30, 2011, construction and land development loans totaled $52.5 million, or 9.4% of our total loan portfolio, of which $37.4 million were for residential real estate projects. Approximately $26.2 million of our residential construction loans were made to finance the construction of owner-occupied homes and are structured to be converted to permanent loans at the end of the construction phase. Land development loans, which are loans made with land as security, totaled $2.2 million, or 0.4% of our total loan portfolio at September 30, 2011. In general, construction and land development lending involves additional risks because of the inherent difficulty in estimating a property's value both before and at completion of the project as well as the estimated cost of the project. Construction costs may exceed original estimates as a result of increased materials, labor or other costs. In addition, because of current uncertainties

in the residential real estate market, property values have become more difficult to determine than they have historically been. Construction loans and land development loans often involve the disbursement of funds with repayment dependent, in part, on the success of the project and the ability of the borrower to sell or lease the property or refinance the indebtedness, rather than the ability of the borrower or guarantor to repay principal and interest. These loans are also generally more difficult to monitor. In addition, speculative construction loans to builders are often associated with homes that are not pre-sold, and thus pose a greater potential risk than construction loans to individuals on their personal residences. At September 30, 2011, $1.9 million of our construction portfolio was comprised of speculative one- to four- family construction loans. Approximately $3.5 million, or 6.7%, of our total real estate construction and land development loans were non-performing at September 30, 2011. A material increase in our non-performing construction and loan development loans could have a material adverse effect on our financial condition and results of operation.

Our emphasis on commercial real estate lending may expose us to increased

lending risks.

Our current business strategy includes the expansion of commercial real estate lending. This type of lending activity, while potentially more profitable than single-family residential lending, is generally more sensitive to regional and local economic conditions, making loss levels more difficult to predict. Collateral evaluation and financial statement analysis in these types of loans requires a more detailed analysis at the time of loan underwriting and on an ongoing basis. In our primary market of southwest Washington, a further downturn in the real estate market, could increase loan delinquencies, defaults and foreclosures, and significantly impair the value of our collateral and our ability to sell the collateral upon foreclosure. Many of our commercial borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss.

At September 30, 2011, we had $246.0 million of commercial real estate mortgage loans, representing 43.9% of our total loan portfolio. These loans typically involve higher principal amounts than other types of loans, and repayment is dependent upon income generated, or expected to be generated, by the property securing the loan in amounts sufficient to cover operating expenses and debt service, which may be adversely affected by changes in the economy or local market conditions. For example, if the cash flow from the borrower's project is reduced as a result of leases not being obtained or renewed, the borrower's ability to repay the loan may be impaired. Commercial real estate loans also expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans typically cannot be sold as easily as residential real estate. In addition, many of our commercial real estate loans are not fully amortizing and contain large balloon payments upon maturity. Such balloon payments may require the borrower to either sell or refinance the underlying property in order to make the payment, which may increase the risk of default or non-payment.

A secondary market for most types of commercial real estate loans is not readily liquid, so we have less opportunity to mitigate credit risk by selling part or all of our interest in these loans. As a result of these characteristics, if we foreclose on a commercial real estate loan, our holding period for the collateral typically is longer than for one- to four-family residential mortgage loans because there are fewer potential purchasers of the collateral. Accordingly, charge-offs on commercial real estate loans may be larger as a percentage of the total principal outstanding than those incurred with our residential or consumer loan portfolios.

The level of our commercial real estate loan portfolio may subject us to additional regulatory scrutiny.

The FDIC, the Federal Reserve and the Office of the Comptroller of the Currency have promulgated joint guidance on sound risk management practices for financial institutions with concentrations in commercial real estate lending. Under this guidance, a financial institution that, like us, is actively involved in commercial real estate lending should perform a risk assessment to identify concentrations. A financial institution may have a concentration in commercial real estate lending if, among other factors (i) total reported loans for construction, land development, and other land represent 100% or more of total capital, or (ii) total reported loans secured by multifamily and non-farm residential properties, loans for construction, land development and other land, and loans otherwise sensitive to the general commercial real estate market, including loans to commercial real estate related entities, represent 300% or more of total capital. The particular focus of the guidance is on exposure to commercial real estate loans that are dependent

on the cash flow from the real estate held as collateral and that are likely to be at greater risk to conditions in the commercial real estate market (as opposed to real estate collateral held as a secondary source of repayment or as an abundance of caution). The purpose of the guidance is to guide banks in developing risk management practices and capital levels commensurate with the level and nature of real estate concentrations. The guidance states that management should employ heightened risk management practices including board and management oversight and strategic planning, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing. We have concluded that we have a concentration in commercial real estate lending under the foregoing standards because our balance in commercial real estate loans at September 30, 2011 represents more than 300% of total capital. While we believe we have implemented policies and procedures with respect to our commercial real estate loan portfolio consistent with this guidance, bank regulators could require us to implement additional policies and procedures consistent with their interpretation of the guidance that may result in additional costs to us.

Repayment of our commercial loans is often dependent on the cash flows of the borrower, which may be unpredictable, and the collateral securing these loans may fluctuate in value.

At September 30, 2011, we had $22.5 million or 4.0% of total loans in commercial loans. Commercial lending involves risks that are different from those associated with residential and commercial real estate lending. Real estate lending is generally considered to be collateral based lending with loan amounts based on predetermined loan to collateral values and liquidation of the underlying real estate collateral being viewed as the primary source of repayment in the event of borrower default. Our commercial loans are primarily made based on the cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The borrowers' cash flow may be unpredictable, and collateral securing these loans may fluctuate in value. Although commercial loans are often collateralized by equipment, inventory, accounts receivable, or other business assets, the liquidation of collateral in the event of default is often an insufficient source of repayment because accounts receivable may be uncollectible and inventories may be obsolete or of limited use, among other things. Accordingly, the repayment of commercial loans depends primarily on the cash flow and credit worthiness of the borrower and secondarily on the underlying collateral provided by the borrower.

Our business may be adversely affected by credit risk associated with residential property.

At September 30, 2011, $150.7 million, or 26.9% of our total loan portfolio, was secured by one- to four-family mortgage loans and home equity loans. This type of lending is generally sensitive to regional and local economic conditions that significantly impact the ability of borrowers to meet their loan payment obligations, making loss levels difficult to predict. The decline in residential real estate values as a result of the downturn in the Washington housing market has reduced the value of the real estate collateral securing these types of loans and increased the risk that we would incur losses if borrowers default on their loans. Continued declines in both the volume of real estate sales and the sales prices coupled with the current recession and the associated increases in unemployment may result in higher than expected loan delinquencies or problem assets, a decline in demand for our products and services, or lack of growth or a decrease in deposits. These

potential negative events may cause us to incur losses, adversely affect our capital and liquidity, and damage our financial condition and business operations. These declines may have a greater effect on our earnings and capital than on the earnings and capital of financial institutions whose loan portfolios are more diversified.

High loan-to-value ratios on a portion of our residential mortgage loan portfolio exposes us to greater risk of loss.

Many of our residential mortgage loans are secured by liens on mortgage properties in which the borrowers have reduced equity or no equity because either we originated upon purchase a first mortgage with an 80% loan-to-value ratio, have originated a home equity loan with a combined loan-to-value ratio of up to 90%, or because of the decline in home values in our market areas. Residential loans with high loan-to-value ratios will be more sensitive to declining property values than those with lower combined loan-to-value ratios and, therefore, may experience a higher incidence of default and severity of losses. In addition, if the borrowers sell their homes, such borrowers may be unable to repay their loans in full from the sale. As a result, these loans may experience higher rates of delinquencies, defaults and losses.

Our provision for loan losses has increased substantially during recent years and we may be required to make further increases in our provision for loan losses and to charge-off additional loans in the future, which could adversely affect our results of operations.

For the fiscal years ended September 30, 2011 and 2010 we recorded a provision for loan losses of $6.8 million and $10.6 million, respectively. We also recorded net loan charge-offs of $6.1 million and $13.5 million for the fiscal years ended September 30, 2011 and 2010, respectively. During these last two fiscal years, we experienced higher loan delinquencies and credit losses. Our non-performing loans and assets have historically reflected unique operating difficulties for individual borrowers rather than weakness in the overall economy of the Pacific Northwest; however, more recently the deterioration in the general economy has become a significant contributing factor to the increased levels of delinquencies and non-performing loans. Slower sales and excess inventory in the housing market have been the primary causes of the increase in delinquencies and foreclosures for construction and land development loans and land loans, which represent 35.1% of our non-performing assets at September 30, 2011. Further, our portfolio is concentrated in construction and land development loans, land loans and commercial and commercial real estate loans, all of which have a higher risk of loss than residential mortgage loans.

If current trends in the housing and real estate markets continue, and until general economic conditions improve, we expect that we will continue to experience significantly higher than normal delinquencies and credit losses. As a result, we could be required to make further increases in our provision for loan losses and to charge off additional loans in the future, which could have a material adverse effect on our financial condition and results of operations.

We may have losses in the future

We reported net losses of $(2.3 million) and $(242,000) for the fiscal years ended September 30, 2010 and 2009, respectively. These losses primarily

resulted from our high level of non-performing assets and the resultant increased provisions for loan losses and OREO related expenses and write-downs. We reported net income of $1.1 million for the fiscal year ended September 30, 2011, however, we may suffer losses in the future which could materially adversely affect our financial condition and require us to raise additional capital.

Our allowance for loan losses may prove to be insufficient to absorb losses in our loan portfolio.

Lending money is a substantial part of our business and each loan carries a certain risk that it will not be repaid in accordance with its terms or that any underlying collateral will not be sufficient to assure repayment. This risk is affected by, among other things:

* the cash flow of the borrower and/or the project being financed;
* changes and uncertainties as to the future value of the collateral, in the case of a collateralized loan;
* the duration of the loan;
* the credit history of a particular borrower; and
* changes in economic and industry conditions.

We maintain an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense, which we believe is appropriate to provide for probable losses in our loan portfolio. The amount of this allowance is determined by our management through periodic reviews and consideration of several factors, including, but not limited to:

* an ongoing review of the quality, size and diversity of the loan portfolio;
* evaluation of non-performing loans;
* historical default and loss experience;
* existing economic conditions;
* risk characteristics of the various classifications of loans; and

the amount and quality of collateral, including guarantees; securing the loans.

The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review our loans and the loss and delinquency experience, and evaluate economic conditions and make significant estimates of current credit risks and future trends, all of which may undergo material changes. If our estimates are incorrect, the allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in the need for additions to our allowance through an increase in the provision for loan losses. Continuing deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for loan losses. Our allowance for loan losses was $11.9 million or 2.21% of gross loans and 51.2% of non-performing loans at September 30, 2011. In addition, bank regulatory agencies periodically review our

allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. If charge-offs in future periods exceed the allowance for loan losses, we may need additional provisions to increase the allowance for loan losses. Any increases in the provision for loan losses will result in a decrease in net income and may have a material adverse effect on our financial condition, results of operations and our capital.

If our non-performing assets increase, our earnings will be adversely affected.

At September 30, 2011 our non-performing assets (which consist of non-accruing loans, accruing loans 90 days or more past due, non-accrual investment securities, and other real estate owned and other repossessed assets) were $37.0 million, or 5.01% of total assets. Our non-performing assets adversely affect our net income in various ways:

* We do not record interest income on non-accrual loans, non-performing investment securities, or other real estate owned.
* We must provide for probable loan losses through a current period charge to the provision for loan losses.
* Non-interest expense increases when we must write down the value of properties in our other real estate owned portfolio to reflect changing market values or recognize other-than-temporary impairment on non-performing investment securities.
* There are legal fees associated with the resolution of problem assets, as well as carrying costs, such as taxes, insurance, and maintenance fees related to our other real estate owned.
* The resolution of non-performing assets requires the active involvement of management, which can distract them from more profitable activity.

If additional borrowers become delinquent and do not pay their loans and we are unable to successfully manage our non-performing assets, our losses and troubled assets could increase significantly, which could have a material adverse effect on our financial condition and results of operations.

The Company has classified an additional $18.2 million in loans as performing troubled debt restructurings at September 30, 2011.

If our investments in real estate are not properly valued or sufficiently reserved to cover actual losses, or if we are required to increase our valuation allowances, our earnings could be reduced.

We obtain updated valuations in the form of appraisals and broker price opinions when a loan has been foreclosed and the property is taken in as OREO, and at certain other times during the assets holding period. Our net book value ("NBV") in the loan at the time of foreclosure and thereafter is compared to the updated estimated market value of the foreclosed property less estimated selling costs (fair value). A charge-off is recorded for any excess in the asset's NBV over its fair value. If our valuation process is incorrect or if the property declines in value after foreclosure, the fair value of our OREO may not be sufficient to recover our NBV in such assets, resulting in the need for a valuation allowance. Additional material valuation allowances on our OREO could have a material adverse effect on our financial condition and results of operations.

In addition, bank regulators periodically review our OREO and may require us to recognize further valuation allowances. Any increase in our valuation allowances, as required by such regulators, may have a material adverse effect on our financial condition and results of operations.

Other-than-temporary impairment charges in our investment securities portfolio could result in additional losses.

During the year ended September 30, 2011, we recognized a $447,000 other than temporary impairment ("OTTI") charge on private label mortgage backed securities we hold for investment. Management concluded that the decline of the estimated fair value below the cost of these securities was other than temporary and recorded a credit loss through non-interest income. At September 30, 2011 our remaining private label mortgage backed securities portfolio totaled $3.4 million.

We closely monitor our investment securities for changes in credit risk. The valuation of our investment securities also is influenced by external market and other factors, including implementation of Securities and Exchange Commission and Financial Accounting Standards Board guidance on fair value accounting, default rates on residential mortgage securities, rating agency actions, and the prices at which observable market transactions occur. The current market environment significantly limits our ability to mitigate our exposure to valuation changes in our investment securities by selling them. Accordingly, if market conditions deteriorate further and we determine our holdings of private label mortgage backed securities or other investment securities are other than temporarily impaired, our results of operations could be adversely affected.

An increase in interest rates, change in the programs offered by Freddie Mac or our ability to qualify for their programs may reduce our mortgage revenues, which would negatively impact our non-interest income.

The sale of residential mortgage loans to Freddie Mac provides a significant portion of our non-interest income. Any future changes in their program, our eligibility to participate in such program, the criteria for loans to be accepted or laws that significantly affect the activity of Freddie Mac could, in turn, materially adversely affect our results of operations if we could not find other purchasers. Further, in a rising or higher interest rate environment, our originations of mortgage loans may decrease, resulting in fewer loans that are available to be sold. This would result in a decrease in mortgage revenues and a corresponding decrease in non-interest income. In addition, our results of operations are affected by the amount of non-interest expense associated with our loan sale activities, such as salaries and employee benefits, occupancy, equipment and data processing expense and other operating costs. During periods of reduced loan demand, our results of operations may be adversely affected to the extent that we are unable to reduce expenses commensurate with the decline in loan originations.

Our real estate lending also exposes us to the risk of environmental liabilities.

In the course of our business, we may foreclose and take title to real estate, and we could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third persons for property damage, personal injury, investigation, and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, we may be

subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we ever become subject to significant environmental liabilities, our business, financial condition and results of operations could be materially and adversely affected.

Fluctuating interest rates can adversely affect our profitability.

Our profitability is dependent to a large extent upon net interest income, which is the difference, or spread, between the interest earned on loans, securities and other interest-earning assets and the interest paid on deposits, borrowings, and other interest-bearing liabilities. Because of the differences in maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes

in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. We principally manage interest rate risk by managing our volume and mix of our earning assets and funding liabilities. In a changing interest rate environment, we may not be able to manage this risk effectively. Changes in interest rates also can affect: (1) our ability to originate and/or sell loans; (2) the value of our interest-earning assets, which would negatively impact shareholders' equity, and our ability to realize gains from the sale of such assets; (3) our ability to obtain and retain deposits in competition with other available investment alternatives; and (4) the ability of our borrowers to repay adjustable or variable rate loans. Interest rates are highly sensitive to many factors, including government monetary policies, domestic and international economic and political conditions and other factors beyond our control. If we are unable to manage interest rate risk effectively, our business, financial condition and results of operations could be materially harmed.

In addition, a substantial majority of our real estate secured loans held are adjustable-rate loans. Any rise in prevailing market interest rates may result in increased payments for borrowers who have adjustable rate mortgage loans, increasing the possibility of defaults that may adversely affect our profitability.

Increases in deposit insurance premiums and special FDIC assessments will hurt our earnings.

The Dodd-Frank Act established 1.35% as the minimum reserve ratio. The FDIC has adopted a plan under which it will meet this ratio by the statutory deadline of September 30, 2020. The Dodd-Frank Act requires the FDIC to offset the effect on institutions with assets less than $10 billion of the increase in the minimum reserve ratio to 1.35% from the former minimum of 1.15%. The FDIC has not announced how it will implement this offset. In addition to the statutory minimum ratio, the FDIC must set a designated reserve ratio, or DRR, which may exceed the statutory minimum. The FDIC has set 2.0% as the DRR.

As required by the Dodd-Frank Act, the FDIC has adopted final regulations under which insurance premiums are based on an institution's total assets minus its tangible equity instead of its deposits. While our FDIC insurance premiums initially will be reduced by these regulations, it is possible that our future insurance premiums will increase under the final regulations.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition, growth and prospects.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on our liquidity. We rely on customer deposits and advances from the FHLB of Seattle, borrowings from the Federal Reserve Bank of San Francisco and other borrowings to fund our operations. Although we have historically been able to replace maturing deposits and advances if desired, we may not be able to replace such funds in the future if, among other things, our financial condition, the financial condition of the FHLB or FRB, or market conditions change. Our access to funding sources in amounts adequate to finance our activities or on terms which are acceptable could be impaired by factors that affect us specifically or the financial services industry or economy in general such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry in light of the recent turmoil faced by banking organizations and the continued deterioration in credit markets. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity as a result of a downturn in the Washington markets where our deposits are concentrated or adverse regulatory action against us.

Our financial flexibility will be severely constrained if we are unable to maintain our access to funding or if adequate financing is not available to accommodate future growth at acceptable interest rates. Although we consider our sources of funds adequate for our liquidity needs, we may seek additional debt in the future to achieve our long-term business objectives. Additional borrowings, if sought, may not be available to us or, if available, may not be available on reasonable terms. If additional financing sources are unavailable, or are not available on reasonable terms, our financial condition, results of operations, growth and future prospects could be materially adversely affected. Finally, if we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs.

Our growth or future losses may require us to raise additional capital in the future, but that capital may not be available when it is needed or the cost of that capital may be very high.

We are required by federal regulatory authorities to maintain adequate levels of capital to support our operations. At some point, we may need to raise additional capital to support continued growth. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial condition and performance. If we are able to raise capital it may not be on terms that are acceptable to us. Accordingly, we cannot make assurances that we will be able to raise additional capital. If we cannot raise additional capital when needed, our operations could be materially impaired and our financial condition and liquidity could be materially and adversely affected. As a result, we may have to raise additional capital on terms that may be dilutive to our shareholders. In addition, if we are unable to raise additional capital when required by the FDIC, we may be subject to adverse regulatory action. See "- The Company and the Bank are required to comply with the terms of separate memoranda of understanding issued by their respective regulators and lack of compliance could result in additional regulatory actions."

We may experience future goodwill impairment, which could reduce our earnings.

We performed our test for goodwill impairment for fiscal year 2011, but no impairment was identified. Our assessment of the fair value of goodwill is based on an evaluation of current purchase transactions, discounted cash flows from forecasted earnings, our current market capitalization, and a valuation of our assets and liabilities. Our evaluation of the fair value of goodwill involves a substantial amount of judgment. If our judgment was incorrect, or if events or circumstances change, and an impairment of goodwill was deemed to exist, we would be required to write down our goodwill resulting in a charge to earnings, which would adversely affect our results of operations, perhaps materially; however, it would have no impact on our liquidity, operations or regulatory capital.

Our investment in Federal Home Loan Bank of Seattle stock may become impaired.

At September 30, 2011, we owned $5.7 million in FHLB stock. As a condition of membership at the FHLB, we are required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB and is calculated in accordance with the Capital Plan of the FHLB. Our FHLB stock has a par value of $100, is carried at cost, and it is subject to recoverability testing per accounting guidance for the impairment of long lived assets. The FHLB has announced that it had a risk-based capital deficiency under the regulations of the Federal Housing Finance Agency (the "FHFA"), its primary regulator, as of December 31, 2008, and that it would suspend future dividends and the repurchase and redemption of outstanding common stock. As a result, the FHLB has not paid a dividend since the fourth quarter of 2008. The FHLB has communicated that it believes the calculation of risk-based capital under the current rules of the FHFA significantly overstates the market risk of the FHLB's private-label mortgage-backed securities in the current market environment and that it has enough capital to cover the risks reflected in its balance sheet. As a result, we have not recorded an other-than-temporary impairment on our investment in FHLB stock. However, continued deterioration in the FHLB's financial position may result in impairment in the value of those securities. On October 26, 2010, the FHLB announced that it had entered into a Consent Agreement with the FHFA, which requires the FHLB to take certain specified actions related to its business and operations. We will continue to monitor the financial condition of the FHLB as it relates to, among other things, the recoverability of our investment.

We may experience further decreases in the fair value of our mortgage servicing rights, which could reduce our earnings.

Mortgage servicing rights ("MSRs") are capitalized at estimated fair value when acquired through the origination of loans that are subsequently sold with servicing rights retained. MSRs are amortized to servicing income on loans sold over the period of estimated net servicing income. The estimated fair value of MSRs at the date of the sale of loans is determined based on the discounted present value of expected future cash flows using key assumptions for servicing income and costs and prepayment rates on the underlying loans. On a quarterly basis we periodically evaluate the fair value

of MSRs for impairment by comparing actual cash flows and estimated cash flows

from the servicing assets to those estimated at the time servicing assets were originated. Our methodology for estimated the fair value of MSRs is highly sensitive to changes in assumptions, such as prepayment speeds. The effect of changes in market interest rates on estimated rates of loan prepayments represents the predominant risk characteristic underlying the MSRs portfolio. For example, a decrease in mortgage interest rates typically increases the prepayment speeds of MSRs and therefore decreases the fair value of the MSRs. We recorded a $405,000 valuation recovery to our MSRs during the year ended September 30, 2011, which increased our earnings. Future decreases in mortgage interest rates could decrease the fair value of our MSRs, which would decrease our earnings.

Our assets as of September 30, 2011 include a deferred tax asset and we may not be able to realize the full amount of such asset.

We recognize deferred tax assets and liabilities based on differences between the financial statement recorded amounts and the tax bases of assets and liabilities. At September 30, 2011, the net deferred tax asset was approximately $3.8 million, an increase from a balance of approximately $3.4 million at September 30, 2010. The net deferred tax asset results primarily from our provisions for loan losses recorded for financial reporting purposes, which have been larger than net loan charge-offs deducted for tax reporting purposes.

We regularly review our net deferred tax assets for recoverability based on history of earnings expectations for future earnings and expected timing of reversals of temporary differences and record a valuation allowance if deemed necessary. Realization of deferred tax assets ultimately depends on the existence of sufficient taxable income, including taxable income in prior carryback years, as well as future taxable income. We believe the recorded net deferred tax asset at September 30, 2011 is fully realizable; however, if we determine that we will be unable to realize all or part of the net deferred tax asset, we would adjust this net deferred tax asset, which would negatively impact our financial condition and results of operations.

New or changing tax, accounting, and regulatory rules and interpretations could significantly impact strategic initiatives, results of operations, cash flows, and financial condition.

The financial services industry is extensively regulated. Federal and state banking regulations are designed primarily to protect the deposit insurance funds and consumers, not to benefit a company's stockholders. These regulations may sometimes impose significant limitations on operations. The significant federal and state banking regulations that affect us are described in this report under the heading "Item 1. Business - Regulation of the Bank" and "- Regulation of the Company." These regulations, along with the currently existing tax, accounting, securities, insurance, and monetary laws, regulations, rules, standards, policies, and interpretations control the methods by which financial institutions conduct business, implement strategic initiatives and tax compliance, and govern financial reporting and disclosures. These laws, regulations, rules, standards, policies, and interpretations are constantly evolving and may change significantly over time.

Risks specific to our participation in TARP.

Because of our participation in the TARP CPP we are subject to restrictions on compensation paid to our executives. Pursuant to the terms of the TARP CPP we adopted certain standards for executive compensation and corporate governance for the period during which the Treasury holds an investment in us. These standards generally apply to our Chief Executive Officer, Chief Financial Officer and the three next most highly compensated

senior executive officers. The standards include (1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (2) required clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (3) prohibition on making golden parachute payments to senior executives; and (4) agreement not to deduct for tax purposes executive compensation in excess of $500,000 for each senior executive. Pursuant to the American Recovery and Reinvestment Act and its implementing regulations, further compensation restrictions have been imposed on us with respect to our senior executive officers and other most highly compensated employees, including significant limitations on our ability to pay incentive compensation and make

severance payments. Such restrictions and any future limitations on compensation that may be adopted could adversely affect our ability to hire and retain the most qualified management and other personnel.

The securities purchase agreement between us and Treasury limits our ability to pay dividends on and repurchase our common stock. The securities purchase agreement between us and Treasury provides that prior to the earlier of (i) December 23, 2011 and (ii) the date on which all of the shares of the Series A Preferred Stock have been redeemed by us or transferred by Treasury to third parties, we may not, without the consent of Treasury, (a) increase the cash dividend on our common stock or (b) subject to limited exceptions, redeem, repurchase or otherwise acquire shares of our common stock or preferred stock other than the Series A Preferred Stock or any trust preferred securities. In addition, we are unable to pay any dividends on our common stock unless we are current in our dividend payments on the Series A Preferred Stock which as of September 30, 2011 we were not. See "- Regulatory and contractual restrictions may limit or prevent us from paying dividends on our common stock." As of September 30, 2011, the FRB has denied the Company's requests to pay dividends on its Series A Preferred Stock issued under the CPP for the quarterly payments due for the last six quarters beginning with the payments due on May 15, 2010. In addition, because dividends on the Series A Preferred Stock have not been paid for six quarters, the Treasury has the right to appoint two members to the Board of Directors of the Company. The foregoing, together with the potentially dilutive impact of the warrant described in the next risk factor, could have a negative effect on the value of our common stock.

The Series A Preferred Stock impacts net income (loss) to our common shareholders and net income (loss) per common share and the warrant we issued to Treasury may be dilutive to holders of our common stock. The dividends declared or accrued on the Series A Preferred Stock reduce the net income (increase the net loss) to common shareholders and our net income (loss) per common share. The Series A Preferred Stock will also receive preferential treatment in the event of liquidation, dissolution or winding up of the Company. Additionally, the ownership interest of the existing holders of our common stock will be diluted to the extent the warrant we issued to Treasury in conjunction with the sale of the Series A Preferred Stock is exercised. The shares of common stock underlying the warrant represent approximately 5.0% of the shares of our common stock outstanding as of September 30, 2011 (including the shares issuable upon exercise of the warrant in total shares outstanding). Although Treasury has agreed not to vote any of the shares of common stock it receives upon exercise of the warrant, a transferee of any

portion of the warrant or of any shares of common stock acquired upon exercise of the warrant is not bound by this restriction.

If we are unable to redeem our Series A Preferred Stock by December 2013, the cost of this capital to us will increase substantially.

The Company MOU prohibits us from redeeming our outstanding capital stock without the prior written approval of the Federal Reserve Bank of San Francisco. If we are unable to redeem our Series A Preferred Stock prior to December 23, 2013, the cost of this capital to us will increase substantially on that date, from 5.0% per annum (approximately $830,000 annually) to 9.0% per annum (approximately $1.5 million annually). Depending on our financial condition at the time, this increase in the annual dividend rate on the Series A Preferred Stock could have a material negative effect on our liquidity and ability to pay dividends to common shareholders.

Regulatory and contractual restrictions may limit or prevent us from paying dividends on our common stock.

Holders of our common stock are only entitled to receive such dividends as our Board may declare out of funds legally available for such payments. Further, holders of our common stock are subject to the prior dividend rights of any holders of our preferred stock at any time outstanding or depositary shares representing such preferred stock then outstanding. Although we have historically declared cash dividends on our common stock, we are not required to do so. We suspended our cash dividend during the quarter ended June 30, 2010 and we do not know if we will resume the payment of dividends in the future. As discussed above, the Company is not current on its dividend payments on its Series A preferred stock and may not pay dividends to common stockholders under the securities purchase agreement with the Treasury. In addition, under the terms of the Company MOU the payment of dividends by the Company to its shareholders is subject to the prior written non-objection of the FRB. As an entity separate and distinct from the Bank, the Company derives substantially all of its revenue in the form of dividends from the Bank. Accordingly, the Company is and will be dependent upon dividends from the Bank to satisfy its cash needs and to pay dividends on its common

stock. The inability to receive dividends from the Bank could have a material adverse effect on the Company's business, financial condition and results of operations. The Bank's ability to pay dividends is subject to its ability to earn net income and, to meet certain regulatory requirements. The Bank does not currently meet these regulatory requirements. As discussed above, under the Bank MOU, the Bank may not pay dividends to the Company without prior approval from the FDIC and DFI, which also limits the Company's ability to pay dividends on its common stock. The lack of a cash dividend could adversely affect the market price of our common stock.

We rely heavily on the proper functioning of our technology.

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches

will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

We rely on third-party service providers for much of our communications, information, operating and financial control systems technology. If any of our third-party service providers experience financial, operational or technological difficulties, or if there is any other disruption in our relationships with them, we may be required to locate alternative sources of such services, and we cannot assure that we could negotiate terms that are as favorable to us, or could obtain services with similar functionality, as found in our existing systems, without the need to expend substantial resources, if at all. Any of these circumstances could have an adverse effect on our business.

Changes in accounting standards may affect our performance.

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. From time to time there are changes in the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be difficult to predict and can materially impact how we report and record our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in a retrospective adjustment to prior financial statements.

We are dependent on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects.

Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of, and experience in, the community banking industry where the Bank conducts its business. The process of recruiting personnel with the combination of skills and attributes required to carry out our strategies is often lengthy. Our success depends to a significant degree upon our ability to attract and retain qualified management, loan origination, finance, administrative, marketing and technical personnel and upon the continued contributions of our management and personnel. In particular, our success has been and continues to be highly dependent upon the abilities of key executives, including our President, and certain other employees. In addition, our success has been and continues to be highly dependent upon the services of our directors, and we may not be able to identify and attract suitable candidates to replace such directors.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

At September 30, 2011 the Bank operated 22 full service facilities. The following table sets forth certain information regarding the Bank's offices, all of which are owned, except for the Tacoma office, the Gig Harbor office and the Lacey office at 1751 Circle Lane SE, which are leased.

Location	Year Opened	Approximate Square Footage	Deposits at September 30, 2011
			(In thousands)
Main Office:			
624 Simpson Avenue Hoquiam, Washington 98550	1966	7,700	$68,544
Branch Offices:			
300 N. Boone Street Aberdeen, Washington 98520	1974	3,400	32,973
201 Main Street South Montesano, Washington 98563	2004	3,200	32,894
361 Damon Road Ocean Shores, Washington 98569	1977	2,100	22,081
2418 Meridian Avenue East Edgewood, Washington 98371	1980	2,400	38,329
202 Auburn Way South Auburn, Washington 98002	1994	4,200	27,730
12814 Meridian Avenue East (South Hill) Puyallup, Washington 98373	1996	4,200	32,949
1201 Marvin Road, N.E. Lacey, Washington 98516	1997	4,400	20,724
101 Yelm Avenue W. Yelm, Washington 98597	1999	3,400	18,543
20464 Viking Way NW Poulsbo, Washington 98370	1999	1,800	15,686
2419 224th Street E. Spanaway, Washington 98387	1999	3,900	27,511
801 Trosper Road SW Tumwater, Washington 98512	2001	3,300	28,588
7805 South Hosmer Street Tacoma, Washington 98408	2001	5,000	26,795

(Table continued on following page)

Approximate Deposits at

Location	Year Opened	Square Footage	September 30, 2011
			(In thousands)
2401 Bucklin Hill Road Silverdale, Washington 98383	2003	4,000	$47,206
423 Washington Street SE Olympia, Washington 98501	2003	3,000	17,286
3105 Judson Street Gig Harbor, Washington 98335	2004	2,700	24,343
117 N. Broadway Aberdeen, Washington 98520	2004	3,700	21,112
313 West Waldrip Street Elma, Washington 98541	2004	5,900	21,474
1751 Circle Lane SE Lacey, Washington 98503	2004	900	15,650
101 2nd Street Toledo, Washington 98591	2004	1,800	21,284
209 NE 1st Street Winlock, Washington 98586	2004	3,400	15,865
714 W. Main Street Chehalis, Washington 98532	2009	4,600	15,111
Loan Center/Data Center:			
120 Lincoln Street Hoquiam, Washington 98550	2003	6,000	N/A
Other Properties:			
305 8th Street(1) Hoquiam, Washington 98550	2004	4,100	N/A

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(1) Office at 305 8th Street, Hoquiam, Washington was consolidated into the office at 624 Simpson Avenue, Hoquiam, Washington on November 15, 2004. The building is currently being developed into additional office space for Bank personnel.

Management believes that all facilities are appropriately insured and are adequately equipped for carrying on the business of the Bank.

At September 30, 2011 the Bank operated 23 proprietary ATMs that are part of a nationwide cash exchange network.

Item 3. Legal Proceedings

Periodically, there have been various claims and lawsuits involving the Bank, such as claims to enforce liens, condemnation proceedings on properties in which the Bank holds security interests, claims involving the making and servicing of real property loans and other issues incident to the Bank's business. The Bank is not a party to any pending

legal proceedings that it believes would have a material adverse effect on the financial condition or operations of the Bank.

Item 4. [Removed and Reserved]

PART II

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

The Company's common stock is traded on the Nasdaq Global Market under the symbol "TSBK." As of November 30, 2011, there were 7,045,036 shares of common stock issued and approximately 580 shareholders of record. The following table sets forth the high and low sales prices of, and dividends paid on, the Company's common stock for each quarter during the years ended September 30, 2011 and 2010. The high and low price information was provided by the Nasdaq Stock Market.

	High	Low	Dividends per Common Share
Fiscal 2011			
First Quarter..................	$ 4.30	$ 3.28	$ --
Second Quarter.................	5.95	3.62	--
Third Quarter..................	6.38	4.75	--
Fourth Quarter.................	6.25	3.90	--

	High	Low	Dividends per Common Share
Fiscal 2010			
First Quarter..................	$ 4.75	$ 3.95	$ 0.03
Second Quarter.................	4.42	3.59	0.01
Third Quarter..................	5.28	3.30	--
Fourth Quarter.................	4.25	2.98	--

Dividends

Dividend payments by the Company are dependent primarily on dividends received by the Company from the Bank. Under federal regulations, the dollar amount of dividends the Bank may pay is dependent upon its capital position and recent net income. Generally, if the Bank satisfies its regulatory capital requirements, it may make dividend payments up to the limits prescribed in the FDIC regulations. However, an institution that has converted to a stock form of ownership may not declare or pay a dividend on, or repurchase any of, its common stock if the effect thereof would cause the regulatory capital of the institution to be reduced below the amount required for the liquidation account which was established in connection with the mutual to stock conversion. In addition, the Bank is subject to restrictions on its ability to pay dividends to the Company under the terms of the Bank MOU. The Company is also subject to restrictions on its ability to pay dividends to stockholders under the terms of the Company MOU. Further, the

Company also is subject to restrictions on its ability to pay dividends pursuant to the terms of the securities purchase agreement between the Company and the U.S. Treasury. As of September 30, 2011, the FRB has denied the Company's requests to pay dividends on its Series A Preferred Stock issued under the CPP for the quarterly payments due for the last six quarters beginning with the payments due on May 15, 2010. For additional information regarding the Company's and the Bank's restrictions on the payment of dividends, see "Item 1A, Risk Factors - The Company and the Bank are required to comply with the terms of separate memoranda of understanding issued by their respective regulators and lack of compliance could result in additional regulatory actions," and "- Risks specific to our participation in TARP" and see "- Regulatory and contractual restrictions may limit or prevent us from paying dividends on our common stock."

Equity Compensation Plan Information

The equity compensation plan information presented under subparagraph (d) in Part III, Item 12. of this Form 10-K is incorporated herein by reference.

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Stock Repurchases

The Company is subject to restrictions on its ability to repurchase its common stock pursuant to the terms of the securities purchase agreement between the Company and the U.S. Treasury, and pursuant to the terms of the Company MOU. For additional information, see Item 1A, "Risk Factors - The Company and the Bank are required to comply with the terms of separate memoranda of understanding issued by their respective regulators and lack of compliance could result in additional regulatory actions." and "- Risks specific to our participation in TARP."

The following graph compares the cumulative total shareholder return on our common stock with the cumulative total return on the Nasdaq U.S. Companies Index and with the SNL $250 to $500 Million Asset Thrift Index and the SNL $500 million to $1 Billion Asset Thrift Index, peer group indices. Total return assumes the reinvestment of all dividends and that the value of the Company's Common Stock and each index was $100 on September 30, 2006.

[Graph appears here]

	Period Ending					
Index	09-30-06	09-30-07	09-30-08	09-30-09	09-30-10	09-30-11
Timberland Bancorp, Inc.	$100.00	$ 91.07	$ 45.75	$ 30.20	$ 26.54	$ 26.54
NASDAQ Composite	100.00	120.52	94.10	96.49	108.79	112.05
SNL $250M-$500 M Thrift Index	100.00	92.40	78.57	73.67	75.20	85.01
SNL $500M-$1 B Thrift Index	100.00	96.38	72.16	60.41	57.95	60.22

* Source: SNL Financial LC, Charlottesville, VA

Item 6. Selected Financial Data

The following table sets forth certain information concerning the consolidated financial position and results of operations of the Company and its subsidiary at and for the dates indicated. The consolidated data is derived in part from, and should be read in conjunction with, the Consolidated Financial Statements of the Company and its subsidiary presented herein.

	At September 30,				
	2011	2010	2009	2008	2007
	(In thousands)				
SELECTED FINANCIAL CONDITION DATA:					
Total assets................	$738,224	$742,687	$701,676	$681,883	$644,848
Loans receivable and loans held for sale, net........	528,024	527,591	547,208	557,687	515,341
MBS and other investments held-to-maturity..........	4,145	5,066	7,087	14,233	71
MBS and other investments available-for-sale........	6,717	11,119	13,471	17,098	63,898
FHLB Stock..................	5,705	5,705	5,705	5,705	5,705
Cash and due from financial institutions, interest-bearing deposits in banks and fed funds sold........	112,065	111,786	66,462	42,874	16,670
Certificates of deposit held for investment.......	18,659	18,047	3,251	--	--
Deposits....................	592,678	578,869	505,661	498,572	466,735
FHLB advances...............	55,000	75,000	95,000	104,628	99,697
Federal Reserve Bank advances..................	--	--	10,000	--	--
Shareholders' equity........	86,205	85,408	87,199	74,841	74,547

	Year Ended September 30,				
	2011	2010	2009	2008	2007
	(In thousands, except per share data)				
SELECTED OPERATING DATA:					
Interest and dividend income....................	$ 33,966	$36,596	$38,801	$43,338	$41,944
Interest expense............	8,533	10,961	13,504	16,413	15,778
Net interest income.........	25,433	25,635	25,297	26,295	26,166
Provision for loan losses...	6,758	10,550	10,734	3,900	686
Net interest income after provision for loan losses.	18,675	15,085	14,563	23,025	25,480
Non-interest income.........	8,681	5,696	6,949	4,178	5,962
Non-interest expense........	25,963	24,641	22,739	20,349	19,451
Income (loss) before					

income taxes	1,393	(3,860)	(1,227)	6,854	11,991
Provision (benefit) for federal and state income taxes	304	(1,569)	(985)	2,849	3,828
Net income (loss)	1,089	(2,291)	(242)	4,005	8,163
Preferred stock dividends	(832)	(832)	(643)	--	--
Preferred stock accretion	(225)	(210)	(129)	--	--
Net income (loss) to common shareholders	$ 32	$(3,333)	$(1,014)	$ 4,005	$ 8,163
Net income (loss) per common share (1):					
Basic	$ --	$ (0.50)	$ (0.15)	$ 0.62	$ 1.20
Diluted	$ --	$ (0.50)	$ (0.15)	$ 0.61	$ 1.17
Dividends per common share (1)	$ --	$ 0.04	$ 0.39	$ 0.43	$ 0.37
Dividend payout ratio (2)	N/A	N/A	N/A	74.33%	32.86%

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(1) Has been restated to reflect the two-for-one split of common stock, in the form of a 100% stock dividend paid on June 5, 2007.

(2) Cash dividends to common shareholders divided by net income (loss) to common shareholders.

	At September 30,				
	2011	2010	2009	2008	2007
	(In thousands)				
OTHER DATA:					
Number of real estate loans outstanding	2,796	2,919	3,062	3,261	3,295
Deposit accounts	56,152	55,598	53,941	53,501	53,166
Full-service offices	22	22	22	21	21

	At or For the Year Ended September 30,				
	2011	2010	2009	2008	2007
KEY FINANCIAL RATIOS:					
Performance Ratios:					
Return (loss) on average assets (1)	0.15%	(0.32)%	(0.04)%	0.61%	1.34%
Return (loss) on average equity (2)	1.26	(2.65)	(0.28)	5.35	10.67
Interest rate spread (3)	3.58	3.63	3.64	3.98	4.18
Net interest margin (4)	3.78	3.87	4.01	4.41	4.69
Average interest-earning assets to average interest-bearing					

liabilities............	115.24	114.51	117.42	115.70	118.01
Noninterest expense as a percent of average total assets...........	3.54	3.43	3.35	3.10	3.20
Efficiency ratio (5)......	76.11	78.65	70.52	65.42	60.54
Book value per common share..................	$9.97	$ 9.89	$10.17	$10.74	$10.72
Asset Quality Ratios:					
Non-accrual and 90 days or more past due loans as a percent of total loans receivable, net...	4.32%	4.86%	5.36%	2.12%	0.29%
Non-performing assets as a percent of total assets (6).............	5.01	5.53	5.52	1.83	0.23
Allowance for loan losses as a percent of total loans receivable, net (7)................	2.21	2.09	2.59	1.44	0.92
Allowance for losses as a percent of non-performing loans (8)..............	51.18	43.01	47.11	67.14	321.95
Net charge-offs to average outstanding loans.......	1.13	2.45	0.79	0.12	--
Capital Ratios:					
Total equity-to-assets ratio..................	11.68%	11.50%	12.43%	10.98%	11.56%
Average equity to average assets.................	11.81	12.05	12.72	11.47	12.58

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(1) Net income (loss) divided by average total assets.
(2) Net income (loss) divided by average total equity.
(3) Difference between weighted average yield on interest-earning assets and weighted average cost of interest-bearing liabilities.
(4) Net interest income (before provision for loan losses) as a percentage of average interest-earning assets.
(5) Non-interest expenses divided by the sum of net interest income and non-interest income.
(6) Non-performing assets include non-accrual loans, loans past due 90 days or more and still accruing, non-accrual investment securities, other real estate owned and other repossessed assets.
(7) Loans receivable includes loans held for sale and is before the allowance for loan losses.
(8) Non-performing loans include non-accrual loans and loans past due 90 days or more and still accruing. Troubled debt restructured loans that are on accrual status are not included.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to assist in understanding the consolidated financial condition and results of operations of the Company. The information contained in this section should be read in conjunction with the Consolidated Financial Statements and accompanying notes thereto included in Item 8 of this Annual Report on Form 10-K.

Special Note Regarding Forward-Looking Statements

Certain matters discussed on this Annual Report on Form 10-K may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not statements of historical fact and often include the words "believes," "expects," "anticipates," "estimates," "forecasts," "intends," "plans," "targets," "potentially," "probably," "projects," "outlook" or similar expressions or future or conditional verbs such as "may," "will," "should," "would" and "could." Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, assumptions and statements about future economic performance. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause our actual results to differ materially from the results anticipated, including, but not limited to: the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and changes in our allowance for loan losses and provision for loan losses that may be impacted by deterioration in the housing and commercial real estate markets and may lead to increased losses and non-performing assets in our loan portfolio, and may result in our allowance for loan losses not being adequate to cover actual losses, and require us to materially increase our loan loss reserves; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources; fluctuations in the demand for loans, the number of unsold homes, land and other properties and fluctuations in real estate values in our market areas; secondary market conditions for loans and our ability to sell loans in the secondary market; results of examinations of us by the Board of Governors of the Federal Reserve System and our bank subsidiary by the Federal Deposit Insurance Corporation, the Washington State Department of Financial Institutions, Division of Banks or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, institute a formal or informal enforcement action or require us to increase our allowance for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds or maintain or increase deposits or impose additional requirements or restrictions, which could adversely affect our liquidity and earnings; our compliance with regulatory enforcement actions, including regulatory memoranda of understandings ("MOUs") to which we are subject; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, or the interpretation of regulatory capital or other rules; the impact of the Dodd Frank Wall Street Reform and Consumer Protection Act and the implementation of related rules and regulations; our ability to attract and retain deposits; further increases in premiums for deposit insurance; our ability to control operating costs and expenses; the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; difficulties in reducing risks associated with the loans on our consolidated balance sheet; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our workforce and potential associated charges; computer systems on which we depend could fail or experience a security breach; our ability to retain key

members of our senior management team; costs and effects of litigation, including settlements and judgments; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we may in the future acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto; our ability to manage loan delinquency rates; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, the interpretation of regulatory capital or other rules and any changes in the rules applicable to institutions participating in the TARP Capital Purchase Program; the

availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; our ability to pay dividends on our common and preferred stock; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations; pricing, products and services; and other risks described elsewhere in this Form 10-K.

Any of the forward-looking statements that we make in this Form 10-K and in the other public statements we make are based upon management's beliefs and assumptions at the time they are made. We undertake no obligation to publicly update or revise any forward-looking statements included in this annual report or to update the reasons why actual results could differ from those contained in such statements, whether as a result of new information, future events or otherwise. We caution readers not to place undue reliance on any forward-looking statements. We do not undertake and specifically disclaim any obligation to revise any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements. These risks could cause our actual results for fiscal 2012 and beyond to differ materially from those expressed in any forward-looking statements by, or on behalf of, us, and could negatively affect the Company's results of operations and stock price performance.

Critical Accounting Policies and Estimates

The Company has established various accounting policies that govern the application of accounting principles generally accepted in the United States of America ("GAAP") in the preparation of the Company's Consolidated Financial Statements. The Company has identified five policies, that as a result of judgments, estimates and assumptions inherent in those policies, are critical to an understanding of the Company's Consolidated Financial Statements. These policies relate to the methodology for the determination of the allowance for loan losses, the valuation of mortgage servicing rights ("MSRs"), the determination of other than temporary impairments in the market value of investment securities, the determination of goodwill impairment and the determination of the recorded value of other real estate owned. These policies and the judgments, estimates and assumptions are described in greater detail in subsequent sections of Management's Discussion and Analysis contained herein and in the notes to the Consolidated Financial Statements

contained in Item 8 of this Form 10-K. In particular, Note 1 of the Notes to Consolidated Financial Statements, "Summary of Significant Accounting Policies," generally describes the Company's accounting policies. Management believes that the judgments, estimates and assumptions used in the preparation of the Company's Consolidated Financial Statements are appropriate given the factual circumstances at the time. However, given the sensitivity of the Company's Consolidated Financial Statements to these critical policies, the use of other judgments, estimates and assumptions could result in material differences in the Company's results of operations or financial condition.

Allowance for Loan Losses. The allowance for loan losses is maintained at a level sufficient to provide for probable loan losses based on evaluating known and inherent risks in the portfolio. The allowance is based upon management's comprehensive analysis of the pertinent factors underlying the quality of the loan portfolio. These factors include changes in the amount and composition of the loan portfolio, actual loan loss experience, current economic conditions, and detailed analysis of individual loans for which full collectibility may not be assured. The detailed analysis includes methods to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. The appropriate allowance for loan loss level is estimated based upon factors and trends identified by management at the time the consolidated financial statements are prepared.

While the Company believes it has established its existing allowance for loan losses in accordance with GAAP, there can be no assurance that regulators, in reviewing the Company's loan portfolio, will not request the Company to significantly increase or decrease its allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that substantial increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed elsewhere in this document. Although management believes the level of the allowance as of

September 30, 2011 was adequate to absorb probable losses inherent in the loan portfolio, a decline in local economic conditions, results of examinations by the Company's or the Bank's regulators or other factors, could result in a material increase in the allowance for loan losses and may adversely affect the Company's financial condition and results of operations.

Mortgage Servicing Rights. MSRs are capitalized when acquired through the origination of loans that are subsequently sold with servicing rights retained and are amortized to servicing income on loans sold in proportion to and over the period of estimated net servicing income. The value of MSRs at the date of the sale of loans is determined based on the discounted present value of expected future cash flows using key assumptions for servicing income and costs and prepayment rates on the underlying loans.

The estimated fair value is evaluated at least annually by a third party firm for impairment by comparing actual cash flows and estimated cash flows from the servicing assets to those estimated at the time servicing assets were originated. The effect of changes in market interest rates on estimated rates of loan prepayments represents the predominant risk characteristic underlying the MSRs' portfolio. The Company's methodology for estimating the fair value of MSRs is highly sensitive to changes in assumptions. For example, the determination of fair value uses anticipated prepayment speeds. Actual

prepayment experience may differ and any difference may have a material effect on the fair value. Thus, any measurement of MSRs' fair value is limited by the conditions existing and assumptions as of the date made. Those assumptions may not be appropriate if they are applied at different times.

OTTI (Other-Than-Temporary Impairment) in the Estimated Fair Value of Investment Securities. Unrealized investment securities losses on available for sale and held to maturity securities are evaluated at least quarterly by a third-party firm to determine whether declines in value should be considered "other than temporary" and therefore be subject to immediate loss recognition through earnings for the portion related to credit losses. Although these evaluations involve significant judgment, an unrealized loss in the fair value of a debt security is generally deemed to be temporary when the fair value of the security is less than the recorded value primarily as a result of changes in interest rates, when there has not been significant deterioration in the financial condition of the issuer, and the Company has the intent and the ability to hold the security for a sufficient time to recover the recorded value. An unrealized loss in the value of an equity security is generally considered temporary when the fair value of the security is below the recorded value primarily as a result of current market conditions and not a result of deterioration in the financial condition of the issuer or the underlying collateral (in the case of mutual funds) and the Company has the intent and the ability to hold the security for a sufficient time to recover the recorded value. Other factors that may be considered in determining whether a decline in the value of either a debt or equity security is "other than temporary" include ratings by recognized rating agencies; capital strength and near-term prospects of the issuer, and recommendation of investment advisors or market analysts. Therefore, continued deterioration of current market conditions could result in additional impairment losses recognized within the Company's investment portfolio.

Goodwill. Goodwill is initially recorded when the purchase price paid for an acquisition exceeds the estimated fair value of the net identified tangible and intangible assets acquired and liabilities assumed. Goodwill is presumed to have an indefinite useful life and is analyzed annually for impairment. An annual test is performed during the third quarter of each fiscal year, or more frequently if indicators of potential impairment exist, to determine if the recorded goodwill is impaired. If the estimated fair value of the Company's sole reporting unit exceeds the recorded value of the reporting unit, goodwill is not considered impaired and no additional analysis is necessary.

One of the circumstances evaluated when determining if an impairment test of goodwill is needed more frequently than annually is the extent and duration that the Company's market capitalization (total common shares outstanding multiplied by current stock price) is less than the total equity applicable to common shareholders. During the quarter ended June 30, 2011, the Company engaged a third party firm to perform the annual test for goodwill impairment. The test concluded that recorded goodwill was not impaired. As of September 30, 2011, there have been no events or changes in the circumstances that would indicate a potential impairment. No assurance can be given, however, that the Company will not record an impairment loss on goodwill in the future.

Other Real Estate Owned and Other Repossessed Assets. Other real estate owned and other repossessed assets consist of properties or assets acquired through or in lieu of foreclosure, and are recorded initially at the estimated fair value of the properties less estimated costs of disposal. Costs relating

to development and improvement of the properties or assets are capitalized while costs relating to holding the properties or assets are expensed. Valuations are periodically performed by management, and a charge to earnings is recorded if the recorded valued of a property exceeds its estimated net realizable value.

New Accounting Pronouncements

For a discussion of new accounting pronouncements and their impact on the Company, see Note 1 of the Notes to the Consolidated Financial Statements contained in "Item 8. Financial Statements and Supplementary Data."

Operating Strategy

The Company is a bank holding company which operates primarily through its subsidiary, the Bank. The Bank is a community-oriented bank which has traditionally offered a wide variety of savings products to its retail customers while concentrating its lending activities on real estate loans. Since 2008, depressed economic conditions have prevailed in portions of the United States, including Washington State where we hold substantially all of our loans and conduct all of our operations. The majority of our loans are secured by collateral and made to borrowers located in Washington State. Western Washington, which includes our primary market areas, has experienced home price declines, increased foreclosures, and has experienced above average unemployment rates. In response to the financial challenges in our market areas we have taken actions to manage our capital, reduce our exposure to speculative construction and land development loans and maintain higher levels of on balance sheet liquidity. We have continued in this low interest environment to originate residential fixed rate mortgage loans primarily for sale in the secondary market. We continue to manage the growth of our commercial and multi-family real estate loan portfolios in a disciplined fashion while continuing to dispose of other real estate owned properties and grow retail deposits.

We believe the resolution of problem financial institutions and continued bank consolidation in Western Washington will provide opportunities for the Company to increase market share within the communities it serves. We are currently pursuing the following strategies:

Improve Asset Quality. We are focused on monitoring existing performing loans, resolving non-performing assets and selling foreclosed assets. We have sought to reduce the level of non-performing assets through collections, write-downs, modifications and sales of other real estate owned properties. We have taken proactive steps to resolve our non-performing loans, including negotiating payment plans, forbearances, loan modifications and loan extensions and accepting short payoffs on delinquent loans when such actions have been deemed appropriate.

Expand our presence within our existing market areas by capturing opportunities resulting from changes in the competitive environment. We currently conduct our business primarily in Western Washington. We have a community bank strategy that emphasizes responsive and personalized service to our customers. As a result of FDIC bank resolutions and anticipated consolidation of banks in our market areas, we believe there is an opportunity for a community and customer focused bank to expand its customer base. By offering timely decision making, delivering appropriate banking products and services, and providing customer access to our senior managers we believe community banks, such as Timberland Bank, can distinguish themselves from larger banks operating in our market areas. We believe we have a significant opportunity to attract additional borrowers and depositors and expand our market presence and market share within our extensive branch footprint.

Continue generating revenues through mortgage banking operations. The substantial majority of the fixed rate residential mortgage loans we originate are sold into the secondary market with servicing retained. This strategy produces gains on the sale of such loans and reduces the interest rate and credit risk associated with fixed rate residential lending. We will continue to originate custom construction and owner builder loans for sale into the secondary market upon the completion of construction.

Portfolio Diversification. In recent years, we have strictly limited the origination of speculative construction, land development and land loans in favor of loans that possess credit profiles representing less risk to the Bank. We will continue originating owner/builder and custom construction loans, multi-family loans, commercial business loans and certain commercial real estate loans which offer higher risk adjusted returns, shorter maturities and more sensitivity to interest rate fluctuations. We anticipate capturing more of each customer's banking relationship by cross selling our loan and deposit products and additional services to our customers.

Increase Core Deposits and other Retail Deposit Products. We focus on establishing a total banking relationship with our customers with the intent of internally funding our loan portfolio. We anticipate that the continued focus on customer relationships will help increase our level of core deposits and locally-based retail certificates of deposit. In addition to our retail branches we maintain technology based products such as business cash management and a business remote deposit product that enables us to compete effectively with banks of all sizes.

Limit Exposure to Increasing Interest Rates. For many years the majority of the loans the Bank has retained in its portfolio have generally possessed periodic interest rate adjustment features or have been relatively short term in nature. Loans originated for portfolio retention have included ARM loans, short term construction loans, and to a lesser extent commercial business loans with interest rates tied to a market index such as the prime rate. Longer term fixed-rate mortgage loans have generally been originated for sale into the secondary market.

Market Risk and Asset and Liability Management

General. Market risk is the risk of loss from adverse changes in market prices and rates. The Company's market risk arises primarily from interest rate risk inherent in its lending, investment, deposit and borrowing activities. The Bank, like other financial institutions, is subject to interest rate risk to the extent that its interest-earning assets reprice differently than its interest-bearing liabilities. Management actively monitors and manages its interest rate risk exposure. Although the Bank manages other risks, such as credit quality and liquidity risk, in the normal course of business management considers interest rate risk to be its most significant market risk that could potentially have the largest material effect on the Bank's financial condition and results of operations. The Bank does not maintain a trading account for any class of financial instruments nor does it engage in hedging activities. Furthermore, the Bank is not subject to foreign currency exchange rate risk or commodity price risk.

Qualitative Aspects of Market Risk. The Bank's principal financial objective is to achieve long-term profitability while reducing its exposure to fluctuating market interest rates. The Bank has sought to reduce the exposure

of its earnings to changes in market interest rates by attempting to manage the difference between asset and liability maturities and interest rates. The principal element in achieving this objective is to increase the interest-rate sensitivity of the Bank's interest-earning assets by retaining in its portfolio, short-term loans and loans with interest rates subject to periodic adjustments. The Bank relies on retail deposits as its primary source of funds. As part of its interest rate risk management strategy, the Bank promotes transaction accounts and certificates of deposit with terms of up to six years.

The Bank has adopted a strategy that is designed to substantially match the interest rate sensitivity of assets relative to its liabilities. The primary elements of this strategy involve originating ARM loans for its portfolio, maintaining residential construction loans as a portion of total net loans receivable because of their generally shorter terms and higher yields than other one- to four-family residential mortgage loans, matching asset and liability maturities, investing in short-term securities, originating fixed-rate loans for retention or sale in the secondary market, and retaining the related mortgage servicing rights.

Sharp increases or decreases in interest rates may adversely affect the Bank's earnings. Management of the Bank monitors the Bank's interest rate sensitivity through the use of a model provided for the Bank by FIMAC Solutions, LLC ("FIMAC"), a company that specializes in providing the financial services industry interest risk rate risk and balance sheet management services. Based on a rate shock analysis prepared by FIMAC based on data at September 30, 2011, an immediate increase in interest rates of 200 basis points would increase the Bank's projected net interest income by approximately 7.3%, primarily because a larger portion of the Bank's interest rate sensitive assets than interest rate sensitive liabilities would reprice within a one year period. See "- Quantitative Aspects of Market Risk" below for

additional information. Management has sought to sustain the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread. Pursuant to this strategy, the Bank actively originates adjustable-rate loans for retention in its loan portfolio. Fixed-rate mortgage loans with maturities greater than seven years generally are originated for the immediate or future resale in the secondary mortgage market. At September 30, 2011, adjustable-rate mortgage loans constituted $300.9 million or 66.1%, of the Bank's total mortgage loan portfolio due after one year. Although the Bank has sought to originate ARM loans, the ability to originate such loans depends to a great extent on market interest rates and borrowers' preferences. Particularly in lower interest rate environments, borrowers often prefer fixed-rate loans.

Consumer, commercial business and construction and land development loans typically have shorter terms and higher yields than permanent residential mortgage loans, and accordingly reduce the Bank's exposure to fluctuations in interest rates. At September 30, 2011, the consumer, commercial business and construction and land development portfolios amounted to $44.2 million, $22.5 million and $52.5 million, or 7.9%, 4.0% and 9.4% of total loans receivable (including loans held for sale), respectively.

Quantitative Aspects of Market Risk. The model provided for the Bank by FIMAC estimates the changes in net portfolio value ("NPV") and net interest

income in response to a range of assumed changes in market interest rates. The model first estimates the level of the Bank's NPV (market value of assets, less market value of liabilities, plus or minus the market value of any off-balance sheet items) under the current rate environment. In general, market values are estimated by discounting the estimated cash flows of each instrument by appropriate discount rates. The model then recalculates the Bank's NPV under different interest rate scenarios. The change in NPV under the different interest rate scenarios provides a measure of the Bank's exposure to interest rate risk. The following table is provided by FIMAC based on data at September 30, 2011.

Hypothetical Interest Rate Scenario(3)	Net Interest Income(1)(2)			Current Market Value		
	Estimated Value	$ Change from Base	% Change from Base	Estimated Value	$ Change from Base	% Change from Base
(Basis Points)	(Dollars in thousands)					
+400	$27,597	$3,253	13.36%	$100,199	$(1,608)	(1.58)%
+300	26,892	2,548	10.47	100,406	(1,401)	(1.38)
+200	26,126	1,782	7.32	101,291	(516)	(0.51)
+100	25,208	864	3.55	101,672	(135)	(0.13)
BASE	24,344	--	--	101,807	--	--
-100	23,680	(664)	(2.73)	101,508	(299)	(0.29)
-200	22,911	(1,433)	(5.89)	109,528	7,721	7.58
-300	22,134	(2,210)	(9.08)	122,757	20,950	20.58
-400	21,673	(2,671)	(10.97)	138,834	37,027	36.37

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(1) Does not include loan fees.
(2) Includes BOLI income, which is included in non-interest income on the Consolidated Financial Statements.
(3) No rates in the model are allowed to go below zero.

Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, loan repayments and deposit decay, and should not be relied upon as indicative of actual results. Furthermore, the computations do not reflect any actions management may undertake in response to changes in interest rates.

In the event of a 100 basis point decrease in interest rates, the Bank would be expected to experience a 0.3% decrease in NPV and a 2.7% decrease in net interest income. In the event of a 200 basis point increase in interest rates, a 0.5% decrease in NPV and a 7.3% increase in net interest income would be expected. Based upon the modeling described above, the Bank's asset and liability structure generally results in decreases in net interest income in a declining

interest rate scenario and increases in net interest income in a rising rate scenario. This structure also generally results in a decrease in NPV when rates increase and an increase in NPV when rates decrease by 200 basis points or more.

As with any method of measuring interest rate risk, certain shortcomings are inherent in the method of analysis presented in the foregoing table. For

example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets have features which restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, expected rates of prepayments on loans and early withdrawals from certificates could possibly deviate significantly from those assumed in calculating the table.

Comparison of Financial Condition at September 30, 2011 and September 30, 2010

The Company's total assets decreased by $4.5 million, or 0.6%, to $738.2 million at September 30, 2011 from $742.7 million at September 30, 2010. The decrease was primarily attributable to a decrease in mortgage-backed securities and other investments and a decrease in the prepaid FDIC insurance assessment. These decreases were partially offset by an increase in BOLI.

Net loans receivable increased by $433,000, or 0.1%, to $528.0 million at September 30, 2011 from $527.6 million at September 30, 2010. While the total of the loan portfolio was relatively unchanged year over year, the composition of the portfolio changed as commercial real estate loan balances increased and construction and land development loan balances and land loan balances decreased.

Total deposits increased by $13.8 million, or 2.4%, to $592.7 million at September 30, 2011 from $578.9 million at September 30, 2010, primarily as a result of increases in savings account balances, non-interest bearing account balances and money market account balances.

Shareholders' equity increased by $797,000, or 0.9%, to $86.2 million at September 30, 2011 from $85.4 million at September 30, 2010. The increase was primarily due to net income for the year ended September 30, 2011, and was partially offset by accrued preferred stock dividends. The Company remains well capitalized with a total risk based capital ratio of 16.5% at September 30, 2011.

A more detailed explanation of the changes in significant balance sheet categories follows:

Cash and Cash Equivalents and Certificates of Deposit Held for Investment: Cash and cash equivalents and certificates of deposit ("CDs") held for investment increased by $891,000, or 0.7%, to $130.7 million at September 30, 2011 from $129.8 million at September 30, 2010. The Company continued to maintain high levels of liquidity primarily for regulatory and asset-liability management purposes.

Mortgage-backed Securities and Other Investments: MBS and other investments decreased by $5.3 million, or 32.9%, to $10.9 million at September 30, 2011 from $16.2 million at September 30, 2010. The decrease was primarily as a result of regular amortization and prepayments on MBS, the sale of $2.3 million in MBS and OTTI charges recorded on private label residential MBS. The securities on which the OTTI charges were recognized were acquired from the in-kind redemption of the Company's investment in the AMF family of mutual funds in June 2008. For additional details on investments and mortgage-backed securities, see "Item 1, Business - Investment Activities" and Note 3 of the Notes to the Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplemental Data."

Loans Receivable and Loans Held for Sale, Net of Allowance for Loan Losses: Net loans receivable, including loans held for sale, increased by

$433,000 or 0.1% to $528.0 million at September 30, 2011 from $527.6 million at September 30, 2010. While the total of the loan portfolio was relatively unchanged year over year, the composition of the portfolio changed as commercial real estate loan balances increased by $38.0 million, construction

and land development loan balances decreased by $16.8 million, land loan balances decreased by $13.8 million and one-to four-family loan balances decreased by $6.3 million. The increase in commercial real estate loan balances and the decrease in construction loan balances were in part due to a number of commercial real estate construction projects completing the construction phase and converting to permanent financing.

Loan originations decreased by 12.3% to $160.2 million for the year ended September 30, 2011 from $182.5 million for the year ended September 30, 2010, primarily due to a reduction in the demand for single family home loan refinances. The Company continued to sell longer-term fixed rate loans for asset-liability management purposes and to generate non-interest income. The Company sold $62.5 million in fixed rate one- to four-family mortgage loans during the year ended September 30, 2011 compared to $68.3 million for the fiscal year ended September 30, 2010. For additional information on loans, see "Item 1, Business - Lending Activities - Loan Originations, Purchases and Sales" and Note 4 of the Notes to Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplementary Data."

Premises and Equipment: Premises and equipment totaled $17.4 million at both September 30, 2011 and September 30, 2010. For additional information on premises and equipment, see "Item 2, Properties" and Note 6 of the Notes to Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplementary Data."

Other Real Estate Owned: OREO and other repossessed assets decreased by $708,000, or 6.1% to $10.8 million at September 30, 2011 from $11.5 million at September 30, 2010. At September 30, 2011, the balance was comprised of 46 individual properties and four other repossessed assets. The properties consisted of two condominium projects totaling $3.5 million, 28 land parcels totaling $3.3 million, 11 single family homes totaling $1.9 million, three commercial real estate properties totaling $1.2 million and two land development projects totaling $794,000. The largest OREO property was a condominium project with a balance of $2.6 million. For additional information on OREOs, see "Item 1, Business Lending Activities - Other Real Estate Owned and Other Repossessed Assets" and Note 7 of the Notes to Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplementary Data."

Bank Owned Life Insurance: BOLI increased $2.5 million, or 18.8%, to $15.9 million at September 30, 2011 from $13.4 million at September 30, 2010. The increase was due to the purchase of $2.0 million in additional BOLI policies and BOLI net earnings of $517,000.

Goodwill and Core Deposit Intangible: The value of goodwill at $5.7 million at September 30, 2011 remained unchanged from September 30, 2010. The amortized value of core deposit intangible decreased by $167,000 to $397,000 at September 30, 2011 from $564,000 at September 30, 2010 due to scheduled amortization. The Company recorded goodwill and core deposit intangible in connection with an acquisition of seven branches and related deposits in October 2004. The Company performed its annual review of goodwill during the

quarter ended June 30, 2011 and determined that there was no impairment to goodwill. For additional information on goodwill and core deposit intangible, see Note 1 and Note 8 of the Notes to Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplemental Data."

Mortgage Servicing Rights: MSRs increased $179,000, or 9.3%, to $2.1 million at September 30, 2011 from $1.9 million at September 30, 2010, primarily due to a partial recovery of the MSR valuation allowance established during the year ended September 30, 2010. The principal amount of loans serviced for Freddie Mac increased $18.0 million, or 6.4%, to $298.9 million at September 30, 2011 from $280.9 million at September 30, 2010. The Company recorded a $405,000 valuation recovery on MSRs during the year ended September 30, 2011. For additional information on MSRs, see Note 5 of the Notes to Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplemental Data."

Prepaid FDIC Insurance Assessment: The prepaid FDIC insurance assessment decreased $1.2 million, or 35.6%, to $2.1 million at September 30, 2011 from $3.3 million at September 30, 2010 as a portion of the prepaid amount was expensed.

Deposits: Deposits increased by $13.8 million, or 2.4%, to $592.7 million at September 30, 2011 from $578.9 million at September 30, 2010. The increase was primarily a result of a $16.2 million increase in savings account balances, $5.7 million increase in non-interest-bearing account balances, a $5.3 million increase in money market account balances and a $2.0 million increase in NOW checking account balances. These increases were partially offset by a $15.4 million decrease in CD account balances. The increases in savings account balances and money market account balances and the decrease in CD accounts were in part due to the low interest rate environment, as some depositors opted to place maturing CD funds into non-maturity accounts to retain flexibility if interest rates increased. The Company also experienced deposit inflows due to a number of customers transferring funds from other financial institutions during the year ended September 30, 2011. For additional information on deposits, see "Item 1, Business - Deposit Activities and Other Sources of Funds" and Note 9 of the Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplementary Data."

FHLB Advances: FHLB advances decreased by $20.0 million, or 26.7%, to $55.0 million at September 30, 2011 from $75.0 million at September 30, 2010 as the Company used a portion of its liquid assets to repay maturing advances. For additional information on borrowings, see "Item 1, Business - Deposit Activities and Other Sources of Funds - Borrowings" and Note 10 of the Notes to Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplementary Data."

Shareholders' Equity: Total shareholders' equity increased by $797,000, or 0.9%, to $86.2 million at September 30, 2011 from $85.4 million at September 30, 2010. The increase was primarily due to net income of $1.1 million, a $264,000 reduction in unearned shares issued to ESOP equity account and a $196,000 reduction in the accumulated other comprehensive loss equity component. These increases to shareholders' equity were partially offset by the accrual of $832,000 in preferred stock dividends.

The FRB has denied the Company's request to pay cash dividends on its outstanding Series A Preferred Stock issued under the CPP for quarterly

payments due for the last six quarters commencing with the payment due May 15, 2010. Cash dividends on the Series A Preferred Stock are cumulative and accrue and compound on each subsequent date. Accordingly, during the deferral period, the Company will continue to accrue, and reflect in the consolidated financial statements, the deferred dividends on the outstanding Series A Preferred Stock. As a result of not receiving permission from the FRB, the Company has not made these six quarterly payments as of September 30, 2011. Since the Company has six unpaid quarterly dividend payments on the Series A Preferred Stock, the Treasury has the right to appoint two directors to the Company's board of directors until all accrued but unpaid dividends have been paid.

For additional information on shareholders' equity, see the Consolidated Statements of Shareholders' Equity contained in "Item 8, Financial Statements and Supplementary Data."

Comparison of Operating Results for the Years Ended September 30, 2011 and 2010

The Company reported net income of $1.09 million for the year ended September 30, 2011 compared to a net loss of $(2.29 million) for the year ended September 30, 2010. Net income to common shareholders after adjusting for preferred stock dividends and preferred stock discount accretion was $32,000 for the year ended September 30, 2011 compared to net loss to common shareholders of $(3.33 million) for the year ended September 30, 2010. The improved earnings were primarily due to decreased provision for loan losses and increased non-interest income, which were partially offset by increased non-interest expenses and decreased net interest income. Net income per diluted common share was $0.00 for the year ended September 30, 2011 compared to a loss per diluted common share of $(0.50) for the year ended September 30, 2010.

The decrease in the provision for loan losses was primarily a result of a decrease in the level of net charge-offs, a decrease in non-performing loans and a decrease in the Company's construction and land development loan balances.

The increase in non-interest income was primarily a result of a reduction in net OTTI on MBS and other investments and a net change in the valuation recovery (allowance) on MSRs. These increases to non-interest income were partially offset by a decrease in service charges on deposits.

The increase in non-interest expense was primarily attributable to increases in salaries and employee benefits expense, OREO related expenses, loan foreclosure related expenses and ATM expenses. These increases to non-interest expense were partially offset by a decrease in FDIC insurance expense.

The decrease in net interest income was primarily attributable to interest margin compression as the yield on interest earning assets decreased at a greater rate than funding costs decreased.

A more detailed explanation of the income statement categories is presented below.

Net Income (Loss): The Company reported net income of $1.09 million for

the year ended September 30, 2011 compared to a net loss of $(2.29 million) for the year ended September 30, 2010. Net income to common shareholders after adjusting for preferred stock dividends and preferred stock discount accretion was $32,000 for the year ended September 30, 2011 compared to net loss to common shareholders of $(3.33 million) for the year ended September 30, 2010. Net income per diluted common share was $0.00 for the year ended September 30, 2011 compared to a loss per diluted common share of $(0.50) for the year ended September 30, 2010.

The $0.50 increase in net income per diluted common share for the year ended September 30, 2011 was primarily the result of a $3.79 million ($2.50 million net of income tax - approximately $0.37 per diluted common share) decrease in provision for loan losses and a $2.99 million ($1.97 million net of income tax - approximately $0.28 per diluted common share) increase in non-interest income. These increases to earnings per diluted common share were partially offset by a $1.32 million ($873,000 net of income tax - approximately $0.13 per diluted common share) increase in non-interest expense and a $202,000 ($133,000 net of income tax - approximately $0.02 per diluted common share) decrease in net interest income.

Net Interest Income: Net interest income decreased by $202,000, or 0.8%, to $25.43 million for the year ended September 30, 2011 from $25.64 million for the year ended September 30, 2010. The decrease in net interest income was primarily attributable to interest margin compression as the yield on interest earning assets decreased at a greater rate than funding costs decreased.

Total interest and dividend income decreased by $2.63 million, or 7.2%, to $33.97 million for the year ended September 30, 2011 from $36.60 million for the year ended September 30, 2010 as the yield on interest earning assets decreased to 5.04% from 5.53%. The decrease in the weighted average yield on interest earning assets was primarily a result of a decrease in overall market rates, an increase in the level of lower yielding cash equivalents and other liquid assets and a change in the composition of the loan portfolio as the level of higher yielding construction and land development loans decreased.

Total interest expense decreased by $2.43 million, or 22.2%, to $8.53 million for the year ended September 30, 2011 from $10.96 million for the year ended September 30, 2010 as the average rate paid on interest-bearing liabilities decreased to 1.46% for the year ended September 30, 2011 from 1.90% for the year ended September 30, 2010. The decrease in funding costs was primarily a result of a decrease in overall market rates and a decrease in the level of average FHLB advances.

The net interest margin decreased nine basis points to 3.78% for the year ended September 30, 2010 from 3.87% for the year ended September 30, 2010 as the yield on interest earning assets decreased at a greater rate than the funding costs decreased. The margin compression was primarily due to a decrease in overall market rates and an increased level of average liquid assets with lower yields.

Provision for Loan Losses: The provision for loan losses decreased by $3.79 million, or 35.9%, to $6.76 million for the year ended September 30, 2011 from $10.55 million for the year ended September 30, 2010. The decrease in the provision for loan losses was primarily a result of a decrease in the level of net charge-offs, a decrease in non-performing loans and a decrease in the Company's construction and land development loan balances. The Company had net charge-offs of $6.08 million for the year ended September 30, 2011 compared to net charge-offs of

$13.46 million for the year ended September 30, 2010. The net charge-offs to average outstanding loans ratio was 1.13% for the year ended September 30, 2011 compared to 2.45% for the year ended September 30, 2010.

The Company has established a comprehensive methodology for estimating the provision for loan losses. On a quarterly basis the Company performs an analysis that considers pertinent factors underlying the quality of the loan portfolio. These factors include changes in the amount and composition of the loan portfolio, historic loss experience for various loan segments, changes in economic conditions, delinquency rates, a detailed analysis of impaired loans, and other factors to determine an appropriate level of allowance for loan losses. Impaired loans are subject to an impairment analysis to determine an appropriate reserve to be held against each loan. The aggregate principal impairment amount determined at September 30, 2011 was $2.29 million.

Based on the comprehensive methodology, management deemed the allowance for loan losses of $11.95 million at September 30, 2011 (2.21% of loans receivable and loans held for sale and 51.2% of non-performing loans) adequate to provide for probable losses based on an evaluation of known and inherent risks in the loan portfolio at that date. While the Company believes it has established its existing allowance for loan losses in accordance with GAAP, there can be no assurance that regulators, in reviewing the Company's loan portfolio, will not request the Company to increase significantly its allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that, substantial increases will not be necessary should the quality of any loans deteriorate. Any material increase in the allowance for loan losses would adversely affect the Company's financial condition and results of operations. For additional information, see "Item 1, Business - Lending Activities - Allowance for Loan Losses."

Non-interest Income: Total non-interest income increased by $2.99 million, or 52.4%, to $8.68 million for the year ended September 30, 2011 from $5.70 million for the year ended September 30, 2010. This increase was primarily a result of a $1.73 million reduction in net OTTI on MBS and other investments, a $1.30 million net change in the valuation recovery (allowance) on MSRs and a $292,000 increase in ATM transaction fees. These increases to non-interest income were partially offset by a $333,000 decrease in service charges on deposits.

The Company's net OTTI loss on MBS and other investments decreased by $1.73 million to $447,000 for the year ended September 30, 2011 from $2.18 million for the year ended September 30, 2010. The OTTI charges for both years were on private label MBS that were acquired from an in-kind redemption from the AMF family of mutual funds in June 2008. At September 30, 2011, the Company's remaining private label MBS had been reduced to $3.42 million from an original acquired balance of $15.30 million. The Company recorded a $405,000 MSR valuation recovery during the year ended September 30, 2011 compared to an $890,000 valuation allowance recorded during the year ended September 30, 2010. The partial recovery of the valuation allowance was primarily due to an increase in the expected life and corresponding estimated fair value of the MSR portfolio. The increased income from ATM transaction fees was primarily due to several deposit promotions designed to increase ATM and debit card usage. The reduction in service charges on deposits was primarily a result of fewer overdrafts on checking accounts.

Non-interest Expense: Total non-interest expense increased by $1.32

million, or 5.4%, to $25.96 million for the year ended September 30, 2011 from $24.64 million for the year ended September 30, 2010. The increase was primarily attributable to a $512,000 increase in salaries and employee benefits, a $492,000 increase in OREO and other repossessed assets expense, a $478,000 increase in loan administration and foreclosure related expenses, a $197,000 increase in deposit operations related expenses and a $104,000 increase in ATM expenses. These increases to non-interest expense were partially offset by a $498,000 decrease in FDIC insurance expense. The comparison between periods for FDIC insurance expense was affected by a non-recurring accrual adjustment in the prior year which increased the expense by $400,000 for the year ended September 30, 2010.

The increase in salaries and employee benefits expense was partially a result of a decreased level of loan originations. Under GAAP, the portion of a loan origination fee that is attributable to the estimated employee costs to generate the loan is recorded as a reduction to salaries and employee benefit expense. With the decrease in loan originations, the loan origination fees that reduced salaries and employee benefit expense decreased by $127,000 during the year ended September 30, 2011 compared to the year ended September 30, 2010. The comparison between periods

for salaries and employee benefits was also affected by a change in the Bank's vacation accrual policy during the prior year which reduced salaries and employee benefits expense by $340,000 during the year ended September 30, 2010.

The increase in OREO related expenses and loan foreclosure related expenses were primarily a result of an increase in the number of OREO properties held and an increase in foreclosure activity. The OREO related expenses were also increased as a result of valuation write-downs based on updated appraisals received for several properties.

The Company's efficiency ratio improved to 76.11% for the year ended September 30, 2011 from 78.65% for the year ended September 30, 2010.

Provision (Benefit) for Federal and State Income Taxes: The Company recorded a provision for federal and state income taxes of $304,000 for the year ended September 30, 2011 as income before income taxes was $1.39 million. This compares to a benefit for federal and state income taxes of $(1.57 million) recorded for the year ended September 30, 2010 as the loss before income taxes was $(3.86 million). The Company's effective federal and state income tax (benefit) rate was 21.8% for the year ended September 30, 2011 compared to (40.6%) for the year ended September 30, 2010. The change in the effective tax (benefit) rate is primarily due to changes in the percentage of non-taxable income (such as BOLI) and changes to the Company's deferred tax valuation allowance. In periods with income before income taxes, the effective tax rate is reduced by non-taxable income items. In periods with a loss before income taxes, the effective benefit rate is increased by non-taxable income items and other adjustments that increase the tax benefit.

For additional information on federal income taxes, see Note 13 of the Consolidated Financial Statements contained in "Item 8, Financial Statements and Supplementary Data."

Comparison of Operating Results for the Years Ended September 30, 2010 and 2009

The Company reported a net loss of $(2.29 million) for the year ended September 30, 2010 compared to a net loss of $(242,000) for the year ended September 30, 2009. Net loss to common shareholders after adjusting for preferred stock dividends and preferred stock discount accretion was $(3.33 million) for the year ended September 30, 2010 compared to a net loss to common shareholders of $(1.01 million) for the year ended September 30, 2009. The increased loss was primarily due to increased non-interest expenses and decreased non-interest income, which were partially offset by increased net interest income, a decreased provision for loan losses and an increased benefit for federal income taxes. Loss per diluted common share was $(0.50) for the year ended September 30, 2010, compared to a loss per diluted common share of $(0.15) for the year ended September 30, 2009.

The increased non-interest expense was primarily attributable to an increase in FDIC insurance expense, an increase in salaries and employee benefits expense, an increase in OREO related expenses, an increase in the Company's general liability insurance expense and increases in premises and equipment expenses.

The decrease in non-interest income was primarily a result of a decrease in gain on sale of loans, a decrease in BOLI net earnings and an MSR valuation allowance. These decreases to non-interest income were partially offset by a decrease in the OTTI loss on mortgage-backed securities.

A more detailed explanation of the Statement of Operations categories is presented below.

Net Loss: The net loss for the year ended September 30, 2010 increased by $2.05 million to $(2.29 million) from $(242,000) for the year ended September 30, 2009. Net loss to common shareholders after adjusting for preferred stock dividends and preferred stock discount accretion was $(3.33 million) or $(0.50) per diluted common share for the year ended September 30, 2010, compared to a net loss to common shareholders of $(1.01 million) or $(0.15) per diluted common share for the year ended September 30, 2009.

The $0.35 increase in loss per diluted common share for the year ended September 30, 2010 was primarily the result of a $1.90 million ($1.26 million net of income tax - $0.19 per diluted common share) increase in non-interest expense, a $1.25 million ($826,000 net of income tax - $0.13 per diluted common share) decrease in non-interest income

and a $270,000 increase in preferred stock dividends and preferred stock discount accretion which increased the net loss to common shareholders by approximately $0.04 per diluted common share. Changes to the benefit for income taxes due to a decrease in the amount of dividend deductions and adjustments to the Company's deferred tax valuation allowance also increased the loss per diluted common share by approximately $0.04 per diluted common share. These increases to the loss per diluted common share were partially offset by a $338,000 ($223,000 net of income tax - $0.03 per diluted common share) increase in net interest income and a $184,000 ($121,000 net of income tax - $0.02 per diluted common share) decrease in the provision for loan losses.

Net Interest Income: Net interest income increased by $338,000, or 1.3%, to $25.64 million for the year ended September 30, 2010 from $25.30 million

for the year ended September 30, 2009. The increase in net interest income was primarily attributable to an increased average level of interest earning assets which was partially offset by margin compression due to an increased level of relatively low yielding cash equivalents and other liquid assets.

Total interest and dividend income decreased by $2.21 million, or 5.7%, to $36.60 million for the year ended September 30, 2010 from $38.80 million for the year ended September 30, 2009 as the yield on interest earning assets decreased to 5.53% from 6.15%. The decrease in the weighted average yield on interest earning assets was primarily a result of an increase in the amount of lower yielding cash equivalents and other liquid assets and a change in the composition of the loan portfolio as the level of higher yielding construction and land development loans decreased.

Total interest expense decreased by $2.54 million to $10.96 million for the year ended September 30, 2010 from $13.50 million for the year ended September 30, 2009 as the average rate paid on interest-bearing liabilities decreased to 1.90% for the year ended September 30, 2010 from 2.51% for the year ended September 30, 2009. The decrease in funding costs was primarily a result of a decrease in overall market rates and a decrease in the level of average FHLB advances.

The net interest margin decreased 14 basis points to 3.87% for the year ended September 30, 2010 from 4.01% for the year ended September 30, 2009 as the yield on interest earning assets decreased at a greater rate than the funding costs decreased. The margin compression was primarily due to an increased level of liquid assets with lower yields and the reversal of interest income on loans placed on non-accrual status during the year ended September 30, 2010. The reversal of interest income on loans placed on non-accrual status during the year ended September 30, 2010 reduced the net interest margin by approximately 12 basis points.

Provision for Loan Losses: The provision for loan losses decreased by $184,000, or 1.7%, to $10.55 million for the year ended September 30, 2010 from $10.73 million for the year ended September 30, 2009. The small decrease in the provision for loan losses was primarily a result of a decrease in the level of non-performing loans and a decrease in the Bank's construction and land development loan balances. The Company had net charge-offs of $13.46 million for the year ended September 30, 2010 compared to net charge-offs of $4.44 million for the year ended September 30, 2009. The net charge-off total for the year ended September 30, 2010 included $3.36 million in impairments that were identified and specifically provisioned for in the previous fiscal year. The net charge-offs to average outstanding loans ratio was 2.45% for the year ended September 30, 2010 and 0.79% for the year ended September 30, 2009.

Non-interest Income: Total non-interest income decreased by $1.25 million, or 18.0%, to $5.70 million for the year ended September 30, 2010 from $6.95 million for the year ended September 30, 2009. This decrease was primarily a result of a $1.28 million decrease in gain on sale of loans, an $890,000 valuation allowance on mortgage servicing rights, and a $474,000 decrease in BOLI net earnings. Also impacting the comparison between the years was $139,000 in non-recurring income recorded during the year ended September 30, 2009 for property easements sold. These decreases to non-interest income were partially offset by a $1.37 million decrease in net OTTI losses recorded and a $358,000 increase in ATM transaction fees.

The decreased income from loan sales was primarily a result of a decrease in the amount of residential mortgage loans sold in the secondary market for the year ended September 30, 2010. The sale of one-to four-family mortgage loans totaled $68.3 million for the year ended September 30, 2010 compared to $162.6 million for the year ended September 30, 2009. The higher loan sales

during the year ended September 30, 2009 was primarily due to increased

refinance activity that was attributable to decreased interest rates for fixed rate mortgage loans. The $890,000 valuation allowance on the Company's mortgage servicing rights was primarily the result of lower mortgage interest rates at September 30, 2010 relative to September 30, 2009. The lower interest rates reduced the market value of the Company's mortgage servicing rights by reducing the expected duration of the cash flows associated with the asset. The higher BOLI income for the year ended September 30, 2009 was primarily due to a $377,000 gain on a BOLI death claim benefit and a $134,000 non-recurring gain associated with transferring a portion of the BOLI portfolio to a new insurance company during the year ended September 30, 2009.

The Company's net OTTI loss on mortgage-backed securities decreased by $1.37 million to $2.18 million for the year ended September 30, 2010 from $3.55 million for the year ended September 30, 2009. The OTTI charges for both years were on private label mortgage-backed securities that were acquired from an in-kind redemption from the AMF family of mutual funds in June 2008. At September 30, 2010, the Company's remaining private label mortgage-backed securities had been reduced to $4.95 million from an original acquired balance of $15.30 million.

Non-interest Expense: Total non-interest expense increased by $1.90 million, or 8.4%, to $24.64 million for the year ended September 30, 2010 from $22.74 million for the year ended September 30, 2009. The increase was primarily attributable to an $881,000 increase in FDIC insurance expense, a $353,000 increase in the Company's general liability insurance expense, a $265,000 increase in salaries and employee benefit expense, a $239,000 increase in OREO related expenses and a $194,000 increase in premises and equipment expense.

The increase in FDIC insurance expense was primarily due to increased assessments rates and a non-recurring accrual adjustment which increased the expense by $400,000 for the year ended September 30, 2010. The increase in general liability insurance expense was primarily due to increased insurance costs for financial institutions in this economic cycle.

The increase in salaries and employee benefit expense was primarily a result of a decreased level of loan originations. Under GAAP, the portion of a loan origination fee that is attributable to the estimated employee costs to generate the loan is recorded as a reduction of salaries and employee benefit expense. With the decrease in loan originations, the loan origination fees that reduced salaries and employee benefit expense decreased by $381,000 during the year ended September 30, 2010 compared to the year ended September 30, 2009.

The increase in OREO related expenses was primarily a result of valuation write-downs based on updated appraisals received for several properties. The increase in premises and equipment expense for the current fiscal year was primarily the result of a capital gain on the sale of Company owned property that reduced premises and equipment expenses by $235,000 for the year ended September 30, 2009.

The Company's efficiency ratio increased to 78.65% for the year ended September 30, 2010 from 70.52% for the year ended September 30, 2009.

Benefit for Federal and State Income Taxes: The benefit for federal and state income taxes increased by $584,000 to $1.57 million for the year ended September 30, 2010 from $985,000 for the year ended September 30, 2009 primarily as a result of an increased loss before income taxes. The Company's effective federal and state income tax (benefit) rate was (40.5%) for the year ended September 30, 2010 compared to (80.0%) for the year ended September 30, 2009. The change in the effective tax (benefit) rate is primarily due to changes in the percentage of non-taxable income and changes to the Company's deferred tax valuation allowance. The benefit for federal and state income taxes for the year ended September 30, 2009 was increased by a higher level of non-taxable income, primarily due to an increase in BOLI net earnings. The benefit for income taxes for the year ended September 30, 2009 was also increased by approximately $180,000 due to adjustments made to the Company's deferred tax valuation allowance for a previous non-deductible capital loss carry forward. In periods with a loss before income taxes, the effective benefit rate is increased by non-taxable income items and other adjustments that increase the tax benefit.

Average Balances, Interest and Average Yields/Cost

The earnings of the Company depend largely on the spread between the yield on interest-earning assets and the cost of interest-bearing liabilities, as well as the relative amount of the Company's interest-earning assets and interest-bearing liability portfolios.

The following table sets forth, for the periods indicated, information regarding average balances of assets and liabilities as well as the total dollar amounts of interest income from average interest-earning assets and interest expense on average interest-bearing liabilities and average yields and costs. Such yields and costs for the periods indicated are derived by dividing income or expense by the average daily balance of assets or liabilities, respectively, for the periods presented.

	Year Ended September 30,							
	2011			2010			20	
	Average Balance	Interest and Dividends	Yield/ Cost	Average Balance	Interest and Dividends	Yield/ Cost	Average Balance	Inter an Divid
	(Dollars in thousands)							
Interest-earning assets:								
Loans receivable (1)(2)...	$537,740	$32,976	6.13%	$555,050	$35,344	6.43%	$564,741	$37
Mortgage-backed securities and other investments.............	11,625	612	5.26	17,513	910	5.20	25,762	1

FHLB stock and equity securities	6,680	31	0.46	6,679	35	0.52	6,655	
Federal funds sold	--	--	--	--	--	--	9,032	
Interest-bearing deposits	117,491	347	0.29	82,455	307	0.37	24,964	
Total interest-earning assets	673,536	33,966	5.04	661,697	36,596	5.53	631,154	38
Non-interest-earning assets	59,792			56,482			47,851	
Total assets	$733,328			$718,179			$679,005	
Interest-bearing liabilities:								
Savings accounts	$ 73,696	459	0.62	$ 63,695	454	0.71	$ 55,814	
Money market accounts	57,996	435	0.75	59,988	677	1.13	61,777	1
NOW accounts	157,095	1,415	0.90	141,240	1,749	1.24	97,879	1
Certificates of deposit	240,174	3,827	1.59	234,550	4,927	2.10	224,673	7
Short-term borrowings(3)	511	--	0.05	923	3	0.33	672	
Long-term borrowings (4)	55,000	2,397	4.35	77,479	3,151	4.07	96,721	4
Total interest bearing liabilities	584,472	8,533	1.46	577,875	10,961	1.90	537,536	13
Non-interest bearing liabilities	62,225			53,734			55,086	
Total liabilities	646,697			631,609			592,622	
Shareholders' equity	86,631			86,570			86,383	
Total liabilities and shareholders' equity	$733,328			$718,179			$679,005	
Net interest income		$25,433			$25,635			$25
Interest rate spread			3.58%			3.63%		
Net interest margin (5)			3.78%			3.87%		
Ratio of average interest-earning assets to average interest-bearing liabilities			115.24%			114.51%		

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(1) Does not include interest on loans on non-accrual status. Includes loans originated for sale
Amortized net deferred loan fees, late fees, extension fees and prepayment penalties (2011, $
$829; and 2009, $1,229) included with interest and dividends.
(2) Average balance includes non-accrual loans.
(3) Includes FHLB, FRB and PCBB advances with original maturities of less than one year and other
borrowings-repurchase agreements.
(4) Includes FHLB advances with original maturities of one year or greater.
(5) Net interest income divided by total average interest earning assets.

Rate/Volume Analysis

The following table sets forth the effects of changing rates and volumes on net interest income on the Company. Information is provided with respect to the (i) effects on interest income attributable to changes in volume (changes in volume multiplied by prior rate), and (ii) effects on interest income attributable to changes in rate (changes in rate multiplied by prior volume), and (iii) the net change (sum of the prior columns). Changes in both rate and volume have been allocated to rate and volume variances based on the absolute values of each.

	Year Ended September 30, 2011 Compared to Year Ended September 30, 2010 Increase (Decrease) Due to			Year Ended September 30, 2010 Compared to Year Ended September 30, 2009 Increase (Decrease) Due to		
	Rate	Volume	Net Change	Rate	Volume	Net Change
	(In thousands)					
Interest-earning assets:						
Loans receivable (1)....	$(1,283)	$(1,085)	$(2,368)	$(1,273)	$(632)	$(1,905)
Mortgage-backed securities and other investments............	11	(309)	(298)	(38)	(431)	(469)
FHLB stock and equity securities............	(4)	--	(4)	(3)	--	(3)
Federal funds sold		--	--	--	(36)	(36)
Interest-bearing deposits..............	(72)	112	40	(5)	213	208
Total net change in income on interest-earning assets.........	(1,348)	(1,282)	(2,630)	(1,319)	(886)	(2,205)
Interest-bearing liabilities:						
Savings accounts.......	(61)	66	5	3	57	60
NOW accounts...........	(515)	180	(335)	204	514	718
Money market accounts..	(220)	(21)	(241)	(330)	(29)	(359)
Certificate accounts...	(1,216)	115	(1,101)	(2,408)	324	(2,084)
Short-term borrowings..	(1)	(1)	(2)	1	--	1
Long-term borrowings...	212	(966)	(754)	(94)	(785)	(879)
Total net change in expense on interest-bearing liabilities....	(1,801)	(627)	(2,428)	(2,624)	81	(2,543)
Net change in net interest income........	$ 453	$ (655)	$ (202)	$ 1,305	$(967)	$ 338

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(1) Excludes interest on loans on non-accrual status. Includes loans originated for sale.

Liquidity and Capital Resources

The Company's primary sources of funds are customer deposits, proceeds from principal and interest payments on loans, the sale of loans, maturing securities and FHLB advances. While the maturity and scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

The Bank must maintain an adequate level of liquidity to ensure the availability of sufficient funds to fund loan originations and deposit withdrawals, to satisfy other financial commitments and to take advantage of investment opportunities. The Bank generally maintains sufficient cash and short-term investments to meet short-term liquidity needs. At September 30, 2011, the Bank's regulatory liquidity ratio (net cash, and short-term and marketable assets, as a percentage of net deposits and short-term liabilities) was 22.20%. At September 30, 2011, the Bank maintained an uncommitted credit facility with the FHLB that provided for immediately available advances up to an aggregate amount

equal to 30% of total assets, limited by available collateral, under which $55.0 million was outstanding. The Bank also maintains a short-tem borrowing line with the Federal Reserve Bank with total credit based on eligible collateral. At September 30, 2011 the Bank had no outstanding balance on this borrowing line.

Liquidity management is both a short and long-term responsibility of the Bank's management. The Bank adjusts its investments in liquid assets based upon management's assessment of (i) expected loan demand, (ii) projected loan sales, (iii) expected deposit flows, and (iv) yields available on interest-bearing deposits. Excess liquidity is invested generally in interest-bearing overnight deposits and other short-term government and agency obligations. If the Bank requires funds beyond its ability to generate them internally, it has additional borrowing capacity with the FHLB and collateral for repurchase agreements.

The Bank's primary investing activity is the origination of mortgage loans. During the years ended September 30, 2011, 2010 and 2009, the Bank originated $142.4 million, $154.1 million and $273.6 million of mortgage loans, respectively. At September 30, 2011, the Bank had loan commitments totaling $34.2 million and undisbursed loans in process totaling $18.3 million. The Bank anticipates that it will have sufficient funds available to meet current loan commitments. Certificates of deposit that are scheduled to mature in less than one year from September 30, 2011 totaled $157.2 million. Historically, the Bank has been able to retain a significant amount of its deposits as they mature.

The Bank's liquidity is also affected by the volume of loans sold and loan principal payments. During the years ended September 30, 2011, 2010 and 2009, the Bank sold $62.5 million, $68.3 million and $162.9 million in fixed rate, one- to four-family mortgage loans, respectively. During the years ended September 30, 2011, 2010 and 2009, the Bank received $96.7 million, $150.3 million and $150.7 million in principal repayments, respectively.

The Bank's liquidity has been impacted by increases in deposit levels. During the years ended September 30, 2011, 2010 and 2009, deposits increased by $13.8 million, $73.2 million and $7.1 million, respectively.

Cash and cash equivalents, certificate of deposits held for investment and mortgage-backed securities and other investments decreased to $141.6 million at September 30, 2011 from $146.0 million at September 30, 2010.

Federally-insured state-chartered banks are required to maintain minimum levels of regulatory capital. Under current FDIC regulations, insured state-chartered banks generally must maintain (i) a ratio of Tier 1 leverage capital to total assets of at least 3.0% (4.0% to 5.0% for all but the most highly rated banks), (ii) a ratio of Tier 1 capital to risk weighted assets of at least 4.0% and (iii) a ratio of total capital to risk weighted assets of at least 8.0%. The Bank is required to maintain at least a 10.0% Tier 1 leverage capital ratio pursuant to the Bank MOU. At September 30, 2011, the Bank was in compliance with all applicable capital requirements, including the higher Tier 1 leverage capital ratio required by the Bank MOU . For additional details see Note 18 of the Notes to Consolidated Financial Statements contained in "Item 8. Financial Statements and Supplementary Data" and "Item 1. Business - Regulation of the Bank - Capital Requirements."

Contractual obligations. The following table presents, as of September 30, 2011, the Company's significant fixed and determinable contractual obligations, within the categories described below, by payment date or contractual maturity. These contractual obligations, except for the operating lease obligations are included in the Consolidated Balance Sheet. The payment amounts represent those amounts contractually due at September 30, 2011.

	Payments due by period				
Contractual obligations	Less than 1 year	1 year through 3 years	After 3 years through 5 years	After 5 years	Total
	(In thousands)				
Short-term debt obligations...	$ 729	$ --	$ --	$ --	$ 729
Long-term debt obligations ...	10,000	--	--	45,000	55,000
Operating lease obligations...	211	355	240	--	806
Total contractual obligations................	$10,940	$ 355	$ 240	$45,000	$56,535

Effect of Inflation and Changing Prices

The consolidated financial statements and related financial data presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America which require the measurement of financial position and operating results in terms of historical dollars, without considering the change in the relative purchasing power of money over time due to inflation. The primary impact of inflation on the operation of the Company is reflected in increased operating costs. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than do general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The information contained under "Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations - Market Risk and Asset and Liability Management" of this Form 10-K is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data

Management's Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. All internal control systems, no matter how well designed, have inherent limitations, including the possibility of human error and the circumvention of overriding controls. Also, projections of any evaluation of

effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in Internal Control -- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as of September 30, 2011.

TIMBERLAND BANCORP, INC. AND SUBSIDIARY

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Shareholders of Timberland Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of Timberland Bancorp, Inc. and Subsidiary (collectively, "the Company") as of September 30, 2011 and 2010, and the related consolidated statements of operations, comprehensive income (loss), shareholders' equity, and cash flows for the years then ended. The Company's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. The consolidated financial statements of the Company for the year ended September 30, 2009 were audited by other auditors whose report dated December 14, 2009, expressed an unqualified opinion on those statements.

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

In our opinion, the 2011 and 2010 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Timberland Bancorp, Inc. and Subsidiary as of September 30, 2011 and 2010, and the results of their operations and their cash flows for the years then ended

in conformity with accounting principles generally accepted in the United States of America.

/s/ Delap LLP

Lake Oswego, Oregon
December 12, 2011

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders
Timberland Bancorp, Inc.

We have audited the consolidated statements of operations, shareholders' equity, cash flows, and comprehensive income of Timberland Bancorp, Inc. and Subsidiary for the year ended September 30, 2009. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of the operations and cash flows of Timberland Bancorp, Inc. and Subsidiary for the year ended September 30, 2009, in conformity with U.S. generally accepted accounting principles.

/s/McGladrey & Pullen, LLP

Seattle, Washington
December 14, 2009

Consolidated Balance Sheets

(Dollars in Thousands, Except Per Share Amounts)

Timberland Bancorp, Inc. and Subsidiary

September 30, 2011 and 2010	2011	2010
Assets		
Cash and cash equivalents:		
Cash and due from financial institutions	$ 11,455	$ 9,466
Interest-bearing deposits in banks	100,610	102,320
Total cash and cash equivalents	112,065	111,786
Certificates of deposit ("CDs") held for investment (at cost which approximates fair value)	18,659	18,047
Mortgage-backed securities ("MBS") and other investments - held to maturity, at amortized cost (estimated fair value $4,229 and $4,842)	4,145	5,066
MBS and other investments - available for sale	6,717	11,119
Federal Home Loan Bank of Seattle ("FHLB") stock	5,705	5,705
Loans receivable, net of allowance for loan losses of $11,946 and $11,264	523,980	524,621
Loans held for sale	4,044	2,970
Net loans receivable	528,024	527,591
Premises and equipment, net	17,390	17,383
Other real estate owned ("OREO") and other repossessed assets	10,811	11,519
Accrued interest receivable	2,411	2,630
Bank owned life insurance ("BOLI")	15,917	13,400
Goodwill	5,650	5,650
Core deposit intangible ("CDI")	397	564
Mortgage servicing rights ("MSRs"), net	2,108	1,929
Prepaid Federal Deposit Insurance Corporation ("FDIC") insurance assessment	2,103	3,268
Other assets	6,122	7,030
Total assets	$738,224	$742,687
Liabilities and shareholders' equity		
Liabilities		
Deposits:		
Non-interest-bearing demand	$ 64,494	$ 58,755
Interest-bearing	528,184	520,114
Total deposits	592,678	578,869
FHLB advances	55,000	75,000
Repurchase agreements	729	622
Other liabilities and accrued expenses	3,612	2,788
Total liabilities	652,019	657,279
Commitments and contingencies (See Note 16)	--	--
Shareholders' equity		
Preferred stock, $0.01 par value; 1,000,000 shares authorized; 16,641 shares, Series A, issued and outstanding; $1,000 per share liquidation value	15,989	15,764
Common stock, $0.01 par value; 50,000,000 shares authorized; 7,045,036 shares issued and outstanding	10,457	10,377
Unearned shares issued to Employee Stock Ownership Plan ("ESOP")	(1,983)	(2,247)
Retained earnings	62,270	62,238
Accumulated other comprehensive loss	(528)	(724)

Total shareholders' equity	86,205	85,408
Total liabilities and shareholders' equity	$738,224	$742,687

See notes to consolidated financial statements.

Consolidated Statements of Operations

(Dollars in Thousands, Except Per Share Amounts)

Timberland Bancorp, Inc. and Subsidiary
Years Ended September 30, 2011, 2010 and 2009

	2011	2010	2009
Interest and dividend income			
Loans receivable	$32,976	$35,344	$37,249
MBS and other investments	612	910	1,379
Dividends from mutual funds and FHLB stock	31	35	38
Interest-bearing deposits in banks	347	307	135
Total interest and dividend income	33,966	36,596	38,801
Interest expense			
Deposits	6,136	7,807	9,472
FHLB advances - long term	2,397	3,151	4,031
Federal Reserve Bank of San Francisco ("FRB") borrowings and repurchase agreements	--	3	1
Total interest expense	8,533	10,961	13,504
Net interest income	25,433	25,635	25,297
Provision for loan losses	6,758	10,550	10,734
Net interest income after provision for loan losses	18,675	15,085	14,563
Non-interest income			
Other than temporary impairment ("OTTI") on MBS and other investments	(236)	(998)	(5,820)
Adjustment for portion recorded as (transferred from)other comprehensive income (loss) before taxes	(211)	(1,178)	2,274
Net OTTI on MBS and other investments	(447)	(2,176)	(3,546)
Realized losses on MBS and other investments	(2)	(20)	(76)
Gain on sales of MBS and other investments	79	--	--
Service charges on deposits	3,907	4,240	4,312
ATM transaction fees	1,911	1,619	1,261
BOLI net earnings	517	491	965
Gain on sale of loans, net	1,548	1,547	2,828

Servicing income on loans sold	9	135	103
Escrow fees	73	74	158
Fee income from non-deposit investment sales	92	84	102
Valuation recovery (allowance) on MSRs, net	405	(890)	--
Other	589	592	842
Total non-interest income, net	8,681	5,696	6,949

See notes to consolidated financial statements.

Consolidated Statements of Operations (continued)

(Dollars in Thousands, Except Per Share Amounts)

Timberland Bancorp, Inc. and Subsidiary
Years Ended September 30, 2011, 2010 and 2009

	2011	2010	2009
Non-interest expense			
Salaries and employee benefits	$12,578	$12,066	$11,801
Premises and equipment	2,743	2,768	2,574
Advertising	800	829	895
OREO and other repossessed assets, net	1,374	882	643
ATM	802	698	613
Postage and courier	540	539	549
Amortization of CDI	167	191	217
State and local taxes	622	626	604
Professional fees	753	664	745
FDIC insurance	1,161	1,659	778
Other insurance	359	435	82
Loan administration and foreclosure	959	481	374
Data processing and telecommunication	996	941	921
Deposit operations	675	478	515
Other	1,434	1,384	1,428
Total non-interest expense	25,963	24,641	22,739
Income (loss) before income taxes	1,393	(3,860)	(1,227)
Provision (benefit) for federal and state income taxes	304	(1,569)	(985)
Net income (loss)	1,089	(2,291)	(242)
Preferred stock dividends	(832)	(832)	(643)
Preferred stock discount accretion	(225)	(210)	(129)
Net Income (loss) to common shareholders	$ 32	$(3,333)	$(1,014)
Net income (loss) per common share			
Basic	$ 0.00	$ (0.50)	$ (0.15)
Diluted	0.00	(0.50)	(0.15)

See notes to consolidated financial statements.

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Consolidated Statements of Comprehensive Income (Loss)

(Dollars in Thousands)

Timberland Bancorp, Inc. and Subsidiary
Years Ended September 30, 2011, 2010 and 2009

	2011	2010	2009
Comprehensive income (loss)			
Net income (loss)	$ 1,089	$ (2,291)	$ (242)
Cumulative effect of FASB guidance regarding recognition of OTTI	--	--	(91)
Unrealized holding gain on securities available for sale, net of tax	14	491	18
Change in OTTI on securities held to maturity, net of tax:			
Additions	(65)	(23)	(1,804)
Additional amount recognized related to credit loss for which OTTI was previously recognized	16	580	574
Amount reclassified to credit loss for previously recorded market loss	188	209	(248)
Accretion of OTTI securities held to maturity, net of tax	43	31	--
Total comprehensive income (loss)	$ 1,285	$ (1,003)	$(1,793)

See notes to consolidated financial statements.

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Consolidated Statements of Shareholders' Equity

(Dollars in Thousands, Except Per Share Amounts)

Timberland Bancorp, Inc. and Subsidiary
Years Ended September 30, 2011, 2010 and 2009

	Number of Shares		Amount		Unearned Shares Issued to ESOP	Retained Earnings	Accumulated Other Comprehensive Los
	Preferred Stock	Common Stock	Preferred Stock	Common Stock			
Balance, September 30, 2008	--	6,967,579	$ --	$ 8,672	$(2,776)	$69,406	$ (461

Net loss	--	--	--	--	--	(242)	--
Issuance of preferred stock with attached common stock warrants	16,641	--	15,425	1,158	--	--	--
Accretion of preferred stock discount	--	--	129	--	--	(129)	--
Issuance of MRDP (1) shares	--	19,758	--	--	--	--	--
Exercise of stock options	--	57,699	--	392	--	--	--
Cash dividends							
($0.39 per common share)	--	-	--	--	--	(2,736)	--
(5% preferred stock)	--	-	--	--	--	(536)	--
Earned ESOP shares	--	--	--	(47)	264	-	--
MRDP compensation expense	--	-	--	137	--	-	--
Stock option compensation expense	--	-	--	3	--	--	--
Cumulative effect of Financial Accounting Standards Board ("FASB") guidance regarding recognition of OTTI	--	-	--	--	--	91	(91
Unrealized holding gain on securities available for sale, net of tax	--	-	--	--	--	-	18
Change in OTTI on securities held to maturity, net of tax	--	-	--	--	--	-	(1,478
Balance, September 30, 2009	16,641	7,045,036	15,554	10,315	(2,512)	65,854	(2,012
Net loss	--	--	--	--	--	(2,291)	--
Accretion of preferred stock discount	--	--	210	--	--	(210)	--
Cash dividends							
($0.04 per common share)	--	-	--	--	--	(283)	--
(5% preferred stock)	--	-	--	--	--	(832)	--
Earned ESOP shares	--	-	--	(78)	265	-	--
MRDP compensation expense	--	-	--	134	--	--	--
Stock option compensation expense	--	-	--	6	--	-	--
Unrealized holding gain on securities available for sale, net of tax	--	-	--	--	--	--	491
Change in OTTI on securities held to maturity, net of tax	--	-	--	--	--	-	766
Accretion of OTTI on securities held to maturity, net of tax	--	-	--	--	--	-	31
Balance, September 30, 2010	16,641	7,045,036	15,764	10,377	(2,247)	62,238	(724

(1) 1998 Management Recognition and Development Plan ("MRDP").

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity (continued)

(Dollars in Thousands, Except Per Share Amounts)

Timberland Bancorp, Inc. and Subsidiary
Years Ended September 30, 2011, 2010 and 2009

	Number of Shares		Amount				Accumu late Othe Compre hensiv Los
	Preferred Stock	Common Stock	Preferred Stock	Common Stock	Unearned Shares Issued to ESOP	Retained Earnings	
Balance, September 30, 2010	16,641	7,045,036	$15,764	$10,377	$(2,247)	$62,238	$(724
Net income	--	--	--	--	--	1,089	--
Accretion of preferred stock discount	--	--	225	--	--	(225)	--
5% preferred stock dividend	--	-	--	--	--	(832)	--
Earned ESOP shares	--	-	--	(61)	264	-	--
MRDP compensation expense	--	-	--	134	--	-	--
Stock option compensation expense	--	-	--	7	--	-	--
Unrealized holding gain on securities available for sale, net of tax	--	-	--	--	--	-	14
Change in OTTI on securities held to maturity, net of tax	--	-	--	--	--	-	139
Accretion of OTTI on securities held to maturity, net of tax	--	-	--	--	--	-	43
Balance, September 30, 2011	16,641	7,045,036	$15,989	$10,457	$(1,983)	$ 62,270	$ (528

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(Dollars in Thousands)

Timberland Bancorp, Inc. and Subsidiary
Years Ended September 30, 2011, 2010 and 2009

	2011	2010	2009

Cash flows from operating activities			
Net income (loss)	$1,089	$ (2,291)	$ (242)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation	992	1,141	1,136
Deferred federal income taxes	(526)	466	(1,813)
Amortization of CDI	167	191	217
Earned ESOP shares	264	265	264
MRDP compensation expense	171	173	169
Stock option compensation expense	7	6	3
Stock option tax effect	--	--	46
Gain on sale of MBS and other investments	(79)	--	--
Net OTTI on MBS and other investments	447	2,176	3,546
Realized losses on MBS and other investments	2	20	76
Gain on sale of OREO and other repossessed assets, net	(548)	(291)	(60)
Gain on sale of loans, net	(1,548)	(1,547)	(2,828)
(Gain) loss on disposition of premises and equipment, net	16	6	(233)
Provision for loan losses	6,758	10,550	10,734
Provision for OREO losses	1,402	535	306
Loans originated for sale	(63,264)	(69,123)	(158,942)
Proceeds from sale of loans	63,738	68,330	162,913
MSRs valuation allowance	405	890	--
BOLI net earnings	(517)	(491)	(965)
Decrease in deferred loan origination fees	(287)	(210)	(308)
Net change in accrued interest receivable and other assets, and other liabilities and accrued expenses	2,010	(4,752)	(2,546)
Net cash provided by operating activities	10,699	6,044	11,473
Cash flows from investing activities			
Net increase in CDs held for investment	(612)	(14,796)	(3,251)
Activity in securities held to maturity:			
Maturities and prepayments	850	1,222	1,763
Activity in securities/mutual funds available for sale:			
Maturities and prepayments	2,243	3,062	3,451
Proceeds from sales	2,272	--	--
(Increase) decrease in loans receivable, net	(10,157)	3,532	(11,158)
Additions to premises and equipment	(1,015)	(484)	(2,347)
Proceeds from sale of OREO and other repossessed assets	4,181	4,507	2,317
Purchase of BOLI	(2,000)	--	--
Proceeds from the disposition of premises and equipment	--	--	282
Net cash used by investing activities	(4,238)	(2,957)	(8,943)

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows (continued)

(Dollars in Thousands)

Timberland Bancorp, Inc. and Subsidiary
Years Ended September 30, 2011, 2010 and 2009

	2011	2010	2009
Cash flows from financing activities			
Net increase in deposits	$ 13,809	$ 73,208	$ 7,089
Repayment of FHLB advances - long term	(20,000)	(20,000)	(9,628)
Net increase (decrease) in FRB borrowings - short term	--	(10,000)	10,000
Net increase (decrease) in repurchase agreements	107	(155)	19
Proceeds from exercise of stock options	--	--	346
ESOP tax effect	(61)	(78)	(47)
MRDP compensation tax effect	(37)	(39)	(32)
Issuance of stock warrants	--	--	1,158
Issuance of preferred stock	--	--	15,425
Payment of dividends	--	(699)	(3,272)
Net cash provided (used) by financing activities	(6,182)	42,237	21,058
Net increase in cash and cash equivalents	279	45,324	23,588
Cash and cash equivalents			
Beginning of year	111,786	66,462	42,874
End of year	$ 112,065	$111,786	$ 66,462
Supplemental disclosures of cash flow information			
Income taxes paid	$ 2,097	$ 3	$ 1,452
Interest paid	8,725	11,189	13,674
Supplemental disclosures of non-cash investing and financing activities			
Loans transferred to OREO and other repossessed assets	$ 5,782	$ 9,434	$ 10,237
Shares issued to MRDP	--	--	138
Loans originated to facilitate sale of OREO	1,538	1,349	1,021

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 1 - Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of

Timberland Bancorp, Inc. ("Company"); its wholly owned subsidiary, Timberland Bank ("Bank"); and the Bank's wholly owned subsidiary, Timberland Service Corp. All significant intercompany transactions and balances have been eliminated in consolidation.

Nature of Operations

The Company is a bank holding company which operates primarily through its subsidiary, the Bank. The Bank was established in 1915 and, through its 22 branches located in Grays Harbor, Pierce, Thurston, Kitsap, King and Lewis counties in Washington State, attracts deposits from the general public, and uses those funds, along with other borrowings, primarily to provide residential real estate, construction, commercial real estate, commercial business and consumer loans to borrowers primarily in western Washington and to a lesser extent, to invest in mortgage-backed securities and other investment securities.

Consolidated Financial Statement Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and prevailing practices within the banking industry. The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities, as of the date of the consolidated balance sheet, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the determination of OTTI in the estimated fair value of mortgage-backed securities and FHLB stock, the valuation of MSRs, the valuation of OREO and the determination of goodwill impairment.

Certain prior year amounts have been reclassified to conform to the fiscal 2011 presentation with no change to net income (loss) or shareholders' equity previously reported.

Segment Reporting

The Company has one reportable operating segment which is defined as community banking in western Washington under the operating name, "Timberland Bank".

(continued)

Note 1 - Summary of Significant Accounting Policies (continued)

U.S. Treasury Department's Capital Purchase Program

On December 23, 2008, the Company received $16.64 million from the U.S. Treasury Department ("Treasury") as part of the Treasury's Capital Purchase Program ("CPP"). The CPP was established as part of the Troubled Asset Relief

Program ("TARP"). The Company sold 16,641 shares of senior preferred stock, with a related warrant to purchase 370,899 shares of the Company's common stock at a price of $6.73 per share at any time through December 23, 2018. The preferred stock has a 5.0% dividend for the first five years, after which the rate increases to 9.0% until the preferred shares are redeemed by the Company.

Preferred stock is initially recorded at the amount of proceeds received. Any discount from the liquidation value is accreted to the expected call date and charged to retained earnings. This accretion is recorded using the level-yield method. Preferred dividends paid (or accrued) and any accretion is deducted from (added to) net income (loss) for computing net income (loss) to common shareholders and net income (loss) per share computations.

On February 1, 2010, the FRB determined that the Company required additional supervisory attention and entered into a Memorandum of Understanding with the Company (the "Company MOU"). Under the agreement the Company must among other things obtain prior written approval, or non-objection from the FRB to declare or pay any dividends (see Note 18). The FRB has denied the Company's requests to pay dividends on its Series A Preferred Stock issued under the CPP for quarterly payments due for the last seven quarters commencing with the payments due May 15, 2010. There can be no assurance that the FRB will approve such payments or dividends in the future. The Company may not declare or pay dividends on its common stock or, with certain exceptions, repurchase common stock without first having paid all cumulative preferred dividends that are due. Since dividends on the Series A Preferred Stock have not been paid for six quarters, the Treasury has the right to appoint two members to the Board of Directors of the Company.

MBS and Other Investments

MBS and other investments are classified upon acquisition as either held to maturity or available for sale. Securities that the Company has the positive intent and ability to hold to maturity are classified as held to maturity and reflected at amortized cost. Securities classified as available for sale are reflected at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income/loss, net of tax effects. Premiums and discounts are amortized to earnings using the interest method over the contractual life of the securities. Gains and losses on sales of securities are recognized on the trade date and determined using the specific identification method.

In estimating whether there are any OTTI losses, management considers 1) the length of time and the extent to which the fair value has been less than amortized cost, 2) the financial condition and near term prospects of the issuer, 3) the impact of changes in market interest rates and 4) the intent and ability of the Company to retain its investment for a period of time sufficient to allow for any anticipated recovery in fair value.

(continued)

Note 1 - Summary of Significant Accounting Policies (continued)

MBS and Other Investments (concluded)

Declines in the fair value of individual securities available for sale that are deemed to be other than temporary are reflected in earnings when identified. The fair value of the security then becomes the new cost basis. For individual securities which the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, the other than temporary decline in the fair value of the security related to 1) credit loss is recognized in earnings and 2) market or other factors is recognized in other comprehensive income or loss. Credit loss is recorded if the present value of cash flows is less than the amortized cost. For individual securities which the Company intends to sell the security or more likely than not will not recover all of its amortized cost, the OTTI is recognized in earnings equal to the entire difference between the security's cost basis and its fair value at the balance sheet date. For individual securities for which credit loss has been recognized in earnings, interest accruals and amortization and accretion of premiums and discounts are suspended when the credit loss is recognized. Interest received after accruals have been suspended is recognized on a cash basis.

FHLB Stock

The Company, as a member of the FHLB, is required to maintain an investment in capital stock of the FHLB in an amount equal to the greater of 1% of its outstanding home loans or 5% of advances from the FHLB. The recorded amount of FHLB stock equals its estimated fair value because the shares can only be redeemed by the FHLB at the $100 per share par value.

The Company views its investment in the FHLB stock as a long-term investment. Accordingly, when evaluating for impairment, the value is determined based on the ultimate recovery of the par value rather than recognizing temporary declines in value. The determination of whether a decline affects the ultimate recovery is influenced by criteria such as: 1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and length of time a decline has persisted; 2) the impact of legislative and regulatory changes on the FHLB and 3) the liquidity position of the FHLB. As of September 30, 2011, the FHLB reported that it had met all of its regulatory capital requirements, but remained classified as "undercapitalized" by its regulator, the Federal Housing Finance Agency ("FHFA"). On October 25, 2010, the FHLB announced that it had entered into a Consent Agreement with the FHFA, which requires the FHLB to take certain specified actions related to its business and operations. The FHLB will not pay a dividend or repurchase capital stock while it is classified as undercapitalized. While the FHLB was classified as undercapitalized as of September 30, 2011, the Company does not believe that its investment in the FHLB is impaired. However, this estimate could change in the near term if: 1) significant other-than-temporary losses are incurred on the FHLB's mortgage-backed securities causing a significant decline in its regulatory capital status; 2) the economic losses resulting from credit deterioration on the FHLB's mortgage-backed securities increases significantly or 3) capital preservation strategies being utilized by the FHLB become ineffective.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are stated in the aggregate at the lower of cost or estimated fair value. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. Gains or losses on sales of loans are recognized at the time of sale. The gain or loss is the difference between the net sales

proceeds and the recorded value of the loans, including any remaining unamortized deferred loan origination fees.

(continued)

Note 1 - Summary of Significant Accounting Policies (continued)

Loans Receivable

Loans are stated at the amount of unpaid principal, reduced by the undisbursed portion of construction loans in process, deferred loan origination fees and the allowance for loan losses.

Troubled Debt Restructured Loans

A troubled debt restructured loan is a loan for which the Bank, for reasons related to a borrower's financial difficulties, grants a concession to the borrower that the Bank would not otherwise consider.

The loan terms which have been modified or restructured due to a borrower's financial difficulty, include but are not limited to: a reduction in the stated interest rate; an extension of the maturity at an interest rate below current market; a reduction in the face amount of the debt; a reduction in the accrued interest; or re-aging, extensions, deferrals and renewals. Troubled debt restructured loans are considered impaired and are individually evaluated for impairment.

Impaired Loans

A loan is generally considered impaired when it is probable that the Company will be unable to collect all contractual principal and interest payments due in accordance with the original or modified terms of the loan agreement. Impaired loans are measured based on the estimated fair value of the collateral less estimated cost to sell if the loan is considered collateral dependent. Impaired loans not considered to be collateral dependent are measured based on the present value of expected future cash flows discounted at the loan's original effective interest rate.

The categories of non-accrual loans and impaired loans overlap, although they are not coextensive. The Company considers all circumstances regarding the loan and borrower on an individual basis when determining whether an impaired loan should be placed on non-accrual status, such as the financial strength of the borrower, the estimated collateral value, reasons for the delays in payment, payment record, the amount past due and the number of days past due.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level sufficient to provide for estimated loan losses based on evaluating known and inherent risks in the loan portfolio. The allowance is provided based upon management's comprehensive analysis of the pertinent factors underlying the quality of the

loan portfolio. These factors include changes in the amount and composition of the loan portfolio, delinquency levels, actual loan loss experience, current economic conditions, and a detailed analysis of individual loans for which full collectability may not be assured. The detailed analysis includes methods to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. The allowance consists of specific and general components. The specific component relates to loans that are deemed impaired. For such loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the recorded value of that loan. The general component covers non-classified loans and classified loans that are not evaluated individually for impairment and is based on historical loss experience adjusted for qualitative factors. Qualitative factors are determined by loan type and adjust historical

(continued)

Note 1 - Summary of Significant Accounting Policies (continued)

Allowance for Loan Losses (concluded)

loss experience to reflect the current environment and portfolio performance trends including recent charge-off trends. Allowances are provided based on management's continuing evaluation of the pertinent factors underlying the quality of the loan portfolio, including changes in the size and composition of the loan portfolio, actual loan loss experience, current economic conditions, collateral values, geographic concentrations, seasoning of the loan portfolio, specific industry conditions, and the duration of the current business cycle. The appropriateness of the allowance for loan losses on loans is estimated based upon these factors and trends identified by management at the time consolidated financial statements are prepared.

In accordance with the FASB guidance for receivables, a loan is considered impaired when it is probable that a creditor will be unable to collect all amounts (principal and interest) due according to the contractual terms of the loan agreement. Smaller balance homogenous loans, such as residential mortgage loans and consumer loans, may be collectively evaluated for impairment. When a loan has been identified as being impaired, the amount of the impairment is measured by using discounted cash flows, except when, as an alternative, the current estimated fair value of the collateral, reduced by estimated costs to sell, is used. The valuation of real estate collateral is subjective in nature and may be adjusted in future periods because of changes in economic conditions. Management considers third-party appraisals, as well as independent fair market value assessments from realtors or persons involved in selling real estate in determining the estimated fair value of particular properties. In addition, as certain of these third-party appraisals and independent fair market value assessments are only updated periodically, changes in the values of specific properties may have occurred subsequent to

the most recent appraisals. Accordingly, the amounts of any such potential changes and any related adjustments are generally recorded at the time such information is received. When the measurement of the impaired loan is less than the recorded investment in the loan (including accrued interest and net deferred loan origination fees or costs), impairment is recognized by creating or adjusting an allocation of the allowance for loan losses and uncollected accrued interest is reversed against interest income. If ultimate collection of principal is in doubt, all cash receipts on impaired loans are applied to reduce the principal balance.

A provision for loan losses is charged against operations and is added to the allowance for loan losses based on quarterly comprehensive analyses of the loan portfolio. The allowance for loan losses is allocated to certain loan categories based on the relative risk characteristics, asset classifications and actual loss experience of the loan portfolio. While management has allocated the allowance for loan losses to various loan portfolio segments, the allowance is general in nature and is available for the loan portfolio in its entirety.

The ultimate recovery of all loans is susceptible to future market factors beyond the Company's control. These factors may result in losses or recoveries differing significantly from those provided in the consolidated financial statements. The Company has experienced a significant decline in valuations for some real estate collateral since October 2008. If real estate values continue to decline and as updated appraisals are received on collateral for impaired loans, the Company may need to increase the allowance for loan losses appropriately. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses, and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

(continued)

Note 1 - Summary of Significant Accounting Policies (continued)

Interest on Loans and Loan Fees

Interest on loans is accrued daily based on the principal amount outstanding. Generally, the accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due or when they are past due 90 days as to either principal or interest (based on contractual terms), unless they are well secured and in the process of collection. All interest accrued but not collected for loans that are placed on non-accrual status or charged off is reversed against interest income. Subsequent collections on a cash basis are applied proportionately to past due principal and interest, unless collectability of principal is in doubt, in which case all payments are applied to principal. Loans are returned to accrual status when the loan is deemed current, and the

collectability of principal and interest is no longer doubtful, or on one- to four-family loans when the loan is less than 90 days delinquent.

The Bank charges fees for originating loans. These fees, net of certain loan origination costs, are deferred and amortized to income, on the level-yield basis, over the loan term. If the loan is repaid prior to maturity, the remaining unamortized deferred loan origination fee is recognized in income at the time of repayment.

MSRs

The Bank holds rights to service loans that it has originated and sold to Federal Home Loan Mortgage Corporation ("Freddie Mac"). MSRs are capitalized at estimated fair value when acquired through the origination of loans that are subsequently sold with the servicing rights retained and are amortized to servicing income on loans sold in proportion to and over the period of estimated net servicing income. The value of MSRs at the date of the sale of loans is estimated based on the discounted present value of expected future cash flows using key assumptions for servicing income and costs and prepayment rates on the underlying loans. The estimated fair value is periodically evaluated for impairment by comparing actual cash flows and estimated future cash flows from the servicing assets to those estimated at the time servicing assets were originated. Fair values are estimated using discounted cash flows based on current market rates of interest. For purposes of measuring impairment, the rights must be stratified by one or more predominant risk characteristics of the underlying loans. The Company stratifies its capitalized MSRs based on product type, and term of the underlying loans. The amount of impairment recognized is the amount, if any, by which the amortized cost of the rights exceed their fair value. Impairment, if deemed temporary, is recognized through a valuation allowance to the extent that fair value is less than the recorded amount.

BOLI

BOLI policies are recorded at their cash surrender value less applicable cash surrender charges. Income from BOLI is recognized when earned.

(continued)

Note 1 - Summary of Significant Accounting Policies (continued)

Goodwill

Goodwill is initially recorded when the purchase price paid for an acquisition exceeds the estimated fair value of the net identified tangible and intangible assets acquired. Goodwill is presumed to have an indefinite useful life and is analyzed annually for impairment. An annual review is performed during the third quarter of each fiscal year, or more frequently if indicators of potential impairment exist, to determine if the recorded goodwill is impaired. If the fair value of the Company's sole reporting unit exceeds the recorded

value of the reporting unit, goodwill is not considered impaired and no additional analysis is necessary.

During the quarter ended June 30, 2011, the Company engaged a third party firm to perform the annual test for goodwill impairment. The test concluded that recorded goodwill was not impaired. As of September 30, 2011, management believes that there have been no events or changes in the circumstances that would indicate a potential impairment. No assurance can be given, however, that the Company will not record an impairment loss on goodwill in the future.

CDI

The CDI is amortized to non-interest expense using an accelerated method over a ten-year period.

Premises and Equipment

Premises and equipment are recorded at cost. Depreciation is computed using the straight-line method over the following estimated useful lives: buildings and improvements - up to 40 years; furniture and equipment - three to seven years; and automobiles - five years. The cost of maintenance and repairs is charged to expense as incurred. Gains and losses on dispositions are reflected in earnings.

Impairment of Long-Lived Assets

Long-lived assets, consisting of premises and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the recorded amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the recorded amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the recorded amount of the assets exceeds the discounted recovery amount or estimated fair value of the assets. No events or changes in circumstances have occurred during the years ended September 30, 2011 or 2010 that would cause management to evaluate the recoverability of the Company's long-lived assets.

(continued)

Note 1 - Summary of Significant Accounting Policies (continued)

Other Real Estate Owned and Other Repossessed Assets

Other real estate owned and other repossessed assets consist of properties or assets acquired through or in lieu of foreclosure, and are recorded initially at the estimated fair value of the properties less estimated costs of disposal. Costs relating to development and improvement of the properties or assets are capitalized while costs relating to holding the properties or

assets are expensed. The valuation of real estate collateral is subjective in nature and may be adjusted in future periods because of changes in economic conditions. Management considers third-party appraisals, as well as independent fair market value assessments from realtors or persons involved in selling real estate in determining the estimated fair value of particular properties. In addition, as certain of these third-party appraisals and independent fair market value assessments are only updated periodically, changes in the values of specific properties may have occurred subsequent to the most recent appraisals. Accordingly, the amounts of any such potential changes and any related adjustments are generally recorded at the time such information is received.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Income Taxes

The Company files a consolidated federal income tax return with the Bank. The Bank provides for income taxes separately and remits to (receives from) the Company amounts currently due.

Deferred federal income taxes result from temporary differences between the tax basis of assets and liabilities, and their reported amounts in the consolidated financial statements. These temporary differences will result in differences between income (loss) for tax purposes and income (loss) for financial reporting purposes in future years. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision (benefit) for income taxes. Valuation allowances are established to reduce the net recorded amount of deferred tax assets if it is determined to be more likely than not, that all or some portion of the potential deferred tax asset will not be realized.

With respect to accounting for uncertainty in incomes taxes a tax provision is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely to be realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The Company recognizes interest and or/penalties related to income tax matters as income tax expense.

(continued)

Note 1 - Summary of Significant Accounting Policies (continued)

Income Taxes (concluded)

The Company is no longer subject to United States federal income tax examination by tax authorities for years ended on or before September 30, 2007.

Employee Stock Ownership Plan

The Bank sponsors a leveraged Employee Stock Ownership Plan ("ESOP"). The ESOP is accounted for in accordance with the accounting requirements for stock compensation. Accordingly, the debt of the ESOP is recorded as other borrowed funds of the Bank, and the shares pledged as collateral are reported as unearned shares issued to the employee stock ownership plan on the consolidated balance sheets. The debt of the ESOP is payable to the Company and is therefore eliminated in the consolidated financial statements. As shares are released from collateral, compensation expense is recorded equal to the average market price of the shares for the period, and the shares become available for net income (loss) per common share calculations. Dividends paid on unallocated shares reduce the Company's cash contributions to the ESOP.

Cash and Cash Equivalents and Cash Flows

The Company considers amounts included in the consolidated balance sheets' captions "Cash and due from financial institutions," and "Interest-bearing deposits in banks," all of which mature within ninety days, to be cash equivalents for purpose of reporting cash flows. Cash flows from loans, deposits, FRB borrowings and repurchase agreements are reported net.

Interest-bearing deposits in banks as of September 30, 2011 and 2010 included deposits with the Federal Reserve Bank of San Francisco of $93,465,000 and $88,805,000, respectively. The Company also maintains balances in correspondent bank accounts which, at times, may exceed FDIC insurance limits of $250,000. Management believes that its risk of loss associated with such balances is minimal due to the financial strength of the correspondent banks.

Advertising

Costs for advertising and marketing are expensed as incurred.

Stock-Based Compensation

The Company measures compensation cost for all stock-based awards based on the grant-date fair value and recognizes compensation cost over the service period of stock-based awards.

The fair value of stock options is determined using the Black-Scholes valuation model. The fair value of stock grants under the MRDP is equal to the fair value of the shares at the grant date.

The Company's stock compensation plans are described more fully in Note 15.

(continued)

Note 1 - Summary of Significant Accounting Policies (continued)

Net Income (Loss) Per Common Share

Basic net income (loss) per common share is computed by dividing net income (loss) available for common stock by the weighted average number of common shares outstanding during the period, without considering any dilutive items. Diluted net income per common share is computed by dividing net income available for common stock by the weighted average number of common shares and common stock equivalents for items that are dilutive, net of shares assumed to be repurchased using the treasury stock method at the average share price for the Company's common stock during the period. Diluted loss per common share is the same as basic loss per common share for the years ended September 30, 2010 and 2009 due to the anti-dilutive effect of common stock equivalents. Common stock equivalents arise from assumed conversion of outstanding stock options and outstanding warrants to purchase common stock. Shares owned by the Bank's ESOP that have not been allocated are not considered to be outstanding for the purpose of computing net income (loss) per common share.

Related Party Transactions

The Chairman of the Board of the Bank and the Company is a member of the law firm that provides general counsel to the Bank. Legal fees paid to this law firm for the years ended September 30, 2011, 2010 and 2009 totaled $176,000, $133,000 and $125,000, respectively.

Recent Accounting Pronouncements

In July 2010, the FASB issued updated guidance on disclosure requirements for the credit quality of financing receivables and the allowance for loan losses. The new guidance requires entities to provide disclosures designed to facilitate financial statement users' evaluation of (i) the nature of credit risk inherent in the entity's portfolio of financing receivables, (ii) how that risk is analyzed and assessed in arriving at the allowance for credit losses and (iii) the changes and reasons for those changes in the allowance for loan losses. Disclosures must be disaggregated by portfolio segment, the level at which an entity develops and documents a systematic method for determining its allowance for loan losses, and class of financing receivable, which is generally a disaggregation of portfolio segment. The required disclosures include, among other things, a roll forward of the allowance for loan losses as well as information about modified, impaired, non-accrual and past due loans and credit quality indicators. This guidance became effective for the Company's consolidated financial statements as of December 31, 2010 and for the year ended September 30, 2011.

(continued)

Note 1 - Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements (continued)

In December 2010, the FASB issued updated guidance on goodwill and other intangibles regarding when to perform step two of the goodwill impairment test for reporting units with zero or negative carrying amounts. This guidance became effective for the Company on October 1, 2011. The Company does not expect it to have a material impact on its consolidated financial statements.

In September 2011, the FASB issued guidance regarding testing goodwill for impairment. The new guidance allows an entity the option to make a qualitative evaluation about the likelihood of goodwill impairment to determine whether it should calculate the fair value of the reporting unit. The guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In April 2011, the FASB issued updated guidance on receivables and the determination of whether a loan modification is a troubled debt restructuring. The new guidance clarifies which loan modifications constitute troubled debt restructurings and is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring, both for purposes of recording an impairment loss and for disclosure of troubled debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude under the guidance that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. This guidance became effective for the Company as of July 1, 2011, and applies retrospectively to restructurings occurring on or after October 1, 2010. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In April 2011, the FASB issued guidance regarding Transfer and Servicing for the Reconsideration of Effective Control for Repurchase Agreements. The guidance removes from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and the collateral maintenance implementation guidance related to that criterion. Other criteria applicable to the assessment of effective control are not changed by the amendments. The guidance is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted.
The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In May 2011, the FASB issued amended guidance regarding the application of existing fair value measurement guidance. The provisions of the amended guidance clarify the application of existing fair value measurement guidance and revise certain measurement and disclosure requirements to achieve convergence of GAAP and International Financial Reporting Standards. The provisions of this amended guidance are effective for the Company's first reporting period beginning January 1, 2012, with early adoption not permitted. The Company is in the process of evaluating the impact of adoption of this guidance and does not expect it to have a material impact on its consolidated financial statements.

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Notes to Consolidated Financial Statements

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 1 - Summary of Significant Accounting Policies (concluded)

Recent Accounting Pronouncements (concluded)

In June 2011, the FASB issued amended guidance on the presentation of comprehensive income (loss). The new guidance eliminates the current option to present the components of other comprehensive income (loss) in the statement of changes in equity and requires the presentation of net income (loss) and other comprehensive income (loss) (and their respective components) either in a single continuous statement or in two separate but consecutive statements. The amendments do not alter any current recognition or measurement requirements with respect to the items of other comprehensive income (loss). The provisions of this guidance are effective for the Company's first reporting period beginning on January 1, 2012, with early adoption permitted. The Company does not expect it to have a material impact on its consolidated financial statements.

Note 2 - Restricted Assets

Federal Reserve Board regulations require that the Bank maintain certain minimum reserve balances on hand or on deposit with the Federal Reserve Bank, based on a percentage of transaction account deposits. The amounts of the reserve requirement balances as of September 30, 2011 and 2010 were approximately $933,000 and $781,000, respectively.

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Notes to Consolidated Financial Statements

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 3 - Mortgage-Backed Securities and Other Investments

Mortgage-backed securities and other investments were as follows as of September 30 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value

2011

Held to Maturity				
Mortgage-backed securities:				
U.S. government agencies	$ 1,831	$ 45	$ (4)	$ 1,872
Private label residential	2,287	311	(271)	2,327
U.S. agency securities	27	3	--	30
Total	$ 4,145	$ 359	$ (275)	$ 4,229
Available for Sale				
Mortgage-backed securities:				
U.S. government agencies	$ 4,395	$ 188	$ --	$ 4,583
Private label residential	1,227	59	(152)	1,134
Mutual Funds	1,000	--	--	1,000
Total	$ 6,622	$ 247	$ (152)	$ 6,717

2010

Held to Maturity				
Mortgage-backed securities:				
U.S. government agencies	$ 2,107	$ 29	$ (5)	$ 2,131
Private label residential	2,931	161	(411)	2,681
U.S. agency securities	28	2	--	30
Total	$ 5,066	$ 192	$ (416)	$ 4,842
Available for Sale				
Mortgage-backed securities:				
U.S. government agencies	$ 7,846	$ 262	$ --	$ 8,108
Private label residential	2,198	73	(248)	2,023
Mutual Funds	1,000	--	(12)	988
Total	$ 11,044	$ 335	$ (260)	$ 11,119

(continued)

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 3 - Mortgage-Backed Securities and Other Investments (continued)

The following table summarizes the estimated fair value and gross unrealized losses for all securities and the length of time the unrealized losses existed as of September 30, 2011 (in thousands):

	Less Than 12 Months		12 Months or Longer		Tota
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value
Held to Maturity					
Mortgage-backed securities:					
U.S. government agencies	$ 109	$ (1)	$ 357	$ (3)	$ 466
Private label residential	--	--	819	(271)	819
Total	$ 109	$ (1)	$ 1,176	$ (274)	$ 1,285
Available for Sale					
Mortgage-backed securities:					
Private label residential	$ --	$ --	$ 760	$ (152)	$ 760
Total	$ --	$ --	$ 760	$ (152)	$ 760

The Company has evaluated these securities and has determined that the decline in their value is temporary. The unrealized losses are primarily due to unusually large spreads in the market for private label mortgage-related products. The fair value of the mortgage-backed securities is expected to recover as the securities approach their maturity date and/or as the pricing spreads narrow on mortgage-related securities. The Company has the ability and the intent to hold the investments until the market value recovers. Furthermore, as of September 30, 2011, management does not have the intent to sell any of the securities classified as available for sale where the estimated fair value is below the recorded value and believes that it is more likely than not that the Company will not have to sell such securities before a recovery of cost (or recorded value if previously written down).

During the year ended September 30, 2011, the Company recorded net OTTI charges through earnings on residential mortgage-backed securities of $447,000. For the year ended September 30, 2010, the Company recorded net OTTI charges through earnings on residential mortgage-backed securities of $2,176,000. Effective January 1, 2009, the Company adopted new accounting guidance in accordance with GAAP, which provides for the bifurcation of OTTI into (i) amounts related to credit losses which are recognized through earnings and (ii) amounts related to all other factors which are recognized as

a component of other comprehensive income (loss).

(continued)

Notes to Consolidated Financial Statements

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 3 - Mortgage-Backed Securities and Other Investments (continued)

To determine the component of the gross OTTI related to credit losses, the Company compared the amortized cost basis of the OTTI security to the present value of its revised expected cash flows, discounted using its pre-impairment yield. The revised expected cash flow estimates for individual securities are based primarily on an analysis of default rates, prepayment speeds and third-party analytic reports. Significant judgment of management is required in this analysis that includes, but is not limited to, assumption regarding the collectability of principal and interest, net of related expenses, on the underlying loans.

The following table presents a summary of the significant inputs utilized to measure management's estimates of the credit loss component on OTTI securities as of September 30, 2011 and 2010:

	Range		Weighted
	Minimum	Maximum	Average
At September 30, 2011			
Constant prepayment rate	6.00%	15.00%	10.71%
Collateral default rate	0.43%	24.23%	8.03%
Loss severity rate	11.93%	64.54%	39.22%
At September 30, 2010			
Constant prepayment rate	6.00%	15.00%	8.28%
Collateral default rate	3.69%	68.09%	34.75%
Loss severity rate	30.02%	60.43%	45.35%

The following table presents the OTTI losses for the years ended September 30, 2011 and 2010 (in thousands).

	2011		2010	
	Held to Maturity	Available For Sale	Held to Maturity	Available For Sale
Total OTTI losses	$ 210	$ 26	$ 895	$ 103
Portion of OTTI losses recognized in other comprehensive loss (before taxes)(1)	211	--	1,178	--
Net impairment losses recognized in earnings (2)	$ 421	$ 26	$ 2,073	$ 103

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(1) Represents OTTI losses related to all other factors.
(2) Represents OTTI losses related to credit losses.

(continued)

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 3 - Mortgage-Backed Securities and Other Investments (continued)

The following table presents a roll forward of the credit loss component of held to maturity and available for sale debt securities that have been written down for OTTI with the credit loss component recognized in earnings for the years ended September 30, 2011 and 2010 (in thousands).

	2011	2010
Balance, beginning of year	$ 4,725	$ 3,551
Additions:		
Credit losses for which OTTI was not previously recognized	53	400
Additional increases to the amount related to credit loss for which OTTI was previously recognized	398	1,818
Subtractions:		
Realized losses recorded previously as credit losses	(1,811)	(1,044)
Recovery of prior credit loss	(4)	--
Balance, end of year	$ 3,361	$ 4,725

During the year ended September 30, 2011 there were realized gains on two available for sale securities in the amount of $79,000. There were no gross realized gains on sales of securities for the years ended September 30, 2010 and 2009. During the year ended September 30, 2011, the Company recorded a $1,813,000 realized loss (as a result of securities being deemed worthless) on twenty-eight held to maturity and one available for sale residential mortgage-backed securities of which $1,811,000 had been recognized previously as a credit loss. During the year ended September 30, 2010, the Company recorded a $1,064,000 realized loss (as a result of securities being deemed worthless) on eighteen held to maturity residential mortgage-backed securities of which $1,044,000 had been recognized previously as a credit loss. During the year ended September 30, 2009, the Company recorded a $109,000 realized loss on three held to maturity residential mortgage-backed securities of which $33,000 had been recognized previously as a credit loss.

The recorded amount of residential mortgage-backed and agency securities pledged as collateral for public fund deposits, federal treasury tax and loan deposits, FHLB collateral, retail repurchase agreements and other non-profit organization deposits totaled $7,883,000 and $12,800,000 at September 30, 2011 and 2010, respectively.

(continued)

Notes to Consolidated Financial Statements

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 3 - Mortgage-Backed Securities and Other Investments (concluded)

The contractual maturities of debt securities at September 30, 2011, are as follows (in thousands). Expected maturities may differ from scheduled maturities due to the prepayment of principal or call provisions.

	Held to Maturity		Available for Sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	$ --	$ --	$ 1	$ 1
Due after one year to five years	23	24	--	--
Due after five to ten years	38	40	110	117
Due after ten years	4,084	4,165	5,511	5,599
Total	$ 4,145	$ 4,229	$ 5,622	$ 5,717

Notes to Consolidated Financial Statements

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 4 - Loans Receivable and Allowance for Loan Losses

Loans receivable and loans held for sale by portfolio segment consisted of the following at September 30 (in thousands):

	2011	2010
Mortgage loans:		
One- to four-family	$ 110,636	$ 118,044
Multi-family	30,982	32,267

Commercial	246,037	208,002
Construction - custom and owner / builder	26,205	30,945
Construction - speculative one- to four-family	1,919	4,777
Construction - commercial	12,863	23,528
Construction - multi-family	9,322	3,587
Construction - land development	2,175	6,434
Land	49,236	62,999
Total mortgage loans	489,375	490,583
Consumer loans:		
Home equity and second mortgage	36,008	38,418
Other	8,240	9,086
Total consumer loans	44,248	47,504
Commercial business loans	22,510	17,979
Total loans receivable	556,133	556,066
Less:		
Undisbursed portion of construction loans in process	18,265	17,952
Deferred loan origination fees	1,942	2,229
Allowance for loan losses	11,946	11,264
	32,153	31,445
Loans receivable, net	523,980	524,621
Loans held for sale (one- to four-family)	4,044	2,970
Total loans receivable and loans held for sale, net	$ 528,024	$ 527,591

Certain related parties of the Bank, principally Bank directors and officers, are loan customers of the Bank in the ordinary course of business. These loans were performing according to their terms at September 30, 2011 and 2010. Activity in related party loans during the years ended September 30 was as follows (in thousands):

	2011	2010
Balance, beginning of year	$2,746	$1,781
New loans	17	1,044
Repayments	(265)	(79)
Balance, end of year	$2,498	$2,746

(continued)

Note 4 - Loans Receivable and Allowance for Loan Losses (continued)

Loan Segment Risk Characteristics

The Company believes that its loan classes are the same as its loan segments.

One- To Four-Family Residential Lending: The Company originates both fixed rate and adjustable rate loans secured by one- to four-family residences. A portion of the fixed-rate one- to four-family loans are sold in the secondary market for asset/liability management purposes and to generate non-interest income. The Company's lending policies generally limit the maximum loan-to-value on one- to four-family loans to 90% of the lesser of the appraised value or the purchase price. However, the Company usually obtains private mortgage insurance on the portion of the principal amount that exceeds 80% of the appraised value of the property.

Multi-Family Lending: The Company originates loans secured by multi-family dwelling units (more than four units). Multi-family lending generally affords the Company an opportunity to receive interest at rates higher than those generally available from one- to four-family residential lending. However, loans secured by multi-family properties usually are greater in amount, more difficult to evaluate and monitor and, therefore, involve a greater degree of risk than one- to four-family residential mortgage loans. Because payments on the loans secured by multi-family properties are often dependent on the successful operation and management of the properties, repayment of such loans may be affected by adverse conditions in the real estate market or economy. The Company attempts to minimize these risks by scrutinizing the financial condition of the borrower, the quality of the collateral and the management of the property securing the loan.

Commercial Mortgage Lending: The Company originates commercial real estate loans secured by properties such as office buildings, retail/wholesale facilities, motels, restaurants, mini-storage facilities and other commercial properties. Commercial real estate lending generally affords the Company an opportunity to receive interest at higher rates than those available from one- to four-family residential lending. However, loans secured by such properties usually are greater in amount, more difficult to evaluate and monitor and, therefore, involve a greater degree of risk than one- to four-family residential mortgage loans. Because payments on loans secured by commercial properties often depend upon the successful operation and management of the properties, repayment of these loans may be affected by adverse conditions in the real estate market or economy. The Company attempts to mitigate these risks by generally limiting the maximum loan-to-value ratio to 80% and scrutinizing the financial condition of the borrower, the quality of the collateral and the management of the property securing the loan.

Construction Lending: The Company currently originates the following types of construction loans: custom construction loans, owner/builder construction loans, speculative construction loans (on a very limited basis), commercial real estate construction loans, and multi-family construction loans. The Company is not currently originating new land development loans.

Construction lending affords the Company the opportunity to achieve higher interest rates and fees with shorter terms to maturity than does its single-family permanent mortgage lending. Construction lending, however, is generally considered to involve a higher degree of risk than one-to four family residential lending because of the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost of the project. The nature of these loans is such that they are generally more difficult to evaluate and monitor. If the estimated cost of construction proves to be inaccurate, the Company may be required to advance funds beyond the amount originally committed to complete the project. If the estimate of value upon completion proves to be inaccurate, the Company may be confronted with a project whose value is insufficient to assure full repayment and it may incur a loss. Projects may also be jeopardized by disagreements between

borrowers and builders and by the failure of builders to pay subcontractors. Loans to construct homes for which no purchaser has been identified carry more risk because the payoff for the loan depends on the builder's ability to sell the property prior to the time that the construction loan is due. The Company attempts to mitigate these risks by adhering to strict underwriting policies, disbursement procedures, and monitoring practices.

Note 4 - Loans Receivable and Allowance for Loan Losses (continued)

Construction Lending - Custom and Owner/Builder: Custom construction loans are made to home builders who, at the time of construction, have a signed contract with a home buyer who has a commitment to purchase the finished home. Owner/builder construction loans are originated to home owners rather than home builders and are typically refinanced into permanent loans at the completion of construction.

Construction Lending - Speculative One- To Four-Family: Speculative one-to four-family construction loans are made to home builders and are termed "speculative" because the home builder does not have, at the time of the loan origination, a signed contract with a home buyer who has a commitment for permanent financing with the Bank or another lender for the finished home. The home buyer may be identified either during or after the construction period. The Company is currently originating speculative one-to four-family construction loans on a very limited basis.

Construction Lending - Commercial: Commercial construction loans are originated to construct properties such as office buildings, hotels, retail rental space and mini-storage facilities.

Construction Lending - Multi-Family: Multi-family construction loans are originated to construct apartment buildings and condominium projects.

Construction Lending - Land Development: The Company historically originated loans to real estate developers for the purpose of developing residential subdivisions. The Company is not currently originating any new land development loans.

Land Lending: The Company has historically originated loans for the acquisition of land upon which the purchaser can then build or make improvements necessary to build or to sell as improved lots. Currently, the Company is not offering land loans to new customers and is attempting to decrease its land loan portfolio. Loans secured by undeveloped land or improved lots involve greater risks than one- to four-family residential mortgage loans because these loans are more difficult to evaluate. If the estimate of value proves to be inaccurate, in the event of default or foreclosure, the Company may be confronted with a property value which is insufficient to assure full repayment. The Company attempts to minimize this risk by generally limiting the maximum loan-to-value ratio on land loans to 75%.

Consumer Lending - Home Equity and Second Mortgages: The Company originates home equity lines of credit and second mortgage loans. Home equity lines of credit and second mortgage loans have a greater credit risk than one- to four-family residential mortgage loans because they are secured by mortgages subordinated to the existing first mortgage on the property, which may or may not be held by the Company. The Company attempts to mitigate these risks by adhering to its underwriting policies in evaluating the collateral and the credit worthiness of the borrower.

(continued)

Note 4 - Loans Receivable and Allowance for Loan Losses (continued)

Consumer Lending - Other: The Company originates other consumer loans, which include automobile loans, boat loans, motorcycle loans, recreational vehicle loans, savings account loans and unsecured loans. Other consumer loans generally have shorter terms to maturity than mortgage loans. Other consumer loans generally entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The Company attempts to mitigate these risks by adhering to its underwriting policies in evaluating the credit worthiness of the borrower.

Commercial Business Lending: The Company originates commercial business loans which are generally secured by business equipment, accounts receivable, inventory or other property. The Company also generally obtains personal guarantees from the principals based on a review of personal financial statements. Commercial business lending generally involves risks that are different from those associated with residential and commercial real estate lending. Real estate lending is generally considered to be collateral based lending with loan amounts based on predetermined loan to collateral values, and liquidation of the underlying real estate collateral is viewed as the primary source of repayment in the event of borrower default. Although commercial business loans are often collateralized by equipment, inventory, accounts receivable, or other business assets, the liquidation of collateral in the event of a borrower default is often an insufficient source of repayment, because accounts receivable may be uncollectible and inventories and equipment may be obsolete or of limited use. Accordingly, the repayment of a commercial business loan depends primarily on the creditworthiness of the borrower (and any guarantors), while the liquidation of collateral is a secondary and potentially insufficient source of repayment. The Company attempts to mitigate these risks by adhering to its underwriting policies in evaluating the management of the business and the credit worthiness of the borrowers and the guarantors.

Allowance for Loan Losses

The following table sets forth information for the year ended September 30, 2011 regarding activity in the allowance for loan losses by portfolio segment (in thousands):

	For the Year Ended September 30, 2011				
	Beginning Allowance	Provision	Charge-offs	Recoveries	Ending Allowance
Mortgage loans:					
One-to four-family	$ 530	$ 622	$ 543	$ 151	$ 760
Multi-family	393	642	- -	41	1,076
Commercial	3,173	804	47	105	4,035
Construction - custom and owner / builder	481	(211)	48	- -	222
Construction - speculative one- to four-family	414	(142)	103	- -	169
Construction - commercial	245	1,993	1,444	- -	794
Construction - multi-family	245	1,328	1,219	- -	354
Construction - land development	240	993	1,158	4	79
Land	3,709	744	1,704	46	2,795
Consumer loans:					
Home equity and second mortgage	922	354	150	42	460
Other	451	(8)	30	2	415
Commercial business loans	462	347	22	1	787
Total	$11,264	$6,758	$6,468	$ 392	$11,946

(continued)

Note 4 - Loans Receivable and Allowance for Loan Losses (continued)

A summary analysis of activity in the allowance for loan losses for the years ended September 30 is as follows (in thousands):

	2010	2009
Balance, beginning of year	$ 14,172	$ 8,050
Provision for loan losses	10,550	10,734

Allocated to commitments	- -	(169)
Loans charged off	(13,820)	(4,531)
Recoveries	362	88
Net charge-offs	(13,458)	(4,443)
Balance, end of year	$ 11,264	$ 14,172

The following table presents information on the loans evaluated individually and collectively for impairment in the allowance for loan losses by portfolio segment at September 30, 2011 (in thousands):

	Allowance for Loan Losses			Recorded Investment i	
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectivel Evaluated fo Impairmen
Mortgage loans:					
One- to four-family	$ 45	$ 715	$ 760	$ 3,701	$110,979
Multi-family	632	444	1,076	5,482	25,500
Commercial	255	3,780	4,035	19,322	226,715
Construction - custom and owner / builder	11	211	222	320	16,777
Construction - speculative one- to four-family	37	132	169	700	906
Construction - commercial	738	56	794	5,435	2,479
Construction - multi-family	--	354	354	632	4,867
Construction - land development	--	79	79	1,882	221
Land	560	2,235	2,795	9,997	39,239
Consumer loans:					
Home equity and second mortgage	10	450	460	1,014	34,994
Other	1	414	415	1	8,239
Commercial business loans	--	787	787	44	22,466
	$2,289	$9,657	$11,946	$48,530	$493,382

(continued)

Note 4 - Loans Receivable and Allowance for Loan Losses (continued)

The following table presents an age analysis of past due status of loans by portfolio segment at September 30, 2011 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Non-Accrual (1)	Past Due 90 Days or More and Still Accruing	Total Past Due	Current
Mortgage loans:						
One- to four-family	$ --	$ 1,822	$ 2,150	$ --	$ 3,972	$110,70
Multi-family	--	--	--	1,449	1,449	29,53
Commercial	--	12,723	6,571	--	19,294	226,74
Construction - custom and owner / builder	--	--	320	--	320	16,77
Construction - speculative one- to four-family	--	--	--	--	--	1,60
Construction - commercial	--	--	688	--	688	7,22
Construction - multi-family	--	752	632	--	1,384	4,11
Construction - land development	--	--	1,882	--	1,882	22
Land	1,100	2,558	8,935	29	12,622	36,61
Consumer loans:						
Home equity and second mortgage	643	441	366	--	1,450	34,55
Other	9	7	1	--	17	8,22
Commercial business loans	--	14	44	276	334	22,17
Total	$ 1,752	$18,317	$21,589	$1,754	$ 43,412	$498,50

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(1) Includes non-accrual loans past due 90 days or more and manual non-accrual loans.

Credit Quality Indicators

The Company uses credit risk grades which reflect the Company's assessment of a loan's risk or loss potential. The Company categorizes loans into risk grade categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors such as the estimated fair value of the collateral. The Company uses the following definitions for credit risk ratings as part of the on-going monitoring of the credit quality of its loan portfolio:

Pass: Pass loans are defined as those loans that meet acceptable quality underwriting standards.

Watch: Watch loans are defined as those loans that still exhibit marginal acceptable quality, but have some concerns that justify greater attention. If these concerns are not corrected, a potential for further adverse categorization exists. These concerns could relate to a specific condition peculiar to the borrower or its industry segment or the general economic

environment.

Special Mention: Special mention loans are defined as those loans deemed by management to have some potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in the deterioration of the payment prospects of the loan. Assets in this category do not expose the Company to sufficient risk to warrant a substandard classification.

Substandard: Substandard loans are defined as those loans that are inadequately protected by the current net worth and paying capacity of the obligor, or of the collateral pledged. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. If the weakness or weaknesses are not corrected, there is the distinct possibility that some loss will be sustained.

Loss: Loans in this classification are considered uncollectible and of such little value that continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless loan even though partial recovery may be realized in the future.

Note 4 - Loans Receivable and Allowance for Loan Losses (continued)

The following table lists the loan credit risk grades by portfolio segment utilized by the Company that serve as credit quality indicators. The credit risk loan grades include high and low factors associated with their segments that are utilized to calculate the aggregate ranges of the allowance for loan losses at September 30, 2011 (in thousands):

	Loan Grades				
	Pass	Watch	Special Mention	Substandard	Total
Mortgage loans:					
One- to four-family	$100,159	$ 6,131	$ 2,450	$ 5,940	$114,680
Multi-family	19,279	199	10,380	1,124	30,982
Commercial	212,898	1,042	6,320	25,777	246,037
Construction - custom and owner / builder	16,522	255	--	320	17,097
Construction - speculative one- to four-family	323	--	700	583	1,606
Construction - commercial	2,479	--	--	5,435	7,914
Construction - multi-family	4,115	--	752	632	5,499

Construction – land development	83	--	--	2,020	2,103
Land	26,825	6,604	5,084	10,723	49,236
Consumer loans:					
Home equity and second mortgage	32,389	901	1,513	1,205	36,008
Other	8,179	50	--	11	8,240
Commercial business loans	19,060	20	220	3,210	22,510
Total	$442,311	$15,202	$27,419	$56,980	$541,912

Impaired Loans

At September 30, 2011, 2010 and 2009, the Bank had impaired loans totaling approximately $48,530,000, $42,245,000 and $47,622,000 respectively. Interest income recognized on impaired loans for the years ended September 30, 2011, 2010 and 2009 was $2,054,000, $1,296,000 and $803,000 respectively. Interest income recognized on a cash basis on impaired loans for the years ended September 30, 2011, 2010 and 2009 was $1,299,000, $816,000 and $647,000, respectively. The average investment in impaired loans for the years ended September 30, 2011, 2010 and 2009 was $46,630,000, $42,747,000 and $32,597,000, respectively. The Bank had $25,542,000 in troubled debt restructured loans included in impaired loans at September 30, 2011. The Bank had $144,000 in commitments to lend additional funds on these loans. The Bank had $16,400,000 in troubled debt restructured loans included in impaired loans at September 30, 2010 and there were commitments to lend an additional $1,055,000 in funds on these loans. The Bank had $9,492,000 in troubled debt restructured loans included in impaired loans at September 30, 2009 and there were commitments to lend an additional $1,433,000 in funds on these loans.

Following is a summary of information related to impaired loans at September 30 (in thousands):

	2011	2010
Impaired loans without a valuation allowance	$ 31,863	$ 36,475
Impaired loans with a valuation allowance	16,667	5,770
Total impaired loans	$ 48,530	$ 42,245

(continued)

Note 4 - Loans Receivable and Allowance for Loan Losses (continued)

The following table is a summary of information related to impaired loans by

portfolio segment as of and for the year ended September 30, 2011 (in thousands):

	September 30, 2011				For the Y September
	Recorded Investment	Unpaid Principal Balance (Loan Balance Plus Charge Off)	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Mortgage loans:					
One- to four-family	$ 2,092	$ 2,387	$ --	$ 2,908	$ 30
Multi-family	--	982	--	681	--
Commercial	18,137	19,279	--	14,623	1,060
Construction - custom and owner / builder	209	209	--	303	7
Construction - speculative one- to four-family	--	--	--	502	7
Construction - multi-family	632	1,135	--	1,287	4
Construction - land development	1,882	7,179	--	2,920	5
Land	8,198	11,533	--	7,883	69
Consumer loans:					
Home equity and second mortgage	669	719	--	430	26
Other	--	--	--	13	--
Commercial business loans	44	65	--	44	2
Subtotal	31,863	43,488	--	31,594	1,210
With an allowance recorded:					
Mortgage loans:					
One- to four-family	1,609	1,609	45	768	47
Multi-family	5,482	5,482	632	4,798	298
Commercial	1,185	1,185	255	1,409	50
Construction - custom and owner / builder	111	111	11	45	2
Construction - speculative one- to four-family	700	700	37	1,042	50
Construction - commercial	5,435	6,879	738	3,537	273
Construction - multi-family	--	--	--	65	--
Land	1,799	1,821	560	2,946	114
Consumer loans:					
Home equity and second mortgage	345	345	10	425	10
Other	1	1	1	1	--
Subtotal	16,667	18,133	2,289	15,036	844
Total					
Mortgage loans:					
One- to four-family	3,701	3,996	45	3,676	77
Multi-family	5,482	6,464	632	5,479	298
Commercial	19,322	20,464	255	16,032	1,110
Construction - custom and owner / builder	320	320	11	348	9
Construction - speculative one- to four-family	700	700	37	1,544	57
Construction - commercial	5,435	6,879	738	3,537	273

Construction - multi-family	632	1,135	--	1,352	4
Construction - land development	1,882	7,179	--	2,920	5
Land	9,997	13,354	560	10,829	183
Consumer loans:					
Home equity and second mortgage	1,014	1,064	10	855	36
Other	1	1	1	14	--
Commercial business loans	44	65	--	44	2
Total	$48,530	$61,621	$2,289	$46,630	$2,054

(continued)

Notes to Consolidated Financial Statements

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 4 - Loans Receivable and Allowance for Loan Losses (concluded)

The following table sets forth information with respect to the Company's troubled debt restructurings by portfolio segment during the year ended September 30, 2011 (dollars in thousands):

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
One-to four family	5	$ 1,619	$ 1,619
Multi-family	4	6,534	5,482
Commercial	8	5,903	6,226
Construction - speculative one-to four-family	1	700	700
Construction - commercial	2	6,800	5,451
Construction - land development	4	5,433	5,433
Land	12	7,263	7,051
Home Equity	3	654	654
Total	39	$34,906	$32,616

The balance of troubled debt restructured loans by portfolio segment modified during the year ended September 30, 2011 that subsequently defaulted were as follows (dollars in thousands):

	Number of Contracts	Recorded Investment
Commercial	1	$ 919
Land	1	147
Total	2	$1,066

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Note 5 - Mortgage Servicing Rights

Loans serviced for Freddie Mac are not included in the accompanying consolidated balance sheets. The principal amounts of those loans at September 30, 2011, 2010 and 2009 were $298,924,000, $280,852,000 and $251,837,000, respectively.

Following is an analysis of the changes in mortgage servicing rights for the years ended September 30 (in thousands):

	2011	2010	2009
Balance, beginning of year	$1,929	$2,618	$1,306
Additions	455	805	1,785
Amortization	(681)	(604)	(473)
Valuation allowance	(434)	(890)	(169)
Recovery of valuation allowance	839	- -	169
Balance, end of year	$2,108	$1,929	$2,618

At September 30, 2011, 2010 and 2009, the fair value of mortgage servicing rights totaled $2,108,000, $1,929,000 and $2,650,000, respectively. The fair values for 2011, 2010, and 2009 were estimated using discounted cash flow analyses with discount rates of 10.11%, 10.40% and 10.52%, respectively, and prepayment speed factors of 324, 350 and 185, respectively. At September 30, 2011 and 2010, there were mortgage servicing rights valuation allowances of $485,000 and $890,000, respectively. There was no valuation allowance at September 30, 2009.

Note 6 - Premises and Equipment

Premises and equipment consisted of the following at September 30 (in thousands):

	2011	2010
Land	$ 4,291	$ 4,291
Buildings and improvements	16,517	16,054
Furniture and equipment	6,700	6,758
Property held for future expansion	110	110
Construction and purchases in progress	170	95
	27,788	27,308
Less accumulated depreciation	10,398	9,925
Premises and equipment, net	$17,390	$17,383

The Bank leases certain premises under operating leases. Rental expense of leased premises was $232,000, $228,000 and $243,000 for the years ended September 30, 2011, 2010, and 2009, respectively, which is included in premises and equipment expense.

Minimum net rental commitments under non-cancellable leases having an original or remaining term of more than one year for future years ending September 30 are as follows (in thousands):

2012	$ 211
2013	211
2014	144
2015	144
2016	96
Total minimum payments required	$ 806

Certain leases contain renewal options from five to ten years and escalation clauses based on increases in property taxes and other costs.

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 7 - OREO and Other Repossessed Assets

The following table presents the activity related to OREO and other repossessed assets for the year ended September 30, 2011 (dollars in thousands):

	2011		2010	
	Amount	Number	Amount	Number

Balance, beginning of year	$11,519	30	$ 8,185	26
Additions to OREO and other repossessed assets	5,782	39	9,434	31
Capitalized improvements	83	--	288	--
Lower of cost or fair value losses	(1,402)	--	(829)	--
Disposition of OREO and other repossessed assets	(5,171)	(19)	(5,559)	(27)
Balance, end of year	$10,811	50	$11,519	30

At September 30, 2011, OREO and other repossessed assets consisted of 46 properties in Washington, with balances ranging from $4,000 to $2,647,000 and four other repossessed assets totaling $81,000. At September 30, 2010, OREO consisted of 27 properties in Washington, with balances ranging from $5,000 to $3,048,000 and three other repossessed assets totaling $67,000. The Bank recorded a net gain on sale of OREO and other repossessed assets for the years ended September 30, 2011, 2010 and 2009 of $548,000, $291,000 and $60,000, respectively, which is netted against OREO and other repossessed assets expense in the accompanying consolidated statements of operations.

Note 8 - Core Deposit Intangibles

During the year ended September 30, 2005, the Company recorded a CDI of $2,201,000 in connection with the October 2004 acquisition of seven branches and related deposits. Net unamortized CDI totaled $397,000 and $564,000 at September 30, 2011 and 2010, respectively. Amortization expense related to the CDI for the years ended September 30, 2011, 2010 and 2009 was $167,000, $191,000 and $217,000, respectively.

Amortization expense for the CDI for future years ending September 30 is estimated to be as follows (in thousands):

2012	$ 147
2013	131
2014	116
2015	3
Total	$ 397

Note 9 - Deposits

Deposits consisted of the following at September 30 (in thousands):

	2011	2010
Non-interest-bearing demand	$ 64,494	$ 58,755
NOW checking	155,299	153,304
Savings	83,636	67,448
Money market accounts	61,028	55,723
Certificates of deposit	228,221	243,639
Total deposits	$592,678	$578,869

Certificates of deposit of $100,000 or greater totaled $86,322,000 and $93,006,000 at September 30, 2011 and 2010, respectively. The Bank did not have any brokered deposits at September 30, 2011 or 2010.

Scheduled maturities of certificates of deposit for future years ending September 30 are as follows (in thousands):

2012	$157,161
2013	39,793
2014	8,779
2015	9,453
2016	12,409
Thereafter	626
Total	$228,221

Interest expense by account type is as follows for the years ended September 30 (in thousands):

	2011	2010	2009
NOW checking	$ 1,415	$ 1,749	$ 1,031
Savings	459	454	394
Money market accounts	435	677	1,036
Certificates of deposit	3,827	4,921	6,387
Certificates of deposit - brokered	--	6	624
Total	$ 6,136	$ 7,807	$ 9,472

Note 10 - FHLB Advances and FRB Borrowings

The Bank has long- and short-term borrowing lines with the FHLB with total credit on the lines equal to 30% of the Bank's total assets, limited by available collateral. Borrowings are considered short-term when the original maturity is less than one year. The Bank had $55,000,000 and $75,000,000 of long-term FHLB advances outstanding at September 30, 2011 and 2010, respectively.

The long-term borrowings at September 30, 2011 mature at various dates through September 2017 and bear interest at rates ranging from 3.49% to 4.34%. Under the Advances, Security and Deposit Agreement, virtually all of the Bank's assets, not otherwise encumbered, are pledged as collateral for advances. Principal reductions due for future years ending September 30 are as follows (in thousands):

2012	$ 10,000
2013	--
2014	--
2015	--
2016	--
Thereafter	45,000
	$ 55,000

A portion of the long-term advances have a putable feature and may be called by the FHLB earlier than the scheduled maturities.

The Bank also maintains a short-term borrowing line with the FRB with total credit based on eligible collateral. At September 30, 2011 the Bank had a borrowing capacity on this line of $58,669,000 with no balance outstanding. The Bank had no outstanding balance on this line at September 30, 2010.

Information concerning total short-term borrowings as of and for the years ended September 30 is summarized as follows (dollars in thousands):

	2011	2010	2009
Average daily balance during the period	$ --	$ 384	$ 48
Average daily interest rate during the period	--%	0.66%	0.69%
Maximum month-end balance during the period	$ --	$10,000	$10,000
Weighted average interest rate at end of the period	--	--	0.50%

Note 11 - Repurchase Agreements

Repurchase agreements at September 30, 2011 and 2010 consisted of overnight repurchase agreements with customers totaling $729,000 and $622,000,

respectively.

Information concerning repurchase agreements as of and for the years ended September 30 is summarized as follows (dollars in thousands):

	2011	2010
Average daily balance during the period	$ 511	$ 539
Average daily interest rate during the period	0.05%	0.05%
..		
Maximum month-end balance during the period	$ 729	$ 750
Weighted average rate at end of the period	0.05%	0.05%
Securities underlying the agreements at end of the period:		
Recorded value	$ 673	$ 690
Estimated fair value	688	695

The securities underlying the agreements at September 30, 2011 and 2010 were under the Company's control in safekeeping at third-party financial institutions.

Note 12 - Other Liabilities and Accrued Expenses

Other liabilities and accrued expenses were comprised of the following at September 30 (in thousands):

	2011	2010
Accrued deferred compensation and profit sharing plans payable	$ 184	$ 81
Accrued preferred stock dividends payable	1,248	416
Accrued interest payable on deposits, advances, borrowings and repurchase agreements	545	737
Accounts payable and accrued expenses - other	1,635	1,554
Total other liabilities and accrued expenses	$ 3,612	$ 2,788

Note 13 - Federal Income Taxes

The components of the provision (benefit) for federal income taxes for the years ended September 30 were as follows (in thousands):

	2011	2010	2009

Current	$ 830	$(2,030)	$ 831
Deferred	(526)	466	(1,813)
Provision (benefit)	$ 304	$(1,564)	$ (982)

At September 30, 2011 and 2010, the Company recorded income taxes receivable of $1,071,000 and $2,564,000, respectively, which are included in other assets in the accompanying consolidated balance sheets.

The components of the Company's deferred tax assets and liabilities at September 30 were as follows (in thousands):

	2011	2010
Deferred Tax Assets		
Accrued interest on loans	$ 215	$ 479
Unearned ESOP shares	355	439
Allowance for loan losses	4,362	3,977
Allowance for OREO losses	590	153
CDI	264	257
Unearned MRDP shares	98	60
Net unrealized securities losses	225	341
Capital loss carry-forward	677	680
OTTI credit impairment	185	111
Other	163	159
Total deferred tax assets	7,134	6,656

(continued)

Note 13 - Federal Income Taxes (concluded)

	2011	2010
Deferred Tax Liabilities		
FHLB stock dividends	$ 880	$ 880
Depreciation	228	319
Goodwill	896	768
Mortgage servicing rights	717	656
Prepaid expenses	167	195
Other	15	17
Total deferred tax liabilities	2,903	2,835
Valuation allowance for capital loss on sale of		

securities	(421)	(421)
Net deferred tax assets	$3,810	$3,400

The Company has a capital loss carry forward in the amount of $1,992,000 that will expire in 2013.

The provision (benefit) for federal income taxes for the years ended September 30 differs from that computed at the statutory corporate tax rate as follows (dollars in thousands):

	2011	2010	2009
Expected tax provision (benefit) at statutory rate	$ 474	$(1,312)	$ (429)
BOLI income	(175)	(167)	(337)
Dividends on ESOP	--	(12)	(121)
Other - net	5	(73)	(95)
Provision (benefit) for federal income taxes	$ 304	$(1,564)	$ (982)

Note 14 - Employee Stock Ownership and 401(k) Plan ("KSOP")

Effective October 3, 2007, the Bank established the Timberland Bank Employee Stock Ownership and 401(k) Plan by combining the existing Timberland Bank Employee Stock Ownership Plan (established in 1997) and the Timberland Bank 401(k) Profit Sharing Plan (established in 1970). The KSOP is comprised of two components, the ESOP and the 401(k) Plan. The KSOP benefits employees with at least one year of service who are 21 years of age or older. It may be funded by Bank contributions in cash or stock for the ESOP and in cash only for the 401(k) profit sharing. Employee vesting occurs over six years.

ESOP

The amount of the annual contribution is discretionary, except that it must be sufficient to enable the ESOP to service its debt. All dividends received by the ESOP are used to pay debt service. There were no dividends used to service debt for the year ended September 30, 2011. Dividends of $35,000 and $331,000 were used to service the debt during the years ended September 30, 2010 and 2009, respectively. As of September 30, 2011, 208,032 ESOP shares had been distributed to participants.

In January 1998, the ESOP borrowed $7,930,000 from the Company to purchase

1,058,000 shares of common stock of the Company. The loan is being repaid primarily from the Bank's contributions to the ESOP and is scheduled to be fully repaid by March 31, 2019. The interest rate on the loan is 8.5%. Interest expense on the ESOP debt was $291,000, $315,000, and $337,000 for the years ended September 30, 2011, 2010 and 2009, respectively. The balance of the loan at September 30, 2011 was $3,240,000.

Shares held by the ESOP as of September 30 were classified as follows:

	2011	2010	2009
Unallocated shares	264,500	299,786	335,052
Shares released for allocation	585,468	565,523	550,755
Total ESOP shares	849,968	865,309	885,807

The approximate fair market value of the Bank's unallocated shares at September 30, 2011, 2010 and 2009, was $1,069,000, $1,211,000 and $1,555,000, respectively. Compensation expense recognized under the ESOP for the years ended September 30, 2011 and 2010 was $172,000 and $109,000, respectively. A compensation benefit of $138,000 was recognized for the year ended September 30, 2009.

401(k)

Eligible employees may contribute up to the maximum established by the Internal Revenue Service. Contributions by the Bank are at the discretion of the board of directors except for a 3% safe harbor contribution which is mandatory according to the plan document. Bank contributions totaled $290,000, $294,000 and $475,000 for the years ended September 30, 2011, 2010 and 2009, respectively.

Note 15 - Stock Compensation Plans

Stock Option Plans

Under the Company's stock option plans (1999 Stock Option Plan and 2003 Stock Option Plan), the Company was able to grant options for up to 1,622,500 shares of common stock to employees, officers and directors. Shares issued may be purchased in the open market or may be issued from authorized and unissued shares. The exercise price of each option equals the fair market value of the Company's stock on the date of grant. Generally, options vest in 20% annual installments on each of the five anniversaries from the date of the grant. At September 30, 2011, options for 250,238 shares were available for future grant under the 2003 Stock Option Plan and no shares were available for future grant under the 1999 Stock Option Plan.

Stock option activity for the years ended September 30 is summarized as

follows:

	Number of Shares	Weighted Average Exercise Price
Outstanding September 30, 2008	273,820	$8.07
Options exercised	(57,699)	6.00
Options forfeited	(47,257)	6.00
Outstanding September 30, 2009	168,864	9.35
Options granted	26,000	4.55
Outstanding September 30, 2010	194,864	8.71
Options forfeited	(57,138)	7.42
Outstanding September 30, 2011	137,726	$9.25

The Company uses the Black-Scholes option pricing model to estimate the fair value of stock-based awards with the weighted average assumptions noted in the following table. The risk-free interest rate is based on the U.S. Treasury rate of a similar term as the stock option at the particular grant date. The expected life is based on historical data, vesting terms, and estimated exercise dates. The expected dividend yield is based on the most recent quarterly dividend on an annualized basis in effect at the time the options were granted. The expected volatility is based on historical volatility of the Company's stock price. There were no options granted during the years ended September 30, 2011 and 2009. There were 26,000 options granted during the year ended September 30, 2010 with an aggregate grant date fair value of $34,000. The weighted average assumptions for options granted during the year ended September 30, 2010 were as follows:

Expected volatility	38%
Expected term (in years)	5
Expected dividend yield	2.64%
Risk free interest rate	2.47%
Grant date fair value per share	$1.29

(continued)

Note 15 - Stock Compensation Plans (continued)

There were 5,200 shares that vested during the year ended September 30, 2011 with a total fair value of $7,000. There were no shares that vested during the year ended September 30, 2010. The total fair value of shares that vested during the year ended September 30, 2009 was $13,000.

At September 30, 2011 there were 20,400 unvested options with an aggregate grant date fair value of $26,000, all of which the Company assumes will vest.

There was no aggregate intrinsic value of unvested options at September 30, 2011, as the exercise price was greater than the stock's current market value. At September 30, 2010 there were 26,000 unvested options with an aggregate grant date fair value of $34,000.

Proceeds and related tax benefits realized from options exercised and the intrinsic value of options exercised for the years ended September 30 were as follows (in thousands):

	2011	2010	2009
Proceeds from options exercised	$ --	$ --	$ 346
Related tax benefit recognized	--	--	46
Intrinsic value of options exercised	--	--	56

Additional information regarding options outstanding at September 30, 2011, is as follows:

	Options Outstanding			Options Exercisable		
Range of Exercise Prices	Number	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
$ 4.55	25,500	$ 4.55	8.1	5,100	$ 4.55	8.1
7.85 - 7.98	6,000	7.91	0.6	6,000	7.91	0.6
9.52	56,680	9.52	1.4	56,680	9.52	1.4
11.46 - 11.63	49,546	11.51	2.3	49,546	11.51	2.3
	137,726	$ 9.25	2.9	117,326	$10.06	2.0

There was no aggregate intrinsic value of options outstanding at September 30, 2011, 2010 and 2009, as the exercise price of all options outstanding was greater than the stock's current market value.

Stock Grant Plan

The Company adopted the MRDP in 1998 for the benefit of employees, officers and directors of the Company. The objective of the MRDP is to retain personnel of experience and ability in key positions by providing them with a proprietary interest in the Company.

(continued)

Note 15 - Stock Compensation Plans (continued)

The MRDP allowed for the issuance to participants of up to 529,000 shares of the Company's common stock. Awards under the MRDP have been made in the form of restricted shares of common stock that are subject to restrictions on the transfer of ownership and are subject to a five-year vesting period. Compensation expense in the amount of the fair value of the common stock at the date of the grant to the plan participants is recognized over a five-year vesting period, with 20% vesting on each of the five anniversaries from the date of the grant. At September 30, 2011, there were no shares available for future awards under the MRDP.

A summary of MRDP shares granted and vested for the years ended September 30, were as follows:

	2011	2010	2009
Shares granted	--	--	19,758
Weighted average grant date fair value	$ --	--	$ 7.01
Shares vested	13,435	13,431	9,479
Aggregate vesting date fair value	$61,000	$56,000	$46,000

A summary of unvested MRDP shares as of September 30, 2011 and changes during the year ended September 30, 2011, were as follows:

	Shares	Weighted Average Grant Date Fair Value
Unvested shares, beginning of period	36,427	$ 11.27
Shares vested	(13,435)	12.74
Shares forfeited	(500)	10.09
Unvested shares, end of period	22,492	$ 10.42

At September 30, 2011, there were 22,492 unvested MRDP shares with an aggregate grant date fair value of $234,000.

Expense for Stock Compensation Plans

Compensation expense recorded in the consolidated financial statements for all stock-based plans was as follows for the years ended September 30, (in thousands):

	2011	2010	2009
Stock options	$ 7	$ 6	$ 3
MRDP stock grants	171	134	137
Less: related tax benefit recognized	(37)	(49)	(49)
	$ 141	$ 91	$ 91

(continued)

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 15 - Stock Compensation Plans (concluded)

The compensation expense to be recognized in the future for stock-based awards that have been awarded but not vested for the years ending September 30, is as follows (in thousands):

	Stock Options	Stock Grants (MRDP)	Total Awards
2012	$ 7	$ 112	$ 119
2013	7	38	45
2014	6	2	8
2015	1	- -	1
	$ 21	$ 152	$ 173

Note 16 - Commitments and Contingencies

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. These instruments involve, to varying degrees, elements of credit risk not recognized in the consolidated balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for on-balance-sheet instruments.

A summary of the Bank's commitments at September 30, is as follows (in thousands):

	2011	2010
Undisbursed portion of construction loans in process (see Note 4)	$18,265	$17,952
Undisbursed lines of credit	18,560	26,030
Commitments to extend credit	15,683	8,357

(continued)

Note 16 - Commitments and Contingencies (continued)

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the party. However, such loan to value ratios will subsequently change, based on increases and decreases in the supporting collateral values. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate, land, and income-producing commercial properties.

The Company maintains a separate reserve for losses related to unfunded loan commitments. Management estimates the amount of probable losses related to unfunded loan commitments by applying the loss factors used in the allowance for loan loss methodology to an estimate of the expected amount of funding and applies this adjusted factor to the unused portion of unfunded loan commitments. The reserve for unfunded loan commitments totaled $223,000 and $158,000 at September 30, 2011 and 2010, respectively. These amounts are included in other liabilities and accrued expenses in the accompanying consolidated balance sheet. Increases (decreases) in the reserve for unfunded loan commitments are recorded in non-interest expense in the accompanying consolidated statement of operations.

The Bank has an employee severance compensation plan which expires in 2017, and which provides severance pay benefits to eligible employees in the event of a change in control of the Company or the Bank (as defined in the plan). In general, all employees (except those who are restricted from receiving golden parachute payments in any amount under the compensation limitations for participants in the Treasury's CPP) with two or more years of service will be eligible to participate in the plan. Under the plan, in the event of a change in control of the Company or the Bank, eligible employees who are terminated or who terminate employment (but only upon the occurrence of events specified in the plan) within 12 months of the effective date of a change in control would be entitled to a payment based on years of service or officer rank with the Bank. The maximum payment for any eligible employee would be equal to 24 months of his or her current compensation.

Because of the nature of its activities, the Company is subject to various pending and threatened legal actions which arise in the ordinary course of business. In the opinion of management, liabilities arising from these claims, if any, will not have a material effect on the consolidated financial position of the Company.

Note 17 - Significant Concentrations of Credit Risk

Most of the Bank's lending activity is with customers located in the state of Washington and involves real estate. At September 30, 2011, the Bank had $529,427,000 (including $18,265,000 of undisbursed construction loan proceeds) in loans secured by real estate, which represents 94.5% of the total loan portfolio. The real estate loan portfolio is primarily secured by one- to four-family properties, multi-family properties, undeveloped land, and a variety of commercial real estate property types. At September 30, 2011, there were no concentrations of real estate loans to a specific industry or secured by a specific collateral type that equaled or exceeded 20% of the Bank's total loan portfolio, other than loans secured by one-to four-family properties. The ultimate collectability of a substantial portion of the loan portfolio is susceptible to changes in economic and market conditions in the region and the impact of those changes on the real estate market. The Bank typically originates real estate loans with loan-to-value ratios of no greater than 90%. Collateral and/or guarantees are required for all loans. The

Company also had $18,659,000 in CDs held for investment at September 30, 2011. The CDs are held with FDIC insured institutions, and each CD is below the FDIC insurance limit of $250,000.

Note 18 - Regulatory Matters

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines of the regulatory framework for prompt corrective action, the Bank must meet specific capital adequacy guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital classifications of the Company and the Bank are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Federally-insured state-chartered banks are required to maintain minimum levels of regulatory capital. Under current FDIC regulations, insured state-chartered banks generally must maintain (i) a ratio of Tier 1 leverage capital to total assets of at least 4.0%, (ii) a ratio of Tier 1 capital to risk weighted assets of at least 4.0% and (iii) a ratio of total capital to risk weighted assets of at least 8.0%.

In December 2009, the FDIC and the Washington State Department of Financial Institutions, Division of Banks ("Division") determined that the Bank required supervisory attention and on December 29, 2009 entered into a Memorandum of Understanding with the Bank (the "Bank MOU"). Under the Bank MOU, the Bank must among other things, maintain Tier 1 Capital of not less than 10.0% of the Bank's adjusted total assets and maintain capital ratios above the "well capitalized" thresholds as defined under FDIC Rules and Regulations; obtain the prior consent from the FDIC and the Division prior to the Bank declaring a dividend to its holding company; and not engage in any transactions that would materially change the Bank's balance sheet composition, including growth in total assets of five percent or more or significant changes in funding sources without the prior non-objection of the FDIC.

In addition, on February 1, 2010, the FRB determined that the Company required additional supervisory attention and entered into the Company MOU. Under the Company MOU, the Company must among other things obtain prior written approval, or non-objection from the FRB to declare or pay any dividends, or make any other capital distributions; issue any trust preferred securities; or purchase or redeem any of its stock (see note 1).

The following table compares the Company's and the Bank's actual capital amounts at September 30, 2011 and 2010 to its minimum regulatory capital requirements at that date (dollars in thousands):

(continued)

Notes to Consolidated Financial Statements

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 18 - Regulatory Matters (concluded)

	Actual		Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2011						
Tier 1 leverage capital:						
Consolidated	$81,107	11.1%	$29,261	4.0%	N/A	N/A
Timberland Bank	74,588	10.3	72,662	10.0(1)	$72,662	10.0%
Tier 1 risk adjusted capital:						
Consolidated	81,107	15.2	21,351	4.0	N/A	N/A
Timberland Bank	74,588	14.0	31,951	6.0(1)	31,951	6.0
Total risk based capital:						
Consolidated	87,844	16.5	42,702	8.0	N/A	N/A
Timberland Bank	81,310	15.3	53,251	10.0(1)	53,251	10.0
September 30, 2010						
Tier 1 leverage capital:						
Consolidated	$80,243	11.0%	$29,279	4.0%	N/A	N/A
Timberland Bank	72,784	10.0	72,809	10.0(1)	$72,809	10.0%
Tier 1 risk adjusted capital:						
Consolidated	80,243	15.0	21,397	4.0	N/A	N/A
Timberland Bank	72,784	13.6	32,036	6.0(1)	32,036	6.0
Total risk based capital:						
Consolidated	86,986	16.3	42,794	8.0	N/A	N/A
Timberland Bank	79,515	14.9	53,393	10.0(1)	53,393	10.0

(1) Reflects the higher Tier 1 leverage capital ratio that the Bank is required to comply with under terms of the Bank MOU. Also reflects that the Bank is required to maintain Tier 1 risk adjusted capital ratio and Total risk-based capital ratio at or above the "well capitalized" thresholds under the terms of the Bank MOU.

Restrictions on Retained Earnings

At the time of conversion of the Bank from a Washington-chartered mutual

savings bank to a Washington-chartered stock savings bank, the Bank established a liquidation account in an amount equal to its retained earnings of $23,866,000 as of June 30, 1997, the date of the latest statement of financial condition used in the final conversion prospectus. The liquidation account is maintained for the benefit of eligible account holders who have maintained their deposit accounts in the Bank after conversion. The liquidation account reduces annually to the extent that eligible account holders have reduced their qualifying deposits as of each anniversary date. Subsequent increases do not restore an eligible account holder's interest in the liquidation account. At September 30, 2011 management estimates the value of the liquidation account to be $688,000. In the event of a complete liquidation of the Bank (and only in such an event), eligible depositors who have continued to maintain accounts will be entitled to receive a distribution from the liquidation account before any liquidation may be made with respect to common stock. The Bank may not declare or pay cash dividends if the effect thereof would reduce its regulatory capital below the amount required for the liquidation account.

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 19 - Condensed Financial Information - Parent Company Only

Condensed Balance Sheets - September 30
(in thousands)

	2011	2010
Assets		
Cash and cash equivalents:		
Cash and due from financial institutions	$ 323	$ 641
Interest-bearing deposits in banks	3,864	3,516
Total cash and cash equivalents	4,187	4,157
Loan receivable from Bank	3,240	3,538
Investment in Bank	79,686	77,949
Other assets	483	327
Total assets	$ 87,596	$ 85,971
Liabilities and shareholders' equity		
Accrued expenses	$ 1,391	$ 563
Shareholders' equity	86,205	85,408
Total liabilities and shareholders' equity	$ 87,596	$ 85,971

Condensed Statements of Operations - Years Ended September 30
(in thousands)

	2011	2010	2009
Operating income			

Interest on deposits in banks	$ 1	$ 31	$ 25
Interest on loan receivable from Bank	291	315	338
Dividends from Bank	--	--	416
Total operating income	292	346	779
Non-operating income	--	--	37
Operating expenses	541	683	642
Income (loss) before income taxes and equity in undistributed income (loss) of Bank	(249)	(337)	174
Benefit for income taxes	(85)	(127)	(200)
Income (loss) before equity in undistributed income (loss) of Bank	(164)	(210)	374
Equity in undistributed income (loss) of bank (dividends in excess of income of Bank)	1,253	(2,081)	(616)
Net income (loss)	1,089	(2,291)	(242)
Preferred stock dividends	832	832	643
Preferred stock accretion	225	210	129
Net income (loss) to common shareholders	$ 32	$(3,333)	$(1,014)

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Notes to Consolidated Financial Statements

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 19 - Condensed Financial Information - Parent Company Only (concluded)

Condensed Statements of Cash Flows - Years Ended September 30
(in thousands)

	2011	2010	2009
Cash flows from operating activities			
Net income (loss)	$ 1,089	$ (2,291)	$ (242)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
(Equity in undistributed (income) loss of Bank) dividends in excess of income of Bank	(1,253)	2,081	616
ESOP shares earned	264	265	264
MRDP compensation expense	171	173	169
Stock option compensation expense	7	6	3

Stock option tax effect	--	-	46
Other, net	(160)	471	(608)
Net cash provided by operating activities	118	705	248
Cash flows from investing activities			
Investment in Bank	(288)	(6,958)	(6,308)
Principal repayments on loan receivable from Bank	298	273	252
Net cash provided by (used in) investing activities	10	(6,685)	(6,056)
Cash flows from financing activities			
Proceeds from exercise of stock options	--	--	346
Payment of dividends	--	(699)	(3,272)
ESOP tax effect	(61)	(78)	(47)
MRDP compensation tax effect	(37)	(39)	(32)
Issuance of preferred stock	--	--	15,425
Issuance of stock warrants	--	--	1,158
Net cash provided by (used in) financing activities	(98)	(816)	13,578
Net increase (decrease) in cash	30	(6,796)	7,770
Cash and cash equivalents			
Beginning of year	4,157	10,953	3,183
End of year	$ 4,187	$ 4,157	$ 10,953

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Notes to Consolidated Financial Statements

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 20 - Net Income (Loss) Per Common Share

Basic net income (loss) per common share is computed by dividing net income (loss) available for common stock by the weighted average number of common shares outstanding during the period, without considering any dilutive items. Diluted net income per common share is computed by dividing net income available for common stock by the weighted average number of common shares and common stock equivalents for items that are dilutive, net of shares assumed to be repurchased using the treasury stock method at the average share price for the Company's common stock during the period. Diluted net loss per common share is the same as basic net loss per common share due to the anti-dilutive effect of common stock equivalents. Common stock equivalents arise from assumed conversion of outstanding stock options and outstanding warrants to purchase common stock. In accordance with FASB guidance for stock compensation, shares owned by the Bank's ESOP that have not been allocated are not considered to be outstanding for the purpose of computing net income (loss) per common share. Information regarding the calculation of basic and

diluted net income (loss) per common share for the years ended September 30 is as follows (dollars in thousands, except per share amounts):

	2011	2010	2009
Basic net income (loss) per common share computation			
Numerator - net income (loss)	$ 1,089	$(2,291)	$ (242)
Preferred stock dividends	(832)	(832)	(643)
Preferred stock discount accretion	(225)	(210)	(129)
Net income (loss) to common stockholders	$ 32	$(3,333)	$(1,014)
Denominator - weighted average common shares outstanding	6,745,347	6,713,766	6,621,399
Basic net income (loss) per common share	$ 0.00	$ (0.50)	$ (0.15)
Diluted net income (loss) per common share computation			
Numerator - net income (loss)	$ 1,089	$(2,291)	$ (242)
Preferred stock dividends	(832)	(832)	(643)
Preferred stock discount accretion	(225)	(210)	(129)
Net income (loss) to common stockholders	$ 32	$(3,333)	$(1,014)
Denominator - weighted average common shares outstanding	6,745,347	6,713,766	6,621,399
Effect of dilutive stock options	177	--	--
Weighted average common shares outstanding-assuming dilution	6,745,524	6,713,766	6,621,399
Diluted net income (loss) per common share	$ 0.00	$ (0.50)	$ (0.15)

For the years ended September 30, 2011, 2010 and 2009, options to purchase 154,081, 193,083 and 176,899 shares of common stock, respectively, were outstanding but not included in the computation of diluted net income (loss) per common share because the options' exercise prices were greater than the average market price of the common shares and, therefore, their effect would have been anti-dilutive.

(continued)

Note 20 - Net Income (Loss) Per Common Share (concluded)

For the year ended September 30, 2009, the effect of dilutive stock options was computed to be 1,300 shares. However, the dilutive effect of these options has been excluded from the diluted net loss per common share computation for the year ended September 30, 2009 because the Company reported

a net loss to common shareholders for that period and, therefore, their effect would have been anti-dilutive.

For the years ended September 30, 2011, 2010 and 2009, a warrant to purchase a weighted average of 370,899, 370,899 and 278,174 shares of common stock, respectively, was outstanding but not included in the computation of diluted net income (loss) per common share because the warrant's exercise price was greater than the average market price of the common shares and, therefore, its effect would have been anti-dilutive.

For the year ended September 30, 2009, the effect of dilutive warrants was computed to be 541 shares. However, the dilutive effect of these warrants has been excluded from the diluted net loss per common share computation for the year ended September 30, 2009 because the Company reported a net loss to common shareholders for that period and, therefore, their effect would have been anti-dilutive.

Note 21 - Fair Value Measurement

GAAP requires disclosure of estimated fair values for financial instruments. Such estimates are subjective in nature, and significant judgment is required regarding the risk characteristics of various financial instruments at a discrete point in time. Therefore, such estimates could vary significantly if assumptions regarding uncertain factors were to change. In addition, as the Company normally intends to hold the majority of its financial instruments until maturity, it does not expect to realize many of the estimated amounts disclosed. The disclosures also do not include estimated fair value amounts for items which are not defined as financial instruments but which may have significant value. The Company does not believe that it would be practicable to estimate a representational fair value for these types of items as of September 30, 2011 and 2010. Because GAAP excludes certain items from fair value disclosure requirements, any aggregation of the fair value amounts presented would not represent the underlying value of the Company. Major assumptions, methods and fair value estimates for the Company's significant financial instruments are set forth below:

Cash and Due from Financial Institutions and Interest-Bearing Deposits in Banks

The estimated fair value of financial instruments that are short-term or re-price frequently and that have little or no risk are considered to have an estimated fair value equal to the recorded value.

CDs Held for Investment

The estimated fair value of financial instruments that are short-term or re-price frequently and that have little or no risk are considered to have an estimated fair value equal to the recorded value.

(continued)

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 21 - Fair Value Measurement (continued)

MBS and Other Investments

The estimated fair value of MBS and other investments are based upon the assumptions market participants would use in pricing the security. Such assumptions include observable and unobservable inputs such as quoted market prices, dealer quotes, or discounted cash flows.

FHLB Stock

FHLB stock is not publicly traded; however, the recorded value of the stock holdings approximates the estimated fair value, as the FHLB is required to pay par value upon re-acquiring this stock.

Loans Receivable, Net

At September 30, 2011 and 2010, because of the illiquid market for loan sales, loans were priced using comparable market statistics. The loan portfolio was segregated into various categories and a weighted average valuation discount that approximated similar loan sales was applied to each category.

Loans Held for Sale

The estimated fair value has been based on quoted market prices obtained from Freddie Mac.

Accrued Interest

The recorded amount of accrued interest approximates the estimated fair value.

Deposits

The estimated fair value of deposits with no stated maturity date is included at the amount payable on demand. The estimated fair value of fixed maturity certificates of deposit is computed by discounting future cash flows using the rates currently offered by the Bank for deposits of similar remaining maturities.

FHLB Advances

The estimated fair value of FHLB advances is computed by discounting the future cash flows of the borrowings at a rate which approximates the current offering rate of the borrowings with a comparable remaining life.

Repurchase Agreements

The recorded value of repurchase agreements approximates the estimated fair value due to the short-term nature of the borrowings.

Off-Balance-Sheet Instruments

Since the majority of the Company's off-balance-sheet instruments consist of variable-rate commitments, the Company has determined they do not have a distinguishable estimated fair value.

(continued)

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 21 - Fair Value Measurement (continued)

The estimated fair value of financial instruments at September 30, were as follows (in thousands):

	2011		2010	
	Recorded Amount	Estimated Fair Value	Recorded Amount	Estimated Fair Value
Financial Assets				
Cash and due from financial institutions and interest-bearing deposits in banks	$ 112,065	$112,065	$111,786	$111,786
CDs held for investment	18,659	18,659	18,047	18,047
MBS and other investments	10,862	10,946	16,185	15,961
FHLB stock	5,705	5,705	5,705	5,705
Loans receivable, net	523,980	490,322	524,621	473,986
Loans held for sale	4,044	4,185	2,970	3,059
Accrued interest receivable	2,411	2,411	2,630	2,630
Financial Liabilities				
Deposits	$ 592,678	$595,331	$578,869	$581,046
FHLB advances - long term	55,000	61,009	75,000	81,579
Repurchase agreements	729	729	622	622
Accrued interest payable	545	545	737	737

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the estimated fair value of the Company's financial instruments will change when interest rate levels change and that change may either be favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed interest rate obligations are less likely to prepay in a rising interest rate environment and more likely to prepay in a falling interest rate environment. Conversely, depositors who are receiving fixed interest rates are more likely to withdraw funds before maturity in a rising interest rate environment and less likely to do so in a falling interest rate environment. Management monitors interest rates and maturities of assets and liabilities, and attempts to minimize interest rate risk by adjusting terms of new loans, and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

(continued)

Notes to Consolidated Financial Statements

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 21 - Fair Value Measurement (continued)

Accounting guidance regarding fair value measurements defines fair value and establishes a framework for measuring fair value in accordance with GAAP. Fair value is the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. The following definitions describe the levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2: Significant observable inputs other than quoted prices included within Level 1, such as quoted prices in markets that are not active, and inputs other than quoted prices that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions market participants would use in pricing an asset or liability based on the best information available in the circumstances.

The following table summarizes the balances of assets and liabilities measured at estimated fair value on a recurring basis at September 30 and the total losses resulting from these fair value adjustments for the years ended September 30 (in thousands):

	Fair Value			
	Level 1	Level 2	Level 3	Total Losses
2011				
Available for Sale Securities				
Mutual funds	$ 1,000	$ --	$ -	$ --
MBS	--	5,717	--	26
Total	$ 1,000	$ 5,717	$ --	$ 26
2010				
Available for Sale Securities				
Mutual funds	$ 988	$ --	$ -	$ --
MBS	--	10,131	--	103
Total	$ 988	$ 10,131	$ --	$ 103

(continued)

Notes to Consolidated Financial Statements

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 21 - Fair Value Measurement (concluded)

The following table summarizes the balance of assets and liabilities measured at fair value on a non-recurring basis at September 30 and the total losses resulting from these fair value adjustments for the years ended September 30 (in thousands):

	Fair Value			
	Level 1	Level 2	Level 3	Total Losses
2011				
Impaired loans (1)	$ --	$ --	$18,523	$ 6,468
MBS held to maturity (2)	--	211	--	421
OREO and other repossessed assets (3)	--	--	10,811	1,305
MSRs (4)	--	--	2,108	(405)
Total	$ --	$ 211	$31,442	$ 7,789
2010				
Impaired loans (1)	$ --	$ --	$ 5,770	$13,820
MBS held to maturity (2)	--	866	--	2,115
OREO and other repossessed assets (3)	--	--	11,519	377
MSRs (4)	--	--	1,929	890
Total	$ --	$ 866	$19,218	$17,202

(1) The loss represents charge offs on collateral dependent loans for estimated fair value adjustments based on the estimated fair value of the collateral. A loan is considered to be impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. The specific reserve for collateral dependent impaired loans was based on the estimated fair value of the collateral less estimated costs to sell. The estimated fair value of collateral was determined based primarily on appraisals. In some cases, adjustments were made to the appraised values due to various factors including age of the appraisal, age of comparables included in the appraisal, and known changes in the market and in the collateral. When significant adjustments were based on unobservable inputs, the resulting estimated fair value measurement has been categorized as a Level 3 measurement. (2) The loss represents OTTI credit-related charges on held to maturity MBS. (3) The Company's OREO and other repossessed assets are initially recorded at estimated fair value less estimated costs to sell. This amount becomes the property's new basis. Estimated fair value was generally determined by management based on a number of factors, including third-party appraisals of estimated fair value in an orderly sale. Estimated costs to sell were based on standard market factors. The valuation of OREO and other repossessed assets is subject to significant external and internal judgment.

Management periodically reviews the recorded value to determine whether the property continues to be recorded at the lower of its recorded book value or estimated fair value, net of estimated costs to sell. (4) The fair value of the MSRs was determined using a third-party model, which incorporates the expected life of the loans, estimated cost to service the loans, servicing fees received and other factors. The estimated fair value is calculated by stratifying the mortgage servicing rights based on the predominant risk characteristics that include the underlying loan's interest rate, cash flows of the loan, origination date and term. The amount of impairment recognized is the amount, if any, by which the amortized cost of the rights exceed their estimated fair value. Impairment, if deemed temporary, is recognized through a valuation allowance to the extent that estimated fair value is less than the recorded amount.

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 22 - Selected Quarterly Financial Data (Unaudited)

The following selected financial data are presented for the quarters ended (in thousands, except per share amounts):

	September 30, 2011	June 30, 2011	March 31, 2011	December 31, 2010
Interest and dividend income	$8,231	$8,431	$8,493	$8,811
Interest expense	(1,893)	(2,019)	(2,141)	(2,480)
Net interest income	6,338	6,412	6,352	6,331
Provision for loan losses	(1,758)	(3,400)	(700)	(900)
Non-interest income	1,861	1,761	2,108	2,951
Non-interest expense	(6,627)	(6,782)	(6,178)	(6,376)
Income (loss) before income taxes	(186)	(2,009)	1,582	2,006
Provision (benefit) for income taxes	(113)	(729)	499	647
Net income (loss)	(73)	(1,280)	1,083	1,359
Preferred stock dividends	(208)	(208)	(208)	(208)
Preferred stock discount accretion	(58)	(57)	(56)	(54)
Net income (loss) to common shareholders	$(339)	$(1,545)	$ 819	$1,097
Net Income (loss) per common				

share				
Basic	$(0.05)	$ (0.23)	$ 0.12	$ 0.16
Diluted	(0.05)	(0.23)	0.12	0.16

(continued)

Notes to Consolidated Financial Statements

Timberland Bancorp, Inc. and Subsidiary
September 30, 2011 and 2010

Note 22 - Selected Quarterly Financial Data (Unaudited) (concluded)

	September 30, 2010	June 30, 2010	March 31, 2010	December 31, 2009
Interest and dividend income	$8,996	$9,102	$9,157	$9,341
Interest expense	(2,589)	(2,711)	(2,711)	(2,950)
Net interest income	6,407	6,391	6,446	6,391
Provision for loan losses	(2,005)	(750)	(5,195)	(2,600)
Non-interest income	1,356	1,941	430	1,969
Non-interest expense	(6,029)	(6,422)	(6,692)	(5,498)
Income (loss) before income taxes	(271)	1,160	(5,011)	262
Provision (benefit) for income taxes	(130)	356	(1,833)	38
Net income (loss)	(141)	804	(3,178)	224
Preferred stock dividends	(208)	(208)	(208)	(208)
Preferred stock discount accretion	(54)	(53)	(52)	(51)
Net income (loss) to common shareholders	$(403)	$ 543	$(3,438)	$ (35)
Net Income (loss) per common share				
Basic	$(0.06)	$0.08	$ (0.51)	$(0.01)
Diluted	(0.06)	0.08	(0.51)	(0.01)

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures: An evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")) was carried out under the supervision and with the participation of the Company's Chief Executive Officer, Chief Financial Officer and several other members of the Company's senior management as of the end of the period covered by this annual report. The Company's Chief Executive Officer and Chief Financial Officer concluded that as of September 30, 2011 the Company's disclosure controls and procedures were effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Act is (i) accumulated and communicated to the Company's management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

(b) Changes in Internal Controls: There have been no changes in our internal control over financial reporting (as defined in 13a-15(f) of the Exchange Act) that occurred during the quarter ended September 30, 2011, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. The Company continued, however, to implement suggestions from its internal auditor and independent auditor on ways to strengthen existing controls. The Company does not expect that its disclosure controls and procedures and internal controls over financial reporting will prevent all error and fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgements in decision-making can be faulty, and that breakdowns in controls or procedures can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure is based in part upon certain assumptions about the likelihood of future events and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

Management's Report on Internal Control Over Financial Reporting is included in this Form 10-K under Part II, Item 8, "Financial Statements and Supplementary Data."

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item is contained under the section captioned "Proposal I - Election of Directors" in the Company's Definitive Proxy Statement for the 2011 Annual Meeting of Stockholders ("Proxy Statement") and is incorporated herein by reference.

For information regarding the executive officers of the Company and the Bank, see "Item 1. Business - Executive Officers."

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Compliance with Section 16(a) of the Exchange Act

The information required by this item is contained under the section captioned "Section 16(a) Beneficial Ownership Reporting Compliance" included in the Company's Proxy Statement and is incorporated herein by reference.

Audit Committee Matters and Audit Committee Financial Expert

The Company has a separately designated standing Audit Committee, composed of Directors Robbel, Smith, Goldberg and Stoney. Each member of the Audit Committee is "independent" as defined in the Nasdaq Stock Market listing standards. The Company's Board of Directors has designated Directors Robbel and Stoney as the Audit Committee financial experts, as defined in the SEC's Regulation S-K. Directors Robbel, Smith, Goldberg and Stoney are independent as that term is used in Item 7(c) of Schedule 14A promulgated under the Exchange Act.

Code of Ethics

The Board of Directors ratified its Code of Ethics for the Company's officers (including its senior financial officers), directors and employees during the year ended September 30, 2011. The Code of Ethics requires the Company's officers, directors and employees to maintain the highest standards of professional conduct. The Company's Code of Ethics was filed as an exhibit to its Annual Report on Form 10-K for the year ended September 30, 2003 and is available on our website at www.timberlandbank.com.

Nomination Procedures

There have been no material changes to the procedures by which stockholder may recommend nominees to the Company's Board of Directors.

Item 11. Executive Compensation

The information required by this item is contained under the sections captioned "Executive Compensation" and "Directors' Compensation" included in the Company's Proxy Statement and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and

Related Stockholder Matters

(a) Security Ownership of Certain Beneficial Owners.

The information required by this item is contained under the section captioned "Security Ownership of Certain Beneficial Owners and Management" included in the Company's Proxy Statement and is incorporated herein by reference.

(b) Security Ownership of Management.

The information required by this item is contained under the sections captioned "Security Ownership of Certain Beneficial Owners and Management" and "Proposal I - Election of Directors" included in the Company's Proxy Statement is incorporated herein by reference.

(c) Changes In Control.

The Company is not aware of any arrangements, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change in control of the Company.

(d) Equity Compensation Plan Information. The following table summarizes share and exercise price information about the Company's equity compensation plans as of September 30, 2011.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders:			
Management Recognition and Development Plan.............	--	$ --	--
1999 Stock Option Plan.............	100,094	10.15	--
2003 Stock Option Plan.............	37,632	6.83	250,238
Equity compensation plans not approved by security			

holders............	--	--	--
Total............	137,726		250,238

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

The information required by this item is contained under the sections captioned "Meetings and Committees of the Board of Directors And Corporate Governance Matters - Corporate Governance - Related Party Transactions" and "Meetings and Committees of the Board of Directors and Corporate Governance Matters - Corporate Governance - Director Independence" included in the Company's Proxy Statement and are incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

The information required by this item is contained under the section captioned "Independent Auditor" included in the Company's Proxy Statement and is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Exhibits

- 3.1 Articles of Incorporation of the Registrant (1)
- 3.2 Amended and Restated Bylaws of the Registrant (2)
- 3.3 Articles of Amendment to Articles of Incorporation of the Registrant (3)
- 4.2 Warrant to purchase shares of the Company's common stock dated December 23, 2008 (3)
- 4.3 Letter Agreement (including Securities Purchase Agreement Standard Terms, attached as Exhibit A) dated December 23, 2008 between the Company and the United States Department of the Treasury (3)
- 10.1 Employee Severance Compensation Plan (4)
- 10.2 Employee Stock Ownership Plan (5)
- 10.3 1999 Stock Option Plan (6)
- 10.4 2003 Stock Option Plan (7)
- 10.5 Form of Incentive Stock Option Agreement (8)
- 10.6 Form of Non-qualified Stock Option Agreement (8)
- 10.7 Management Recognition and Development Plan (6)

- 10.8 Form of Management Recognition and Development Award Agreement (7)
- 14 Code of Ethics (9)
- 21 Subsidiaries of the Registrant
- 23.1 Consent of Delap LLP
- 23.2 Consent of McGladrey & Pullen, LLP

31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
32	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act
99.1	Certification of the Principal Executive Officer Pursuant to Section 111(b) of the Emergency Economic Stabilization Act of 2008 for the Fiscal Year Ended September 30, 2011
99.2	Certification of the Chief Financial Officer Pursuant to Section 111(b) of the Emergency Economic Stabilization Act of 2008 for the Fiscal Year Ended September 30, 2011
101	The following materials from Timberland Bancorp, Inc.'s Annual Report on Form 10-K for the year ended September 30, 2011, formatted in Extensible Business Reporting Language (XBRL): (a) Consolidated Balance Sheets; (b) Consolidated Statements of Operations; (c) Consolidated Statements of Comprehensive Income (Loss); (d) Consolidated Statements of Shareholders' Equity; (e) Consolidated Statements of Cash Flows; and (f) Notes to Consolidated Financial Statements (10)

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(1) Filed as an exhibit to the Registrant's Registration Statement on Form S-1 (333-35817) and incorporated by reference.
(2) Incorporated by reference to the Registrant's Current Report on Form 8-K dated April 27, 2010.
(3) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on December 23, 2008.
(4) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 1997; and to the Registrant's Current Report on Form 8-K dated April 13, 2007.
(5) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 1997.
(6) Incorporated by reference to Exhibit 99 included in the Registrant's Registration Statement on Form S-8 (333-32386)
(7) Incorporated by reference to Exhibit 99.2 included in the Registrant's Registration Statement on Form S-8 (333-1161163)
(8) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended September 30, 2005.
(9) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended September 30, 2003.
(10) Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

SIGNATURES

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

TIMBERLAND BANCORP, INC.

Date: December 12, 2011 By: /s/ Michael R. Sand

Michael R. Sand
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURES	TITLE	DATE
/s/ Michael R. Sand Michael R. Sand	President, Chief Executive Officer and Director (Principal Executive Officer)	December 12, 2011
/s/ Jon C. Parker Jon C. Parker	Chairman of the Board	December 12, 2011
/s/ Dean J. Brydon Dean J. Brydon	Chief Financial Officer (Principal Financial and Accounting Officer)	December 12, 2011
/s/ Andrea M. Clinton Andrea M. Clinton	Director	December 12, 2011
/s/ Larry D. Goldberg Larry D. Goldberg	Director	December 12, 2011
/s/ James C. Mason James C. Mason	Director	December 12, 2011
/s/ Ronald A. Robbel Ronald A. Robbel	Director	December 12, 2011
/s/ David A. Smith David A. Smith	Director	December 12, 2011
/s/ Michael J. Stoney Michael J. Stoney	Director	December 12, 2011

EXHIBIT INDEX

Exhibit No.	Description of Exhibit
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