NASB FINANCIAL INC
Form 10-Q
August 09, 2012

Securities and Exchange Commission

Washington, DC 20549

FORM 10-Q

x **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the period ended June 30, 2012

or

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

Commission File Number 0-24033

NASB Financial, Inc.

(Exact name of registrant as specified in its charter)

Missouri	**43-1805201**

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

12498 South 71 Highway, Grandview, Missouri 64030

(Address of principal executive offices) (Zip Code)

(816) 765-2200

(Registrant s telephone number, including area code)

N/A

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

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

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

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

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

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

The number of shares of Common Stock of the Registrant outstanding as of August 6, 2012, was 7,867,614.

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Balance Sheets

	June 30, 2012 (Unaudited)	September 30, 2011
	(Dollars in thousands)	
ASSETS		
Cash and cash equivalents	$ 8,553	5,030
Securities:		
Available for sale, at fair value	190,533	72,125
Stock in Federal Home Loan Bank, at cost	8,097	13,551
Mortgage-backed securities:		
Available for sale, at fair value	575	715
Held to maturity, at cost	28,567	39,146
Loans receivable:		
Held for sale, at fair value	123,862	115,434
Held for investment, net	807,091	987,400
Allowance for loan losses	(34,816)	(70,266)
Total loans receivable, net	896,137	1,032,568
Accrued interest receivable	4,414	4,870
Foreclosed assets held for sale, net	17,488	16,937
Premises and equipment, net	15,176	14,434
Investment in LLCs	17,363	17,674
Deferred income tax asset, net	20,377	19,221
Income taxes receivable		3,124
Other assets	13,289	14,189
	$ 1,220,569	1,253,584
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Customer deposit accounts	$ 844,058	784,681
Brokered deposit accounts	21,358	24,994
Advances from Federal Home Loan Bank	150,000	247,000
Subordinated debentures	25,774	25,774
Escrows	6,909	10,082
Income taxes payable	169	
Accrued expenses and other liabilities	11,092	10,675
Total liabilities	1,059,360	1,103,206
Stockholders equity:		
Common stock of $0.15 par value: 20,000,000 shares authorized; 9,857,112 shares issued	1,479	1,479
Additional paid-in capital	16,656	16,652
Retained earnings	181,775	171,406
Treasury stock, at cost; 1,989,498 shares	(38,418)	(38,418)
Accumulated other comprehensive loss	(283)	(741)

Total stockholders equity	161,209	150,378
	$ 1,220,569	1,253,584

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

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NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statements of Operations

(Unaudited)

	Three months ended June 30, 2012	Three months ended June 30, 2011	Nine months ended June 30, 2012	Nine months ended June 30, 2011
	(Dollars in thousands, except per share data)			
Interest on loans receivable	$ 13,654	16,339	43,817	50,605
Interest on mortgage-backed securities	415	601	1,377	1,730
Interest and dividends on securities	676	1,116	2,142	2,954
Other interest income	5	1	11	7
Total interest income	14,750	18,057	47,347	55,296
Interest on customer and brokered deposit accounts	2,241	3,755	7,155	11,903
Interest on advances from Federal Home Loan Bank	658	1,004	1,859	4,111
Interest on subordinated debentures	135	122	401	371
Total interest expense	3,034	4,881	9,415	16,385
Net interest income	11,716	13,176	37,932	38,911
Provision for loan losses	3,000	68	10,500	49,394
Net interest income (loss) after provision for loan losses	8,716	13,108	27,432	(10,483)
Other income (expense):				
Loan servicing fees, net	39	(73)	104	(30)
Impairment recovery on mortgage servicing rights		25		42
Customer service fees and charges	1,424	1,256	4,036	5,016
Provision for loss on real estate owned	(361)		(3,784)	(11,731)
Gain (loss) on sale of securities available for sale		203	(343)	673
Gain (loss) on sale of securities held to maturity	(32)		(32)	411
Gain from sale of loans receivable held for sale	12,949	5,325	32,785	21,174
Impairment loss on investment in LLCs			(200)	
Other	1,542	(351)	1,833	(1,837)
Total other income	15,561	6,385	34,399	13,718
General and administrative expenses:				
Compensation and fringe benefits	5,633	4,696	16,454	14,572
Commission-based mortgage banking compensation	4,421	2,364	11,730	10,756
Premises and equipment	1,184	1,082	3,669	3,195
Advertising and business promotion	1,614	1,628	3,995	4,229
Federal deposit insurance premiums	361	404	1,148	1,307
Other	2,850	2,182	7,975	6,823
Total general and administrative expenses	16,063	12,356	44,971	40,882
Income (loss) before income tax expense (benefit)	8,214	7,137	16,860	(37,647)
Income tax expense (benefit)	3,159	2,748	6,491	(14,494)
Net income (loss)	$ 5,055	4,389	10,369	(23,153)

Basic earnings (loss) per share	$	0.64	0.56	1.32	(2.94)
Diluted earnings (loss) per share	$	0.64	0.56	1.32	(2.94)
Basic weighted average shares outstanding		7,867,614	7,867,614	7,867,614	7,867,614

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

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statement of Stockholders Equity (Unaudited)

	Common stock	Additional paid-in capital	Retained earnings	Treasury stock	Accumulated other comprehensive income (loss)	Total stockholders equity
			(Dollars in thousands)			
Balance at October 1, 2011	$ 1,479	16,652	171,406	(38,418)	(741)	150,378
Comprehensive income:						
Net income			10,369			10,369
Other comprehensive income, net of tax:						
Unrealized gain on securities available for sale					458	458
Total comprehensive income						10,827
Stock based compensation expense		4				4
Balance at June 30, 2012	$ 1,479	16,656	181,775	(38,418)	(283)	161,209

	Nine months ended June 30, 2012 (Dollars in thousands)
Reclassification Disclosure:	
Unrealized gain on available for sale securities, net of income taxes of $142	$ 227
Reclassification adjustment for loss included in net income, net of income taxes of $144	231
Change in unrealized gain on available for sale securities, net of income taxes of $287	$ 458

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

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Nine months ended June 30, 2012	2011
	(Dollars in thousands)	
Cash flows from operating activities:		
Net income (loss)	$ 10,369	(23,153)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	1,461	1,390
Amortization and accretion, net	(832)	(116)
(Gain) loss on sale of securities available for sale	343	(673)
(Gain) loss on sale of securities held to maturity	32	(411)
Loss from investment in LLCs	116	57
Impairment loss on investment in LLCs	200	
Impairment recovery on mortgage servicing rights		(42)
Gain from loans receivable held for sale	(32,785)	(21,174)
Provision for loan losses	10,500	49,394
Provision for loss on real estate owned	3,784	11,731
Origination of loans receivable held for sale	(1,294,296)	(1,229,443)
Sale of loans receivable held for sale	1,318,653	1,352,568
Stock based compensation stock options	4	37
Changes in:		
Net fair value of loan-related commitments	(1,364)	1,354
Accrued interest receivable	456	267
Prepaid and accrued expenses, other liabilities and income taxes receivable, and income taxes payable	3,816	(15,862)
Net cash provided by operating activities	20,457	125,924
Cash flows from investing activities:		
Principal repayments of mortgage-backed securities:		
Held to maturity	9,654	11,871
Available for sale	118	159
Principal repayments of investment securities:		
Held to maturity		166
Available for sale	25,109	8,198
Principal repayments of mortgage loans receivable held for investment	185,273	131,596
Principal repayments of other loans receivable	3,122	4,222
Loan origination - mortgage loans receivable held for investment	(62,045)	(104,550)
Loan origination - other loans receivable	(2,509)	(2,346)
Purchase of mortgage loans receivable held for investment	(709)	(1,219)
Proceeds from sale of Federal Home Loan Bank stock	5,454	5,882
Purchase of mortgage backed securities held to maturity		(8,768)
Purchase of investment securities available for sale	(163,147)	(71,259)
Proceeds from sale of mortgage backed securities held to maturity	859	
Proceeds from sale of investment securities held to maturity		1,491
Proceeds from sale of investment securities available for sale	19,678	26,916
Proceeds from sale of real estate owned	8,155	18,983
Purchases of premises and equipment, net	(2,203)	(1,785)
Investment in LLCs	(4)	(6)
Other	640	(141)
Net cash provided by investing activities	27,445	19,410

NASB Financial, Inc. and Subsidiary

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Nine months ended June 30,	
	2012	2011
	(Dollars in thousands)	
Cash flows from financing activities:		
Net increase (decrease) in customer and brokered deposit accounts	55,794	(51,499)
Proceeds from advances from Federal Home Loan Bank	25,000	56,000
Repayment on advances from Federal Home Loan Bank	(122,000)	(153,000)
Change in escrows	(3,173)	(3,719)
Net cash used in financing activities	(44,379)	(152,218)
Net increase (decrease) in cash and cash equivalents	3,523	(6,884)
Cash and cash equivalents at beginning of the period	5,030	14,033
Cash and cash equivalents at end of period	$ 8,553	7,149
Supplemental disclosure of cash flow information:		
Cash paid for income taxes (net of refunds)	$ 4,642	2,728
Cash paid for interest	9,461	16,524
Supplemental schedule of non-cash investing and financing activities:		
Conversion of loans receivable to real estate owned, net of specific reserves	$ 15,974	31,148
Conversion of real estate owned to loans receivable	3,907	4,220

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

(1) BASIS OF PRESENTATION

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

The accompanying unaudited condensed consolidated financial statements are prepared in accordance with instructions to Form 10-Q and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (GAAP) for complete financial statements. All adjustments are of a normal and recurring nature, and, in the opinion of management, the statements include all adjustments considered necessary for fair presentation. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended September 30, 2011, filed with the Securities and Exchange Commission on December 14, 2011. Operating results for the nine month period ended June 30, 2012, are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2012. The condensed consolidated balance sheet of the Company as of September 30, 2011, has been derived from the audited balance sheet of the Company as of that date.

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

The Company s critical accounting policies involving the more significant judgments and assumptions used in the preparation of the condensed consolidated financial statements as of June 30, 2012, have remained unchanged from September 30, 2011. These policies relate to the allowance for loan losses, the valuation of foreclosed assets held for sale, the valuation of derivative instruments, and the valuation of equity method investments. Disclosure of these critical accounting policies is incorporated by reference under Item 8 Financial Statements and Supplementary Data in the Company s Annual Report on Form 10-K for the Company s year ended September 30, 2011.

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

(2) RECONCILIATION OF BASIC EARNINGS (LOSS) PER SHARE TO DILUTED EARNINGS (LOSS) PER SHARE

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

	Three months ended		Nine months ended	
	6/30/12	6/30/11	6/30/12	6/30/11
Net income (loss) (in thousands)	$ 5,055	4,389	10,369	(23,153)
Average common shares outstanding	7,867,614	7,867,614	7,867,614	7,867,614
Average common share stock options outstanding				
Average diluted common shares	7,867,614	7,867,614	7,867,614	7,867,614
Earnings (loss) per share:				
Basic	$ 0.64	0.56	1.32	(2.94)
Diluted	0.64	0.56	1.32	(2.94)

At June 30, 2012 and 2011, options to purchase 47,538 and 49,538 shares, respectively, of the Company s stock were outstanding. These options were not included in the calculation of diluted earnings (loss) per share because the option exercise price was greater than the average market price of the common shares for the period, thus making the options anti-dilutive.

(3) SECURITIES AVAILABLE FOR SALE

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

	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Corporate debt securities	$ 58,113	613	723	58,003
U.S. Government sponsored agency securities	132,888	159	528	132,519
Municipal securities	11			11
Total	$ 191,012	772	1,251	190,533

The following table presents a summary of securities available for sale at September 30, 2011. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Corporate debt securities	$ 48,412	263	1,763	46,912
Trust preferred securities	24,942	254		25,196
Municipal securities	17			17
Total	$ 73,371	517	1,763	72,125

During the nine month period ended June 30, 2012, the Company realized gross gains of $227,000 and gross losses of $570,000 on the sale of securities available for sale. The Company realized gross gains of $673,000 and no gross losses on the sale of securities available for sale during the nine month period ended June 30, 2011.

The following table presents a summary of the fair value and gross unrealized losses of those securities available for sale which had unrealized losses at June 30, 2012. Dollar amounts are expressed in thousands.

	Less than 12 months		12 months or longer	
	Estimated Fair Value	Gross unrealized Losses	Estimated fair value	Gross unrealized losses
Corporate debt securities	$ 12,836	361	$ 15,621	362
U.S. Government sponsored agency securities	61,559	528		
Total	$ 74,395	889	$ 15,621	362

Management monitors the securities portfolio for impairment on an ongoing basis. This process involves monitoring market conditions and other relevant information, including external credit ratings, to determine whether or not a decline in value is other-than-temporary. When the fair value of a security is less than its amortized cost, an other-than-temporary impairment is considered to have occurred if the present value of expected cash flows is not sufficient to recover the entire amortized cost, or if the Company intends to, or will be required to, sell the security prior to the recovery of its amortized cost. The unrealized losses at June 30, 2012, are primarily the result of changes in market yields from the time of purchase. Management generally views changes in fair value caused by changes in interest rates as temporary.

The scheduled maturities of securities available for sale at June 30, 2012 are presented in the following table. Dollar amounts are expressed in thousands.

	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Due in less than one year	$ 11,841		12	11,829
Due from one to five years	122,782	361	334	122,809
Due from five to ten years	45,594	411	596	45,409
Due after ten years	10,795		309	10,486
Total	$ 191,012	772	1,251	190,533

(4) SECURITIES HELD TO MATURITY

There were no securities held to maturity at June 30, 2012 and September 30, 2011.

During the nine month period ended June 30, 2011, the Bank recognized a gain of $411,000 on the sale of an asset backed security which was classified as held to maturity. The security, which was secured by a pool of trust preferred securities issued by various banks, had an amortized cost of $1.1 million at the time of sale. The decision was made to sell the security after it was determined that there was significant deterioration in the issuer s creditworthiness.

(5) MORTGAGE-BACKED SECURITIES AVAILABLE FOR SALE

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

	Amortized cost	Gross unrealized gains	Gross unrealized Losses	Estimated fair value
Pass-through certificates guaranteed by GNMA fixed rate	$ 80			80
Pass-through certificates guaranteed by FNMA adjustable rate	145	4		149
FHLMC participation certificates:				
Fixed rate	205	11		216
Adjustable rate	126	4		130
Total	$ 556	19		575

The following table presents a summary of mortgage-backed securities available for sale at September 30, 2011. Dollar amounts are expressed in thousands.

	Amortized Cost	Gross unrealized gains	Gross unrealized Losses	Estimated fair value
Pass-through certificates guaranteed by GNMA fixed rate	$ 86	3		89
Pass-through certificates guaranteed by FNMA adjustable rate	174	6		180
FHLMC participation certificates:				
Fixed rate	268	25		293
Adjustable rate	146	7		153
Total	$ 674	41		715

There were no sales of mortgage-backed securities available for sale during the nine month periods ended June 30, 2012 and 2011.

The scheduled maturities of mortgage-backed securities available for sale at June 30, 2012 are presented in the following table. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Due from one to five years	$ 205	11		216
Due after ten years	351	8		359
Total	$ 556	19		575

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

(6) MORTGAGE-BACKED SECURITIES HELD TO MATURITY

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

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
FHLMC participation certificates:				
Fixed rate	$ 38			38
FNMA pass-through certificates:				
Fixed rate	4			4
Balloon maturity and adjustable rate	25			25
Collateralized mortgage obligations	28,500	97	313	28,284
Total	$ 28,567	97	313	28,351

The following table presents a summary of mortgage-backed securities held to maturity at September 30, 2011. Dollar amounts are expressed in thousands.

	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
FHLMC participation certificates:				
Fixed rate	$ 45	1		46
FNMA pass-through certificates:				
Fixed rate	5	1		6
Balloon maturity and adjustable rate	28			28
Collateralized mortgage obligations	39,068	101	218	38,951
Total	$ 39,146	103	218	39,031

During the quarter ended June 30, 2012, the Bank recognized a loss of $32,000 on the sale of a mortgage backed security which was classified as held to maturity. The security had an amortized cost of $891,000 at the time of sale. The decision was made to sell the security after it was determined that there was significant deterioration in the issuer s creditworthiness. There were no other sales of mortgage-backed securities held to maturity during the nine month periods ended June 30, 2012 and 2011.

The following table presents a summary of the fair value and gross unrealized losses of those mortgage-backed securities held to maturity which had unrealized losses at June 30, 2012. Dollar amounts are expressed in thousands.

	Less than 12 months		12 months or longer	
	Estimated fair Value	Gross unrealized losses	Estimated fair Value	Gross unrealized losses
Collateralized mortgage obligations	$ 11,411	144	$ 9,440	169

Management monitors the securities portfolio for impairment on an ongoing basis by evaluating market conditions and other relevant information, including external credit ratings, to determine whether or not a decline in value is other-than-temporary. When the fair value of a security is less than its amortized cost, an other-than-temporary impairment is considered to have occurred if the present value of expected cash flows is not sufficient to recover the entire amortized cost, or if the Company intends to, or will be required to, sell the security prior to the recovery of its amortized cost. The unrealized losses at June 30, 2012, are primarily the result of changes in market yields from the time of purchase. Management generally views changes in fair value caused by changes in interest rates as temporary. In addition, all scheduled payments for securities with unrealized losses at June 30, 2012, have been made, and it is anticipated that the entire principal balance of such securities will be collected.

The scheduled maturities of mortgage-backed securities held to maturity at June 30, 2012, are presented in the following table. Dollar amounts are expressed in thousands.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Due from one to five years	$ 10			10
Due from five to ten years	1,378		32	1,346
Due after ten years	27,179	97	281	26,995
Total	$ 28,567	97	313	28,351

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

(7) LOANS RECEIVABLE

The Bank has traditionally concentrated its lending activities on mortgage loans secured by residential and business property and, to a lesser extent, development lending. Residential mortgage loans have either long-term fixed or adjustable rates. The Bank also has a portfolio of mortgage loans that are secured by multifamily, construction, development, and commercial real estate properties. The remaining part of North American s loan portfolio consists of non-mortgage commercial and installment loans. The following table presents the Bank s total loans receivable at June 30, 2012 and September 30, 2011. Dollar amounts are expressed in thousands.

	June 30, 2012	September 30, 2011
HELD FOR INVESTMENT		
Mortgage loans:		
Permanent loans on:		
Residential properties	$ 336,135	329,715
Business properties	349,424	409,737
Partially guaranteed by VA or insured by FHA	4,424	3,947
Construction and development	115,621	181,663
Total mortgage loans	805,604	925,062
Commercial loans	17,660	80,937
Installment loans and lease financing to individuals	7,733	9,028
Total loans receivable held for investment	830,997	1,015,027
Less:		
Undisbursed loan funds	(18,369)	(20,944)
Unearned discounts and fees on loans, net of deferred costs	(5,537)	(6,683)
Net loans receivable held for investment	$ 807,091	987,400
HELD FOR SALE		
Mortgage loans:		
Permanent loans on:		
Residential properties	$ 123,862	115,434

Included in the loans receivable balances at June 30, 2012, are participating interests in mortgage loans and wholly owned mortgage loans serviced by other institutions in the amount of $4.4 million. Loans and participations serviced for others amounted to approximately $29.9 million at June 30, 2012. Loans serviced for others are not included in the accompanying consolidated balance sheets.

<u>Lending Practices and Underwriting Standards</u>

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

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

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

At the time a potential borrower applies f