LEWIS GARY L
Form 4
February 09, 2011

FORM 4

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

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

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

OMB Number:	3235-0287
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

(Print or Type Responses)

1. Name and Address of Reporting Person *
LEWIS GARY L

(Last) (First) (Middle)

225 W. WASHINGTON STREET

(Street)

INDIANAPOLIS, IN 46204

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
SIMON PROPERTY GROUP INC /DE/ [SPG]

3. Date of Earliest Transaction (Month/Day/Year)
02/09/2011

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
President Leasing/SR EVP

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	02/09/2011		S		7,500	D	$ 106.2265	44,347	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
LEWIS GARY L 225 W. WASHINGTON STREET INDIANAPOLIS, IN 46204			President Leasing/SR EVP	

Signatures

Gary L. Lewis, and his attorney-in-fact, Shelly Doran	02/09/2011
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. TEXT-INDENT: 0pt; MARGIN-RIGHT: 0pt" align="right">nm(2)

Dividends declared per share:

0.213

0.194

0.189

0.088

nm(2)

2008

2007

2006

2005

2004
Number of: Real estate loans outstanding
2,443

2,967

3,389

3,236

3,081
Deposit accounts
66,366

68,874

70,373

73,013

75,565
Full service offices
15

15

14

15

14

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(1) Net of allowance for loan losses, loans in process and deferred loan fees.
(2) Per share information is not meaningful. Old Home Federal Bancorp did not complete its minority stock offering until December 6, 2004 and did not have any outstanding shares prior to that date.

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	At or For the Year Ended September 30,				
	2008	2007	2006	2005	2004
KEY FINANCIAL RATIOS:					
Performance Ratios:					
Return on average assets (1)	0.54%	0.71%	0.85%	0.82%	0.93%
Return on average equity (2)	2.16	4.75	5.90	5.69	10.47
Dividend payout ratio (3)	74.56	23.52	19.72	10.68	--
Equity-to-assets ratio (4)	24.94	14.94	14.47	14.38	8.86
Interest rate spread (5)	2.25	2.40	2.79	3.15	3.55
Net interest margin (6)	3.21	3.03	3.33	3.57	3.84
Efficiency ratio (7)	73.75	72.46	70.21	72.81	69.20
Noninterest income/operating revenue (8)	31.70	34.40	32.60	31.80	33.50
Average interest-earning assets to average interest-bearing liabilities	137.83	120.71	122.32	121.07	113.62
Noninterest expense as a percent of average total assets	3.28	3.17	3.29	3.59	3.68
Capital Ratios:					
Tier 1 (core) capital (to tangible assets)	21.66%	13.56%	11.77%	12.00%	6.01%
Total risk-based capital (to risk-weighted assets)	32.84	21.38	19.46	20.46	12.76
Tier 1 risk-based capital (to risk-weighted assets)	32.18	20.69	18.82	19.75	12.05
Asset Quality Ratios:					
Nonaccrual and 90 days or more past due loans as a percent of total loans	2.16%	0.32%	0.08%	0.11%	0.16%
Nonperforming assets as a percent of total assets	1.46	0.29	0.05	0.15	0.10
Allowance for losses as a percent of gross loans receivable	0.98	0.62	0.59	0.67	0.67
Allowance for losses as a percent of nonperforming loans	46.04	195.17	766.49	602.97	432.30
Net charge-offs to average outstanding loans	0.18	0.04	0.01	0.05	0.03

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(1) Net income divided by average total assets.

(2) Net income divided by average equity.

(3) Dividends paid to stockholders, excluding shares held by Home Federal MHC, divided by net income.

(4) Average equity divided by average total assets.

(5) Difference between weighted average yield on interest-earning assets and weighted average rate on interest-bearing liabilities.

(6)

Net interest margin, otherwise known as net yield on interest-earning assets, is calculated as net interest income divided by average interest-earning assets.

(7) The efficiency ratio is noninterest expense divided by the sum of net interest income and noninterest income.

(8) Operating revenue is defined as the sum of net interest income and noninterest income.

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

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) contains forward-looking statements, which can be identified by the use of words such as “believes,” “intends,” “expects,” “anticipates,” “estimates” or similar expressions. Forward-looking statements include, but are not limited to:

- statements of our goals, intentions and expectations;
- statements regarding our business plans, prospects, growth and operating strategies;
- statements regarding the quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are subject to significant risks and uncertainties. Actual results may differ materially from those contemplated by the forward-looking statements due to, among others, the following factors:

- general economic conditions, including real estate values, either nationally or in our market area, that are worse than expected;
- changes in the interest rate environment that reduce our interest margins or reduce the fair value of financial instruments;
- the credit risk of lending activities, including risks related to construction and development lending and commercial and small business banking;
- changes in the level and trend of loan delinquencies and write-offs;
- results of examinations by banking regulators;
- increased competitive pressures among financial services companies;
- changes in consumer spending, borrowing and savings habits;
- our ability to successfully manage our growth;
- changes in the value of mortgage servicing rights;
- legislative or regulatory changes that adversely affect our business;
- adverse changes in the securities markets; and
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Public Company Accounting Oversight Board or the Financial Accounting Standards Board.

Any of the forward-looking statements that made in the MD&A, this annual report and in other public statements we make may turn out to be wrong because of inaccurate assumptions we might make, because of the factors illustrated above or because of other factors that we cannot foresee. Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements and you should not rely on such statements.

GENERAL

Home Federal Bancorp, Inc. (“Company”), is the parent company of Home Federal Bank (“Bank”), a community-based financial institution primarily serving the Boise, Idaho, and surrounding metropolitan area known as the Treasure Valley region of southwestern Idaho. We serve Ada, Canyon, Elmore and Gem counties through our 15 full-service banking offices and one loan center. We are in the business of attracting deposits from the public and utilizing those deposits to originate loans. We offer a wide range of loan products to meet the demands of our customers. Historically, lending activities have been primarily directed toward the origination of residential and commercial real estate loans. Real estate lending activities have been primarily focused on first mortgages on owner occupied, and one- to four-family residential properties. To an increasing extent in recent years, lending activities have also included the origination of residential and commercial construction and land development loans and home equity loans. While continuing our commitment to residential lending, management expects commercial lending, including commercial real estate, builder finance and commercial business lending, to become increasingly important activities for us.

Our primary source of pre-tax income is net interest income. Net interest income is the difference between interest income, which is the income that we earn on our loans and investments, and interest expense, which is the interest that we pay on our deposits and borrowings. Changes in levels of interest rates affect our net interest income. We intend to diversity the mix of our assets by reducing the percentage of our assets that are lower-yielding residential loans and mortgage-backed securities and increasing the percentage of our assets consisting of commercial loans that we believe have higher risk-adjusted returns.

Our operating expenses consist primarily of compensation and benefits, occupancy and equipment, data processing, advertising, postage and supplies, professional services and deposit insurance premiums. Compensation and benefits consist primarily of the salaries and wages paid to our employees, non-cash expense related to our employee stock ownership plan (“ESOP”), payroll taxes, expenses for retirement and other employee benefits. Occupancy and equipment expenses, which are the fixed and variable costs of building and equipment, consist primarily of lease payments, taxes, depreciation charges, maintenance and costs of utilities.

Our results of operations may also be affected significantly by general and local economic and competitive conditions, changes in market interest rates, governmental policies and actions of regulatory authorities. See “Item 1A. Risk Factors" in this Annual Report on Form 10-K for additional discussion on the potential impacts of these items.

OVERVIEW

The fiscal year ended September 30, 2008, was a year of unprecedented change for our Company. Not only did we undertake significant internal reorganization, we endured, and are continuing to deal with, the most damaging national financial crisis in over 80 years.

The following list summarizes the key internal strategic initiatives undertaken by management during fiscal 2008:

§ In December 2007, shareholders approved the Conversion of old Home Federal Bancorp, which was reorganized from the mutual holding company structure to the stock holding company structure;
§ A new management team was put in place, including the Chief Executive Officer, Chief Financial Officer, Chief Lending Officer, Consumer Banking Officer, Chief Information Officer and Chief Credit Officer
§ We opened a branch in Nampa, Idaho, and nearly completed the construction of another branch in Boise, which was opened in October 2008;
§ We executed on our strategy to (a) increase commercial and consumer loans and reduce our reliance on one- to four- family residential loans, and (b) increase core deposits and reduce our reliance on high-cost certificates of deposit and borrowings;
§ We reorganized our credit administration and mortgage banking teams to improve loan portfolio and credit risk management and to improve efficiency in our mortgage program; and,
§ We hired several commercial lenders, including leaders specializing in commercial real estate, commercial business loans and builder finance.

To expand on our initiatives, we continued to execute and manage our long-term strategic plan during fiscal 2008, which is to diversify the balance sheet by increasing our commercial, commercial real estate (“CRE”) and consumer loan portfolios and improve our funding mix by reducing borrowings and increasing core deposits.

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Explanation of Responses:

The following table summarizes our progress during the year:

(dollars in thousands)	September 30, 2008		September 30, 2007	
	Balance	Mix	Balance	Mix
Loans, end of period:				
1-4 and multifamily residential	$233,346	50.1%	$278,724	57.6%
Consumer and home equity	56,227	12.1	46,568	9.6
Land development	18,674	4.0	21,899	4.5
Commercial and commercial real estate	157,118	33.8	136,945	28.3
Funding, fiscal year average:				
Checking	$114,473	20.9%	$127,834	20.6%
Savings	24,194	4.4	23,397	3.8
Money market	58,698	10.7	39,908	6.4
Total core deposits	197,365	36.0	191,139	30.9
Certificates of deposit	193,002	35.2	226,522	36.6
FHLB borrowings	157,549	28.8	201,911	32.6

We have found that deposit growth continues to be challenging. According to the Federal Deposit Insurance Corporation, total deposits in Idaho fell 2.6% between June 2007 and June 2008. Competition for deposits continues to put upward pressure on marginal funding costs, despite falling market rates in the second half of fiscal 2008. Many large regional and national banks are encountering significant liquidity pressures because of their loan losses and their inability to access debt and capital markets. An increase in bank failures in calendar 2008 has resulted in concern among many depositors about the safety of their deposit accounts. These factors are exacerbating an already competitive environment for deposits, pushing deposit rate spreads over Treasury not yields significantly higher than historical trends. Often, we encounter competitors offering certificate of deposit rates that are higher than FHLB advance rates. This validates our strategic plan to reduce our reliance on term funding. During fiscal 2008, we were able to increase core deposits by 3.3%. However, we allowed $77.9 million of certificate accounts and FHLB advances to mature rather than to retain high-cost funding.

While we are disappointed that the total balances of our loan and deposit portfolios declined during the year, we recognize that the nation is experiencing the most disruptive economic environment for financial services companies in decades. According to the Federal Reserve Bank, national levels of consumer debt increased at a rate of 6.71% annually from June 2000 to June 2007 and debt service as a percentage of disposable income rose to over 18.1% in the second quarter of 2007 from 15.4% in the second quarter of 2000. Exotic mortgage products, led by subprime, Alt-A, and "option payment" loan programs, placed previously unqualified borrowers into homes they could not afford. The increase in home demand as a result of this dubious increase in the number of "qualified" borrowers pushed home values higher. In an effort to meet demand, homebuilders accelerated the acquisition and development of residential subdivision projects at inflated prices. As interest rates increased between fiscal years 2005 and 2007, commodity prices such as oil and corn skyrocketed. As a result, the consumer debt burden and cost of living increase brought a seven-year boom in housing to an abrupt end in the second half of 2007. The fallout in 2008 from this meltdown includes hundreds of billions of dollars in loan losses for financial institutions, a national economy that has begun to contract, the failure or Federal government seizure of several large financial institutions and investment banks, and over a trillion dollars of capital funds being committed to the financial services industry by the U.S. Treasury.

We did not develop a nontraditional mortgage program with subprime loans or other products with exotic features. None of our one- to four-family residential mortgage loans has negative amortization features. As a result of this disciplined approach, we have been able to avoid the significant losses many other banks have incurred. Nonetheless, the severity and pervasiveness of the current crisis has impacted us indirectly. The overinvestment in land development projects and overbuild of speculative residential homes has begun to depress home prices in the Treasure Valley. The downturn in the national and local economy is causing rapid increases in unemployment in our market areas, which results in increasing foreclosure and bankruptcy rates. The unemployment rate in the Boise City-Nampa MSA increased from 2.2% in September 2007 to 4.8% in September 2008 as a result of nearly 10,000 job losses during that period. While all of these indicators are well below national levels, we recognize the Treasure Valley is a small market MSA and the loss of one or two significant employment sources could have a dire effect on the local economy.

The increase in our nonperforming loans occurred primarily in our land development and speculative construction loan portfolios. While our exposure to land development is limited as a percentage of our loan portfolio, the uncertainty of land values and the length of time that may be needed to sell or develop the lots has, in our estimation, significantly impaired the collectable balance of some of these loans. While our commercial and commercial real estate portfolios performed well during 2008, the severity of the economic downturn could cause the performance of these loans to deteriorate rapidly. To prepare for such an outcome, our credit administration and loss mitigation teams were realigned to report directly to the President and Chief Executive Officer and we appointed a Chief Credit Officer who is independent of the lending team. We will closely monitor our commercial loan portfolio as we anticipate the likelihood of further economic stress.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

This MD&A, as well as disclosures found elsewhere in this Annual Report on Form 10-K, are based upon the Company's consolidated financial statements, which are prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Several factors are considered in determining whether or not a policy is critical in the preparation of financial statements. These factors include, among other things, whether the estimates are significant to the financial statements, the nature of the estimates, the ability to readily validate the estimates with other information including third parties or available prices, and sensitivity of the estimates to changes in economic conditions and whether alternative accounting methods may be utilized under US GAAP.

Management has identified several accounting policies that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of our financial statements. These policies relate to the determination of the allowance for loan losses and the associated provision for loan losses, the fair market value of capitalized mortgage servicing rights, as well as deferred income taxes and the associated income tax expense. Management reviews the allowance for loan losses for adequacy on a quarterly basis and establishes a provision for loan losses that it believes is sufficient for the loan portfolio growth expected and the loan quality of the existing portfolio. The carrying value of the capitalized mortgage servicing rights is also assessed on a quarterly basis. Income tax expense and deferred income taxes are calculated using an estimated tax rate and are based on management's and our tax advisor's understanding of our effective tax rate and the tax code. These estimates are reviewed by our independent auditor on an annual basis and by our regulators when they examine Home Federal Bank.

Allowance for Loan Losses. Management recognizes that losses may occur over the life of a loan and that the allowance for loan losses must be maintained at a level necessary to absorb specific losses on impaired loans and probable losses inherent in the loan portfolio. Management assesses the allowance for loan losses on a quarterly basis by analyzing several factors including delinquency rates, charge-off rates and the changing risk profile of the Bank's loan portfolio, as well as local economic conditions such as unemployment rates, bankruptcies and vacancy rates of business and residential properties.

The Company believes that the accounting estimate related to the allowance for loan losses is a critical accounting estimate because it is highly susceptible to change from period to period, requiring management to make assumptions about probable incurred losses inherent in the loan portfolio at the balance sheet date. The impact of a sudden large loss could deplete the allowance and require increased provisions to replenish the allowance, which would negatively affect earnings.

The Company's methodology for analyzing the allowance for loan losses consists of specific allocations on significant individual credits and a general allowance amount, including a range of losses. The specific allowance component is determined when management believes that the collectibility of an individually reviewed loan has been impaired and a loss is probable. The general allowance component relates to assets with no well-defined deficiency or weakness and takes into consideration loss that is inherent within the portfolio but has not been identified. The general allowance is determined by applying a historical loss percentage to various types of loans with similar characteristics and classified loans that are not analyzed specifically. Adjustments are made to historical loss percentages to reflect current economic and internal environmental factors, such as changes in underwriting standards and management, that may increase or decrease those loss factors. As a result of the imprecision in

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calculating inherent and potential losses, a range is added to the general allowance to provide an allowance for loan losses that is adequate to cover losses that may arise as a result of changing economic conditions and other qualitative factors that may alter historical loss experience.

The allowance is increased by the provision for loan losses, which is charged against current period operating results and decreased by the amount of actual loan charge-offs, net of recoveries.

The Company also estimates a reserve related to unfunded loan commitments. In assessing the adequacy of the reserve, the Company uses a similar approach used in the development of the allowance for loan losses. The reserve for unfunded loan commitments is included in other liabilities on the Consolidated Balance Sheets. The provision for unfunded commitments is charged to noninterest expense.

Mortgage Servicing Rights. Mortgage servicing rights represent the present value of the future loan servicing fees from the right to service loans for others. The most critical accounting policy associated with mortgage servicing is the methodology used to determine the fair value of capitalized mortgage servicing rights, which requires the development of a number of estimates, the most critical of which are the mortgage loan prepayment rate assumptions. The mortgage loan prepayment rate assumptions are significantly impacted by interest rates. In general, during periods of falling interest rates, the mortgage loans prepay faster and the value of mortgage servicing asset declines. Conversely, during periods of rising rates, the value of mortgage servicing rights generally increases due to slower rates of prepayments. The Company performs a quarterly review of mortgage servicing rights to assess changes in value. This review may include an independent appraisal by an outside party of the fair value of the mortgage servicing rights.

In August 2008, the Bank entered into an agreement to sell its mortgage servicing rights to another financial institution. The value of our mortgage servicing rights was reduced to the estimated purchase price at September 30, 2008. The sale is expected to be finalized on October 31, 2008, with the transfer of servicing to be complete by December 16, 2008. After the transfer, we will no longer service loans for others as we now sell residential mortgage loans in the secondary market with servicing released to the investor.

Deferred Income Taxes. Deferred income taxes are reported for temporary differences between items of income or expense reported in the financial statements and those reported for income tax purposes. Deferred taxes are computed using the asset and liability approach as prescribed in SFAS No. 109, Accounting for Income Taxes. Under this method, a deferred tax asset or liability is determined based on the enacted tax rates that will be in effect when the differences between the financial statement carrying amounts and tax basis of existing assets and liabilities are expected to be reported in an institution’s income tax returns. The deferred tax provision for the year is equal to the net change in the net deferred tax asset from the beginning to the end of the year, less amounts applicable to the change in value related to investments available for sale. The effect on deferred taxes of a change in tax rates is recognized as income in the period that includes the enactment date. The primary differences between financial statement income and taxable income result from depreciation expense, mortgage servicing rights, loan loss reserves, deferred compensation, mark to market adjustments on our available for sale securities, and dividends received from the Federal Home Loan Bank of Seattle. Deferred income taxes do not include a liability for pre-1988 bad debt deductions allowed to thrift institutions that may be recaptured if the institution fails to qualify as a bank for income tax purposes in the future.

COMPARISON OF FINANCIAL CONDITION AT SEPTEMBER 30, 2008, AND SEPTEMBER 30, 2007

Total assets increased $15.1 million, or 2.1%, to $725.1 million at September 30, 2008 from $710.0 million at September 30, 2007. The increase was primarily a result of the $87.8 million in net proceeds received from the Conversion completed in December 2007, which was partially offset by a decrease in deposits and borrowings during this same period of $31.7 million and $43.8 million, respectively. Total liabilities decreased $77.4 million, or 13.0%, to $519.9 million.

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Assets. For the year ended September 30, 2008, total assets increased $15.1 million. The increases and decreases were primarily concentrated in the following asset categories:

	Balance at September 30, 2008	Balance at September 30, 2007	Increase / (Decrease) Amount	Percent
	(in thousands)			
Cash and amounts due from depository institutions	$ 23,270	$ 20,588	$ 2,682	13.0%
Mortgage-backed securities, available for sale	188,787	162,258	26,529	16.4
Loans receivable, net of allowance for loan losses	459,813	480,118	(20,305)	(4.2)

Cash and amounts due from depository institutions. The higher cash balance at September 30, 2008, is due to a portion of the proceeds from the Company's Conversion being invested in overnight funds and cash equivalents. In June 2008, the Company invested $5.0 million of excess cash in a certificate of deposit issued by the FHLB, which is scheduled to mature in December 2008. As discussed in greater detail below, competitive pricing for deposits has resulted in the runoff of some deposit balances, which was funded with some of the net proceeds received from the Conversion.

Securities. Mortgage-backed securities increased $26.5 million to $188.8 million at September 30, 2008, from $162.3 million at September 30, 2007. A significant portion of the proceeds from the Conversion were invested in mortgage-backed securities resulting in the increase. Repayments of principal totaled $31.1 million for the year ended September 30, 2008. Management decided to purchase mortgage-backed securities in order to quickly invest Conversion funds and to provide liquidity in future periods to fund loan growth with proceeds from principal repayments.

Nearly all of the Company's mortgage-backed securities are issued by U.S. Government-sponsored enterprises, primarily Fannie Mae and Freddie Mac. While the U.S. Government has recently affirmed its support for government-sponsored enterprises and the mortgage-backed securities they issued, significant deterioration in the financial strength of Fannie Mae, Freddie Mac or mortgage-backed security insurers may have a material effect on the valuation and performance of the Company's mortgage-backed securities portfolio in future periods. The Company does not own preferred stock issued by Fannie Mae or Freddie Mac.

Non-agency, also referred to as "private label," mortgage-backed securities had a fair value of $3.1 million at September 30, 2008, compared to their amortized cost of $3.4 million at September 30, 2008. The securities carried a rating of 'AAA' by Moody's and Standard & Poor's at that date. While spreads on all mortgage-backed securities, when compared to Treasury notes, have widened since June 2007, the value of private label mortgage-backed securities have fallen more and have been more volatile than securities issued by government-sponsored enterprises due to the deterioration of the national residential loan market. We have reviewed the delinquency status and average collateral coverage of the loans pooled in our private label securities portfolio and have concluded the securities were not other than temporarily impaired at September 30, 2008.

Loans. Loans receivable, net, decreased $20.3 million to $459.8 million at September 30, 2008, from $480.1 million at September 30, 2007. One-to four-family residential loans decreased $39.0 million as we sold nearly all of the one-to four-family loans that we originated. Consumer loans increased $9.7 million, led by a $10.0 million increase in home equity lines of credit and second mortgage loans. Commercial and commercial real estate loans increased $20.2 million to $157.1 million at September 30, 2008. We continue to make progress in building our commercial and small business banking programs, including the addition of an experienced commercial banking team to expand our existing commercial lending program. We will also emphasize other commercial banking activities, including business banking, cash management and other products associated with a full-service commercial bank. Construction loans decreased $11.1 million to $33.0 million at September 30, 2008, which reflects the significant slowdown in residential development in 2008.

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Property and equipment. Property and equipment increased $2.9 million as a result of the opening of a newly constructed banking office in Nampa, Idaho, during fiscal 2008 and the construction of another office in Boise. At September 30, 2008, we had five branches in Wal-Mart supermarkets compared to six at September 30, 2007. We closed one in-store branch in fiscal 2008 in conjunction with the opening of the new banking office in Nampa. The banking office in Boise that was in process of construction at September 30, 2008, was opened in October 2008, at which time we closed our existing Fairview Office and relocated those customers to the new office. We plan to open two additional branches on Eagle Road in Boise and Meridian, Idaho, in late 2009; therefore, we anticipate continued increases in property and equipment as we implement our growth strategy.

Bank owned life insurance. The value of bank owned life insurance increased $422,000 to $11.6 million. The policy premiums are invested in six insurance companies, each of which had a rating of at least ‘AA-’ by Standard & Poor’s and an ‘A+’ rating by A.M. Best. These insurance companies have reported immaterial exposure to AIG and Lehman Brothers, two firms who have encountered significant hardship in the current economy. Nonetheless, we continue to closely watch the performance of the companies that have issued our life insurance policies.

Mortgage servicing rights. In August 2008, we entered into an agreement to sell our mortgage servicing rights to another financial institution. The value of mortgage servicing rights at September 30, 2008, reflects the estimated purchase price for the servicing portfolio. We decided to sell our servicing rights as any loans we now sell in the secondary market are sold with servicing released. The placement of Fannie Mae and Freddie Mac into the conservatorship of the Federal government, in addition to sweeping changes in the secondary market, caused uncertainty about the future value of this asset. Lastly, the rapid deterioration of the real estate market and the increase in foreclosures in the Treasure Valley raised concern among management that resources would be diverted to resolving foreclosed assets for loans owned by others and away from the mitigation of loan losses and the workout of troubled loans in our own portfolio. The sale of the mortgage servicing rights is expected to be consummated on October 31, 2008, with the transfer of all servicing to be completed by December 16, 2008. After the transfer, the Bank will no longer service one- to four- family loans for investors.

Deferred taxes. The net deferred tax asset increased $525,000 to $1.8 million at September 30, 2008. The increase was primarily due to increases in the tax assets related to deferred compensation and the allowance for loan losses, offset somewhat by a lower unrealized loss on securities in 2008.

Deposits. Deposits decreased $31.7 million, or 7.8%, to $372.9 million at September 30, 2008, from $404.6 million at September 30, 2007. Certificates of deposit accounted for the majority of the decrease in total deposits during the period as we chose not to match rates offered by local competitors that in some cases exceeded our alternative funding sources. At September 30, 2008, we held no brokered certificates of deposit.

The following table details the changes in deposit accounts:

	Balance at September 30, 2008	Balance at September 30, 2007	Increase / (Decrease) Amount	Increase / (Decrease) Percent
	(in thousands)			
Noninterest-bearing demand	$ 41,398	$ 38,643	$2,755	7.1%
Interest-bearing demand	76,572	81,958	(5,386)	(6.6)
Money market	51,142	45,701	5,441	11.9

Savings	26,409	23,116	3,293	14.2
Certificates of deposit	177,404	215,191	(37,787)	(17.6)
Total deposit accounts	$372,925	$404,609	$(31,684)	(7.8)%

As noted earlier, we believe that increasing core deposits and reducing our reliance on certificates of deposits is an important component in our strategy to transform the balance sheet toward a commercial bank. We believe our investment in free-standing full-service banking offices, reduced reliance on in-store branches, and changes made in the management team and organizational alignment of our retail banking program will help us increase core deposit accounts, despite the significant challenges in our markets. Additionally, we intend to hire several small business

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account managers and a commercial deposit officer in fiscal 2009 to develop a more effective business deposit program.

Our savings account portfolio includes a concentration of low-cost health savings accounts. Health savings accounts totaled $21.1 million and $23.5 million at September 30, 2008 and 2007, respectively, with an average interest rate of 0.90% and 1.10%, respectively. Nearly all of these accounts are originated through broker relationships throughout the United States. We have limited control over these accounts as they are not local to our operating markets. Additionally, changes in tax law or the structure of health savings accounts could cause the balances to be withdrawn.

Borrowings. Federal Home Loan Bank advances decreased $43.8 million, or 24.2%, to $137.0 million at September 30, 2008, from $180.7 million at September 30, 2007. We used principal payment proceeds from our mortgage-backed securities and residential loan portfolios to reduce our advances as they matured. We have $76.9 million of FHLB advances maturing in fiscal 2009 and intend to reduce outstanding advance balances as they mature. However, we recognize that if we are successful in originating commercial and consumer loans at a faster rate than our mortgage loan portfolio is decreasing, we may need to reissue advances to grow assets if we cannot fund those loans with deposit growth. We had $133.4 million of borrowing capacity available at the Federal Home Loan Bank of Seattle and an additional $10.0 million available under a federal funds purchased line with our correspondent bank.

Equity. Stockholders' equity increased $92.6 million, or 82.2%, to $205.2 million at September 30, 2008, from $112.6 million at September 30, 2007. The increase was primarily attributable to the $87.8 million in net proceeds received from the Conversion. We sold approximately 9.4 million shares of stock in subscription, community and syndicated community offerings and issued approximately 7.1 million additional shares of its stock in exchange for the previously outstanding shares of old Home Federal Bancorp.

A portion of the offering proceeds were used to make a loan to the Company's employee stock ownership plan, which purchased 816,000 shares of the Company's common stock for an aggregate cost of $8.2 million. In addition, other significant activity among equity accounts over the past twelve months included $4.0 million in net income, the allocation of earned employee stock ownership plan shares, equity compensation and the exercise of stock options totaling $2.4 million, and an $825,000 decrease in unrealized losses on securities available for sale, offset by $3.0 million in cash dividends paid to stockholders.

We are prohibited from implementing a common stock repurchase program until 12 months following the completion of the Conversion. The anniversary date of the Conversion is December 19, 2008. The Board of Directors and management will consider all relevant factors, including alternative access to capital, regulatory capital requirements, leverage opportunities and possible additional loan losses in deciding whether to implement a stock repurchase program to ensure that a repurchase program does not impede our ability to execute our growth plan. Repurchased shares may be reissued under the Company's equity incentive and recognition and retention plans or as consideration in a strategic acquisition.

COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED SEPTEMBER 30, 2008, AND SEPTEMBER 30 2007

General. Net income for the year ended September 30, 2008 was $4.0 million, or $0.25 per diluted share, compared to net income of $5.3 million, or $0.31 per diluted share, for the year ended September 30, 2007. The decrease in net income during fiscal 2008 was primarily due to a $2.0 million increase in the provision for loan losses, before the effect of income taxes. A $791,000 decline in noninterest income, primarily due to lower loan sale gains, and an $803,000 increase in noninterest expense offset a margin-driven increase in net interest income of $1.3 million.

Net Interest Income. Net interest income increased $1.3 million, or 6.3%, to $22.6 million for the year ended September 30, 2008, from $21.3 million for the year ended September 30, 2007. The increase in net interest income was primarily attributable to a lower balance of certificates of deposit and FHLB advances made possible by the Conversion proceeds.

Our net interest margin increased 18 basis points to 3.21% for the year ended September 30, 2008, from 3.03% for the same period last year. The improvement in the net interest margin is primarily attributable to the increase in interest earning assets that resulted from the proceeds of the Conversion completed on December 19, 2007. In

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addition, decreases in interest expense and a shift in the loan portfolio toward higher yielding commercial loans from residential mortgage loans also contributed to the increase in the margin in 2008.

The following table sets forth the results of balance sheet growth and changes in interest rates to our net interest income. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). Changes attributable to both rate and volume, which cannot be segregated, are allocated proportionately to the changes in rate and volume.

	Year Ended September 30, 2008 Compared to September 30, 2007 Increase (Decrease) Due to		
	Rate	Volume	Total
	(in thousands)		
Interest-earning assets:			
Loans receivable, net	$(1,094)	$(1,713)	$(2,807)
Loans held for sale	(7)	(53)	(60)
Investment securities, including interest-bearing deposits in other banks	(183)	850	667
Mortgage-backed securities	(142)	192	50
Federal Home Loan Bank stock	95	--	95
Total net change in income on interest-earning assets	$(1,331)	$(724)	$(2,055)
Interest-bearing liabilities:			
Savings deposits	$ 70	$ 4	$ 74
Interest-bearing demand deposits	(10)	(77)	(87)
Money market accounts	(276)	492	216
Certificates of deposit	(297)	(1,500)	(1,797)
Total deposits	(513)	(1,081)	(1,594)
Federal Home Loan Bank advances	258	(2,065)	(1,807)
Total net change in expense on interest-bearing liabilities	$(255)	$(3,122)	$(3,401)
Total increase (decrease) in net interest income			$1,346

Interest and Dividend Income. Total interest and dividend income for the year ended September 30, 2008 decreased $2.1 million, or 4.8%, to $40.6 million, from $42.6 million for the same period of the prior year. The decrease during the period was primarily attributable to the decrease in yield on interest-earning assets to 5.75% from 6.06% in the prior year. This decrease in interest and dividend income is the result of lower overall interest rates during the current year compared to prior year. We believe the effect of the shift in the loan portfolio toward commercial loans from residential mortgage loans, which are lower yielding, helped to mitigate further declines in interest income.

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The following table compares detailed average earning asset balances, associated yields, and resulting changes in interest and dividend income for the years ended September 30, 2008 and 2007.

	Year Ended September 30, 2008 Average Balance	2008 Yield	2007 Average Balance (in thousands)	2007 Yield	Increase/ (Decrease) in interest and dividend income
Loans receivable, net of deferred fees/costs	$477,053	6.40%	$503,478	6.62%	$(2,807)
Loans held for sale	2,811	6.27	3,652	6.46	(60)
Investment securities, available for sale, including interest-bearing deposits in other banks	31,996	3.16	6,645	5.19	667
Mortgage-backed securities	184,343	4.74	180,309	4.82	50
FHLB stock	9,591	1.49	9,591	0.50	95
Total interest-earning assets	$705,794	5.75%	$703,675	6.06%	$(2,055)

At September 30, 2008, approximately 60.6% of our gross loans were adjustable rate, compared to 56.9% at September 30, 2007. At September 30, 2008, approximately 15.1% of our adjustable-rate loans are tied to the Prime rate, as published in The Wall Street Journal.

Interest Expense. Interest expense decreased $3.4 million, or 15.9%, to $17.9 million for the year ended September 30, 2008 from $21.3 million for the year ended September 30, 2007. The decrease was due to both declines in the average balance of total interest-bearing liabilities and cost of funds to $512.1 million and 3.50% from $582.9 million and 3.66% for the years ended September 30, 2008 and September 30, 2007, respectively. The decline in interest-bearing liabilities was concentrated in certificates of deposit and borrowings. Capitalized interest expense related to the construction of banking offices for the year ending September 30, 2008, was $24,000.

The following table details average balances, cost of funds and the change in interest expense for the year ended September 30, 2008 and 2007:

	Year Ended September 30, 2008 Average Balance	2008 Cost	2007 Average Balance (in thousands)	2007 Cost	Increase/ (Decrease) in Interest Expense

Savings deposits	$24,194	0.73%	$23,397	0.44%	$ 74
Interest-bearing demand deposits	78,618	0.61	91,198	0.62	(87)
Money market deposits	58,698	2.44	39,908	3.04	216
Certificates of deposit	193,002	4.45	226,522	4.59	(1,797)
FHLB advances	157,549	4.60	201,911	4.49	(1,807)
Total interest-bearing liabilities	$512,061	3.50%	$582,936	3.66%	$(3,401)

Approximately $133.3 million and $76.9 million of certificates of deposit and FHLB advances, respectively, are scheduled to mature during fiscal 2009. Treasury rates were significantly lower at the end of fiscal 2008 compared to the start of the fiscal year and short-term Treasury bill rates were near historical lows at the end of the year. However, the current financial crisis has caused rates on FHLB advances and certificates of deposit to be high compared to historical spreads above Treasury rates. This widening of spreads is due to depositor concerns about the stability of financial institutions and investor concerns about the survivability of Federal Home Loan Banks, thereby

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creating a higher risk premium for deposits and advances. We currently anticipate our certificates to reprice at rates slightly lower than their current costs, which would reduce interest expense, but we cannot be certain that lower market and Treasury rates will necessarily result in lower funding costs in fiscal 2009.

Provision for Loan Losses. A provision for loan losses of $2.4 million was recorded in connection with our analysis of losses in the loan portfolio for the year ended September 30, 2008, compared to a provision for loan losses of $409,000 for the same period of 2007. The increase in the provision takes into account the increase in classified assets during fiscal 2008 as well as the current downturn in the real estate market, internal changes in management and the general economy. We do not originate or purchase one- to four-family subprime loans or nontraditional mortgage products with exotic features such as negative amortization or option payments.

We consider the allowance for loans losses at September 30, 2008, to be our best estimate of probable credit losses inherent in the loan portfolio as of that date based on the assessment of the above-mentioned factors affecting the loan portfolio. While we believe the estimates and assumptions used in the determination of the allowance are reasonable, there can be no assurance that such estimates and assumptions will not be proven incorrect in the future, or that the actual amount of future provisions will not exceed the amount of past provisions or that any increased provision that may be required will not adversely impact our financial condition and results of operations. In addition, the determination of the amount of our allowance for loan losses is subject to review by bank regulators, as part of the routine examination process, which may result in the establishment of additional reserves based upon their judgment of information available to them at the time of their examination.

The following table details selected activity associated with the allowance for loan losses for the years ended September 30, 2008 and 2007:

	At or For the Year Ended September 30, 2008	2007
	(in thousands)	
Provision for loan losses	$ 2,431	$ 409
Net charge-offs	840	203
Allowance for loan losses	4,579	2,988
Allowance for loan losses as a percentage of gross loans receivable at the end of the period	0.98%	0.62%
Allowance for loan losses as a percentage of nonperforming loans at the end of the period	46.04%	195.17%
Nonperforming loans	$ 9,945	$1,531
Nonaccrual and 90 days or more past due loans as a percentage of loans receivable at the end of the period	2.16%	0.32%
Loans receivable, net	$459,813	$480,118

Noninterest Income. Noninterest income decreased $791,000, or 7.0%, to $10.5 million for the year ended September 30, 2008 from $11.3 million for the year ended September 30, 2007, as the gain on sale of loans decreased $655,000 or 46.2%.

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The following table provides a detailed analysis of the changes in components of noninterest income:

	Year Ended September 30,		Increase / (Decrease)	
	2008	2007	Amount	Percent
	(in thousands)			
Service fees and charges	$ 9,077	$ 9,308	$ (231)	(2.5)%
Gain on sale of loans	764	1,419	(655)	(46.2)
Increase in cash surrender value of bank owned life insurance	421	405	16	4.0
Loan servicing fees	484	549	(65))	(11.8)
Mortgage servicing rights, net	(340)	(445)	105	23.6
Other	84	45	39	86.7
Total noninterest income	$10,490	$11,281	$ (791)	(7.0)%

The decrease in the gain on sale of loans is a reflection of the significant slowing in the local residential real estate market as loans originated for sale in the secondary market declined $51.3 million, or 52.7%, in 2008 compared to fiscal 2007. We undertook an organizational realignment of our mortgage banking department in the third quarter of 2008 to improve efficiency and reduce delivery time.

During fiscal 2008, interchange, debit card and checking account service fee income increased 3.2% to $8.9 million, while check losses increased $347,000 to $963,000, offsetting the fee increase. Income from health savings accounts, which are also reported in service fees and charges, declined $76,000 to $269,000 during fiscal 2008. Further deterioration in the economy may result in declines in consumer spending, which may reduce fee income due to the decline in the number of checking account and debit card transactions.

As noted earlier, we entered into an agreement to sell our mortgage servicing rights to another financial institution. We anticipate this sale will be consummated during December 2008, which is the first quarter of fiscal 2009. After the sale is complete, we will no longer receive servicing fee income or amortize the servicing rights asset. These amounts resulted in net revenue of $144,000 and $104,000 during 2008 and 2007, respectively.

Noninterest Expense. Noninterest expense increased $803,000, or 3.4%, to $24.4 million for the year ended September 30, 2008 from $23.6 million for the year ended September 30, 2007. The efficiency ratio, which is the percentage of noninterest expense to net interest income plus noninterest income, increased to 73.7% for the year ended September 30, 2008, compared to 72.5% for the year ended September 30, 2007. By definition, a lower efficiency ratio would be an indication that we are more efficiently utilizing resources to generate net interest income and other fee income.

The following table provides a detailed analysis of the changes in components of noninterest expense:

	Year Ended September 30, 2008	2007	Increase / (Decrease) Amount	Percent
	(in thousands)			
Compensation and benefits	$15,211	$14,249	$ 962	6.8%
Occupancy and equipment	3,007	2,871	136	4.7
Data processing	2,198	2,097	101	4.8
Advertising	1,043	1,427	(384)	(26.9)
Other	2,980	2,992	(12)	0.4
Total noninterest expense	$24,439	$23,636	$ 803	3.4%

Compensation and benefits. Compensation and benefits increased $962,000 or 6.8% to $15.2 million for the year ended September 30, 2008 from $14.2 million for the same period a year ago. The largest factor in the increase was the ESOP. At the completion of the Conversion in December 2007, additional shares were added to the ESOP and

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were the main contributor to the $435,000 or 54.9% increase in ESOP-related expense for the year ended September 30, 2008.

We also hired several commercial lending officers throughout fiscal 2008, with most of them joining the Company during the fourth quarter of fiscal 2008. However, we continue to closely monitor personnel costs as we employed 201 full-time equivalents at September 30, 2008, compared to 223 at September 30, 2007 and 240 at September 30, 2006.

Incentive compensation totaled $359,000 in 2008 compared to $140,000 in 2007 while commissions were $190,000 lower in 2008 due to lower loan production. The Board decided to award a discretionary bonus to non-executive employees in fiscal 2008. The executive officers of the Company, including the end-of-year Chief Executive Officer and Chief Financial Officer as well as the executive vice presidents of commercial and consumer banking, did not receive incentive income during fiscal 2008. The incentive award in fiscal 2007 was lower as no award was granted on the basis of the Company's financial performance. Some incentive compensation was awarded to non-management employees in 2007 related to individual performance above expectations.

Advertising. Advertising expense decreased $384,000 or 26.9%. The amount of dollars spent on advertising dropped for a time coinciding with the portion of the year when the position of Director of Marketing was vacant. We anticipate advertising expense will increase slightly in 2009 as we plan to launch three banking offices during the year – one in October 2008 and two more in the third calendar quarter of 2009 – and we increase our visibility in the marketplace through various media.

Occupancy and equipment and data processing. We anticipate occupancy and equipment and data processing expenses will increase modestly in fiscal 2009 due to the aforementioned increase in banking offices. We launched a stand-alone full-service office in early fiscal 2008 as a replacement for an in-store branch that was closed.

Other expense. We anticipate a significant increase in premiums for FDIC insurance during fiscal 2009. While still in a considerable state of uncertainty, guidance as of September 30, 2008, implied a 94% increase in the assessment rate applied to insurable deposits for Home Federal Bank starting in the second fiscal quarter (first calendar quarter) of 2009. For part of 2008 and most of fiscal 2007, we were able to reduce our FDIC insurance assessment by a credit provided to nearly all financial institutions in conjunction with the merger of the Bank Insurance fund and the Savings Association Insurance Fund into the Deposit Insurance Fund, which is administered by the FDIC.

As a part of the federal government's attempt to strengthen the economic environment, the FDIC increased the insurable balance of deposits from $100,000 to $250,000 until December 31, 2009. Additionally, the FDIC will permit institutions to voluntarily pay a 10 basis points insurance premium in addition to the regular assessment in order to provide unlimited balance coverage on noninterest-bearing deposit accounts and interest bearing checking accounts that yield less than 0.50% annually. On December 5, 2008, we elected to continue to participate in the transaction account guarantee program.

Income Tax Expense. Income tax expense decreased $1.0 million, or 30.7%, to $2.3 million for the year ended September 30, 2008 from $3.3 million for the same period a year ago. Income before income taxes decreased $2.3 million, or 26.6%, to $6.3 million for the year ended September 30, 2008 compared to $8.5 million for the year ended September 30, 2007. Our combined federal and state effective income tax rate for the current period was 36.1% compared to 38.3% for the same period of the prior year. The decrease was due to both an increase in the net downward adjustment of book net income before taxes due to book/tax differences to arrive at taxable net income as well as a decrease in overall book net income before taxes.

COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED SEPTEMBER 30, 2007, AND SEPTEMBER 30, 2006

General. Net income for the year ended September 30, 2007 was $5.3 million, or $0.36 per diluted share, compared to net income of $6.2 million, or $0.43 per diluted share, for the year ended September 30, 2006.

Net Interest Income. Net interest income decreased $1.7 million, or 7.4%, to $21.3 million for the year ended September 30, 2007, from $23.0 million for the year ended September 30, 2006. The decrease in net interest income

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was primarily attributable to a lower net interest margin, despite an overall increase in average interest-earning assets and interest-bearing liabilities in 2007 versus 2006.

Our net interest margin decreased 30 basis points to 3.03% for the year ended September 30, 2007, from 3.33% for the same period last year. The cost of interest bearing liabilities increased 66 basis points to 3.66% for the fiscal year from 3.00% for the same period of the prior year. The decline in the net interest margin reflects the relatively flat yield curve that currently exists, as the cost of shorter-term deposits and borrowed funds increased more rapidly than the yield on longer-term assets

The following table sets forth the results of balance sheet growth and changes in interest rates to our net interest income attributable to changes in rate and volume:

	Year Ended September 30, 2007 Compared to September 30, 2006 Increase / (Decrease) Due to		
	Rate	Volume	Total
	(in thousands)		
Interest-earning assets:			
Loans receivable, net	$1,276	$2,098	$ 3,374
Loans held for sale	11	(7)	4
Investment securities, including interest-bearing deposits in other banks	30	175	205
Mortgage-backed securities	130	(1,036)	(906)
Federal Home Loan Bank stock	48	--	48
Total net change in income on interest-earning assets	$1,495	$1,230	$ 2,725
Interest-bearing liabilities:			
Savings deposits	$ 55	$ (3)	$ 52
Interest-bearing demand deposits	137	(34)	103
Money market accounts	519	161	680
Certificates of deposit	2,232	298	2,530
Total deposits	2,943	422	3,365
Federal Home Loan Bank advances	568	486	1,054
Total net change in expense on interest-bearing liabilities	$3,511	$ 908	$ 4,419
Total increase (decrease) in net interest income			$(1,694)

Interest and Dividend Income. Total interest and dividend income for the year ended September 30, 2007 increased $2.7 million, or 6.8%, to $42.6 million, from $39.9 million for the same period of the prior year. The increase during the period was primarily attributable to the $14.0 million, or 2.0%, increase in the average balance of interest-earning assets and an increase in the yield on interest-earning assets to 6.06% from 5.79% as a result of the general increase in interest rates and changes in our loan portfolio mix.

The following table compares detailed average earning asset balances, associated yields, and resulting changes in interest and dividend income for the years ended September 30, 2007 and 2006.

	Year Ended September 30, 2007		2006		
	Average Balance	Yield	Average Balance (in thousands)	Yield	Increase/ (Decrease) in Interest and Dividend Income from 2006
Loans receivable, net of deferred fees/costs	$503,478	6.62%	$471,291	6.35%	$ 3,374
Loans held for sale	3,652	6.46	3,771	6.15	4
Investment securities, available for sale, including interest-bearing deposits in other banks	6,645	5.19	3,197	4.38	205
Mortgage-backed securities	180,309	4.82	201,838	4.76	(906)
FHLB stock	9,591	0.50	9,591	--	48
Total interest-earning assets	$703,675	6.06%	$689,688	5.79%	$ 2,725

Interest Expense. Interest expense increased $4.4 million, or 26.1%, to $21.3 million for the year ended September 30, 2007 from $16.9 million for the year ended September 30, 2006. The average balance of total interest-bearing liabilities increased $19.1 million, or 3.4%, to $582.9 million for the year ended September 30, 2007 from $563.8 million for the year ended September 30, 2006. The increase was primarily a result of growth in certificates of deposit, money market accounts, and additional FHLB advances. As a result of general market rate increases, the average cost of funds for total interest-bearing liabilities increased 66 basis points to 3.66% for the year ended September 30, 2007 compared to 3.00% for the year ended September 30, 2006.

The following table details average balances, cost of funds and the change in interest expense for the year ended September 30, 2007 and 2006:

	Year Ended September 30, 2007		2006		
	Average Balance	Cost	Average Balance (in thousands)	Cost	Increase/ (Decrease) in Interest Expense from 2006
Savings deposits	$23,397	0.44%	$24,863	0.21%	$ 52
Interest-bearing demand	91,198	0.62	97,916	0.48	103

deposits					
Money market deposits	39,908	3.04	31,875	1.68	680
Certificates of deposit	226,522	4.59	218,496	3.60	2,530
FHLB advances	201,911	4.49	190,684	4.20	1,054
Total interest-bearing liabilities	$582,936	3.66%	$563,834	3.00%	$ 4,419

Provision for Loan Losses. A provision for loan losses of $409,000 was recorded by management in connection with its analysis of the loan portfolio for the year ended September 30, 2007, compared to a provision for loan losses of $138,000 recorded for the same period of 2006. The $271,000 increase in the provision takes into account increased activity within classified assets as well as the current downturn in the real estate market.

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Prior to March 31, 2007, the allowance for loan losses included the estimated loss from unfunded loan commitments. The preferred accounting method is to separate the unfunded loan commitments from the disbursed loan amounts and record the unfunded loan commitment portion as a liability. At September 30, 2007, the reserve for unfunded loan commitments was $138,000, which was included in other liabilities on the Consolidated Balance Sheet. Combining the $138,000 liability for unfunded commitments with the allowance for loan losses provides an allowance of $3.1 million, or 0.65% of gross loans at September 30, 2007, compared to $3.0 million, or 0.59% at September 30, 2006.

The following table details selected activity associated with the allowance for loan losses for the years ended September 30, 2007 and 2006.

	At or For the Year Ended September 30, 2007	2006
	(in thousands)	
Provision for loan losses	$ 409	$ 138
Net charge-offs	203	46
Allowance for loan losses	2,988	2,974
Allowance for loan losses as a percentage of gross loans receivable at the end of the period	0.62%	0.59%
Allowance for loan losses as a percentage of nonperforming loans at the end of the period	195.17%	766.49%
Nonperforming loans	$ 1,531	$ 388
Nonaccrual and 90 days or more past due loans as a percentage of loans receivable at the end of the period	0.32%	0.08%
Loans receivable, net	$480,118	$503,065

Noninterest Income. Noninterest income increased $80,000, or 0.7%, to $11.3 million for the year ended September 30, 2007 from $11.2 million for the year ended September 30, 2006. While overall noninterest income was flat, gain on sale of loans increased $363,000 or 34.4%. This increase in noninterest income was offset by a $266,000 or 148.6% decrease in the value of the mortgage servicing asset. We currently sell a majority of the one-to four-family residential loans we originate. For the year ended September 30, 2006, a larger percentage of the residential mortgage loans originated were held in the loan portfolio. For the year ended September 30, 2007 we had a $150,000 write down of the value of the mortgage servicing rights.

The following table provides a detailed analysis of the changes in components of noninterest income:

Year Ended September 30, 2007	2006	Increase / (Decrease) Amount	Percent
(in thousands)			

Service fees and charges	$9,308	$9,384	$ (76)	(0.8)%
Gain on sale of loans	1,419	1,056	363	34.4
Increase in cash surrender value of bank owned life insurance	405	383	22	5.7
Loan servicing fees	549	620	(71))	(11.5)
Mortgage servicing rights, net	(445)	(179)	(266)	(148.6)
Other	45	(63)	108	171.4
Total noninterest income	$11,281	$11,201	$ 80	0.7%

Noninterest Expense. Noninterest expense decreased $401,000, or 1.7%, to $23.6 million for the year ended September 30, 2007 from $24.0 million for the year ended September 30, 2006.

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The following table provides a detailed analysis of the changes in components of noninterest expense.

	Year Ended September 30,		Increase / (Decrease)	
	2007	2006	Amount	Percent
	(in thousands)			
Compensation and benefits	$14,249	$15,081	$(832)	(5.5)%
Occupancy and equipment	2,871	2,759	112	4.1
Data processing	2,097	1,802	295	16.4
Advertising	1,427	986	441	44.7
Other	2,992	3,409	(417)	(12.2)
Total noninterest expense	$23,636	$24,037	$(401)	(1.7)%

Compensation and benefits decreased $832,000 or 5.5% to $14.2 million for the year ended September 30, 2007 from $15.1 million for the same period a year ago. The decrease was primarily attributable to a decreased incentive payout in the current year. In addition, full-time equivalent employees have decreased from 240 as of September 30, 2006 to 223 as of September 30, 2007. Advertising costs increased $441,000 or 44.7%, primarily as a result of marketing costs related to a debit card rewards program and a business banking campaign that were initiated during the current fiscal year. Other noninterest expenses decreased $417,000 primarily as a result of costs incurred in the prior fiscal year related to the conversion of the core processing system and professional costs associated with the initial year of Sarbanes-Oxley compliance.

Our efficiency ratio was 72.5% for the year ended September 30, 2007 compared to 70.3% for the year ended September 30, 2006. The increase in efficiency ratio was primarily attributable to a $1.7 million, or 7.4% decrease in net interest income.

Income Tax Expense. Income tax expense decreased $543,000, or 14.3%, to $3.3 million for the year ended September 30, 2007 from $3.8 million for the same period a year ago. Income before income taxes decreased $1.5 million, or 14.8%, to $8.5 million for the year ended September 30, 2007 compared to $10.0 million for the year ended September 30, 2006. Our combined federal and state effective income tax rate for the current period was 38.3% compared to 38.0% for the same period of the prior year.

AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS/COST

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, resultant yields, interest rate spread, net interest margin, and the ratio of average interest-earning assets to average interest-bearing liabilities. Average balances have been calculated using the average of daily balances during the period. Interest and dividends are reported on a tax-equivalent basis. During the time periods presented, we did not own any tax-exempt investment securities.

	Year Ended September 30,								
	2008			2007			2006		
	Average Balance	Interest And Dividends	Yield/ Cost	Average Balance	Interest And Dividends	Yield/ Cost	Average Balance	Interest And Dividends	Yield/ Cost
					(in thousands)				
Interest-earning assets:									
Loans receivable, net (1)	$477,053	$30,510	6.40%	$503,478	$ 33,317	6.62%	$471,291	$29,943	6.35%
Loans held for sale	2,811	176	6.26	3,652	236	6.46	3,771	232	6.15
Investment securities, including interest-bearing deposits in other banks	31,996	1,012	3.16	6,645	345	5.19	3,197	140	4.38
Mortgage-backed securities	184,343	8,742	4.74	180,309	8,692	4.82	201,838	9,598	4.76
FHLB stock	9,591	143	1.49	9,591	48	0.50	9,591	--	--
Total interest-earning assets	705,794	$40,583	5.75%	703,675	$ 42,638	6.06%	689,688	$39,913	5.79%
Noninterest earning assets	38,627			38,672			38,015		
Total assets	$744,421			$742,347			$727,703		
Interest-bearing liabilities:									
Savings deposits	$24,194	$177	0.73%	$ 23,397	$ 103	0.44%	$ 24,863	$ 51	0.21%
Interest-bearing demand deposits	78,618	482	0.61	91,198	569	0.62	97,916	466	0.48
Money market accounts	58,698	1,430	2.44	39,908	1,214	3.04	31,875	534	1.68
Certificates of deposit	193,002	8,596	4.45	226,522	10,393	4.59	218,496	7,863	3.60
Total deposits	354,512	10,685	3.01	381,025	12,279	3.22	373,150	8,914	2.39
FHLB advances	157,549	7,250	4.60	201,911	9,057	4.49	190,684	8,003	4.20
Total interest-bearing liabilities	512,061	$17,935	3.50%	582,936	$21,336	3.66%	563,834	$16,917	3.00%
	46,725			48,493			58,559		

Noninterest-bearing liabilities						
Total liabilities	558,786		631,429		622,393	
Stockholders' equity	185,635		110,918		105,310	
Total liabilities and equity	$744,421		$742,347		$727,703	
Net interest income		$22,648		$21,302		$22,996
Interest rate spread		2.25%		2.40%		2.79%
Net interest margin (2)		3.21		3.03		3.33
Ratio of average interest-earning assets to average interest-bearing liabilities		137.83		120.71		122.32

(1) Non-accrual loans are included in the average balance. Loan fees are included in interest income on loans and are insignificant.

(2) Net interest margin, otherwise known as yield on interest earning assets, is calculated as net interest income divided by average interest-earning assets.

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The following table sets forth (on a consolidated basis) for the periods and at the dates indicated, the weighted average yields earned on our assets, the weighted average interest rates paid on our liabilities, together with the net yield on interest-earning assets.

	At September 30, 2008	Year Ended September 30, 2008	2007	2006
Weighted average yield on:				
Loans receivable, net	6.26%	6.40%	6.62%	6.35%
Loans held for sale	6.15	6.26	6.46	6.15
Investment securities, including interest-bearing deposits in other banks	1.62	3.16	5.19	4.38
Mortgage-backed securities	4.68	4.74	4.82	4.76
Federal Home Loan Bank stock	1.49	1.49	0.50	--
Total interest-earning assets	5.62	5.75	6.06	5.79
Weighted average rate paid on:				
Savings deposits	0.84	0.73	0.44	0.21
Interest-bearing demand deposits	0.54	0.61	0.62	0.48
Money market accounts	1.63	2.44	3.04	1.68
Certificates of deposit	3.77	4.45	4.59	3.60
Total deposits	2.46	3.01	3.22	2.39
Federal Home Loan Bank advances	4.68	4.60	4.49	4.20
Total interest-bearing liabilities	3.11	3.50	3.66	3.00
Interest rate spread (spread between weighted average rate on all interest-earning assets and all interest-bearing liabilities)	2.51	2.25	2.40	2.79
Net interest margin (net interest income (expense) as a percentage of average interest-earning assets)	N/A	3.21	3.03	3.33

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RATE/VOLUME ANALYSIS

The following table sets forth the effects of changing rates and volumes on our net interest income. Information is provided with respect to: (1) effects on interest income attributable to changes in volume (changes in volume multiplied by prior rate); and (2) effects on interest income attributable to changes in rate (changes in rate multiplied by prior volume). Changes attributable to both rate and volume, which cannot be segregated, are allocated proportionately to the changes in rate and volume.

	Year Ended September 30, 2008 Compared to Year Ended September 30, 2007 Increase (Decrease) Due to			Year Ended September 30, 2007 Compared to Year Ended September 30, 2006 Increase (Decrease) Due to		
	Rate	Volume	Total	Rate	Volume	Total
	(in thousands)					
Interest-earning assets:						
Loans receivable, net	$ (1,094)	$(1,713)	$(2,807)	$1,276	$2,098	$3,374
Loans held for sale	(7)	(53)	(60)	11	(7)	4
Investment securities, including interest-bearing deposits in other banks	(183)	850	667	30	175	205
Mortgage-backed securities	(142)	192	50	130	(1,036)	(906)
Federal Home Loan Bank stock	95	--	95	48	--	48
Total net change in income on interest-earning assets	$(1,331)	$(724)	$(2,055)	$1,495	$1,230	$2,725
Interest-bearing liabilities:						
Savings deposits	$ 70	$ 4	$ 74	$ 55	$ (3)	$ 52
Interest-bearing demand deposits	(10)	(77)	(87)	137	(34)	103
Money market accounts	(276)	492	216	519	161	680
Certificates of deposit	(297)	(1,500)	(1,797)	2,232	298	2,530
Total deposits	(513)	(1,081)	(1,594)	2,943	422	3,365
Federal Home Loan Bank advances	258	(2,065)	(1,807)	568	486	1,054
Total net change in expense on interest-bearing liabilities	$(255)	$(3,122)	$(3,401)	$3,511	$908	$4,419
			$1,346			$(1,694)

Total increase
(decrease) in net
interest income

Interest expense for the year ended September 30, 2008 was reduced by $24,000. This amount represents that portion of interest attributed to borrowings related to construction of branches.

ASSET AND LIABILITY MANAGEMENT AND MARKET RISK

General. Our Board of Directors has established an asset and liability management policy to guide management in maximizing net interest rate spread by managing the differences in terms between interest-earning assets and interest-bearing liabilities while maintaining acceptable levels of liquidity, capital adequacy, interest rate sensitivity, changes in net interest income, credit risk and profitability. The policy includes the use of an Asset Liability Management Committee whose members include certain members of senior management. The Committee’s purpose is to communicate, coordinate and manage our asset/liability positions consistent with our business plan and Board-approved policies, as well as to price savings and lending products, and to develop new products.

The Asset Liability Management Committee meets to review various areas including:

- economic conditions;
- interest rate outlook;
- asset/liability mix;
- interest rate risk sensitivity;
- change in net interest income
- current market opportunities to promote specific products;
- historical financial results;
- projected financial results; and
- capital position.

The Committee also reviews current and projected liquidity needs. As part of its procedures, the Asset Liability Management Committee regularly reviews interest rate risk by forecasting the impact of alternative interest rate environments on net interest income and market value of portfolio equity, which is defined as the net present value of an institution's existing assets, liabilities and off-balance sheet instruments, and evaluating such impacts against the maximum potential change in market value of portfolio equity that is authorized by the Board of Directors.

Our Risk When Interest Rates Change. The rates of interest we earn on assets and pay on liabilities generally are established contractually for a period of time. Market interest rates change over time. Our loans generally have longer maturities than our deposits. Accordingly, our results of operations, like those of other financial institutions, are impacted by changes in interest rates and the interest rate sensitivity of our assets and liabilities. The risk associated with changes in interest rates and our ability to adapt to these changes is known as interest rate risk and is our most significant market risk.

In recent years, we primarily have utilized the following strategies in our efforts to manage interest rate risk:

- we have increased our originations of shorter term loans and particularly, construction and land development loans and home equity loans;
- we have structured our borrowings with maturities that match fund our loan and investment portfolios;
- we have attempted, where possible, to extend the maturities of our deposits which typically fund our long-term assets; and
- we have invested in securities with relatively short anticipated lives, generally three to five years.

How We Measure the Risk of Interest Rate Changes. We measure our interest rate sensitivity on a quarterly basis utilizing an internal model. Management uses various assumptions to evaluate the sensitivity of our operations to changes in interest rates. Although management believes these assumptions are reasonable, the interest rate sensitivity of our assets and liabilities on net interest income and the market value of portfolio equity could vary substantially if different assumptions were used or actual experience differs from such assumptions. The assumptions we use are based upon proprietary and market data and reflect historical results and current market conditions. These assumptions relate to interest rates, prepayments, deposit decay rates and the market value of certain assets under the various interest rate scenarios. An independent service was used to provide market rates of interest and certain interest rate assumptions to determine prepayments and maturities of loans, investments and borrowings. Time deposits are modeled to reprice to market rates upon their stated maturities. We assumed that non-maturity deposits can be maintained with rate adjustments not directly proportionate to the change in market interest rates. Our historical deposit decay rates were used, which are substantially lower than market decay rates. In the past, we have demonstrated that the tiering structure of our deposit accounts during changing rate environments results in relatively low volatility and less than market rate changes in our interest expense for deposits. Our deposit accounts are tiered by balance and rate, whereby higher balances within an account earn higher rates of interest. Therefore, deposits that are not very rate sensitive (generally, lower balance tiers) are separated from deposits that are rate sensitive (generally, higher balance tiers).

When interest rates rise, we generally do not have to raise interest rates proportionately on less rate sensitive accounts to retain these deposits. These assumptions are based upon an analysis of our customer base, competitive factors and historical experience. The following table shows the change in our net portfolio value at September 30, 2008, that would occur upon an immediate change in interest rates based on our assumptions, but without giving effect to any steps that we might take to counteract that change. The net portfolio value is calculated based upon the present value of the discounted cash flows from assets and liabilities. The difference between the present value of assets and liabilities is the net portfolio value and represents the market value of equity for the given interest rate scenario. Net portfolio value is useful for determining, on a market value basis, how much equity changes in response to various interest rate scenarios. Large changes in net portfolio value reflect increased interest rate sensitivity and generally more volatile earnings streams.

	Net Portfolio Value (“NPV”)			Net Portfolio as % of Portfolio Value of Assets		
Basis Point Change in Rates	Amount	$ Change (1)	% Change	NPV Ratio (2)	% Change (3)	Asset Market Value
			(in thousands)			
300	$ 139,363	$(25,218)	(15.32)%	21.87%	(2.16)%	$637,370
200	147,720	(16,861)	(10.24)	22.63	(1.40)	652,691
100	155,716	(8,865)	(5.39)	23.30	(0.73)	668,436
Base	164,581	--	--	24.03	--	684,816
-100	171,971	7,390	4.49	24.57	.54	699,988
-200	172,929	8,348	5.07	24.36	.33	709,937

Pre-Shock NPV Ratio	24.03
Post-Shock NPV Ratio	22.63
Static Sensitivity Measure – decline in NPV Ratio	1.40
Policy Maximum	3.00

(1) Represents the increase (decrease) of the estimated net portfolio value at the indicated change in interest rates compared to the base net portfolio value.
(2) Calculated as the estimated net portfolio value divided by the portfolio value of total assets.
(3) Calculated as the increase (decrease) of the net portfolio value ratio assuming the indicated change in interest rates over the base net portfolio value ratio.

The following table illustrates the change in net interest income at September 30, 2008, that would occur in the event of an immediate change in interest rates, but without giving effect to any steps that might be taken to counter the effect of that change in interest rates.

Basis Point Change in Rates	Net Interest Income		
	Amount	$ Change (1)	% Change
	(in thousands)		
300	$22,718	$ (398)	(1.72)%
200	22,893	(222)	(0.96)
100	23,008	(107)	(0.46)
Base	23,115	--	Base
-100	23,557	442	1.91
-200	22,656	(459)	(1.99)

(1) Represents the decrease of the estimated net interest income at the indicated change in interest rates compared to net interest income assuming no change in interest rates.

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We use certain assumptions in assessing our interest rate risk. These assumptions relate to interest rates, loan prepayment rates, deposit decay rates and the market values of certain assets under differing interest rate scenarios, among others. The table above also includes projected balances for loans and deposits, actual results for which may be materially different from those estimates.

As with any method of measuring interest rate risk, shortcomings are inherent in the method of analysis presented in the foregoing tables. For example, although assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in the 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, such as adjustable rate mortgage loans, have features that restrict changes in interest rates on a short-term basis and over the life of the asset. Further, if interest rates change, expected rates of prepayments on loans and early withdrawals from certificates of deposit could deviate significantly from those assumed in calculating the table.

LIQUIDITY AND COMMITMENTS

We are required to have sufficient cash flow in order to maintain liquidity to ensure a safe and sound operation. Historically, we have maintained cash flow above the minimum level believed to be adequate to meet the requirements of normal operations, including potential deposit outflows. On a quarterly basis, we review and update cash flow projections to ensure that adequate liquidity is maintained.

Our primary sources of funds are from customer deposits, loan repayments, loan sales, maturing investment securities and advances from the Federal Home Loan Bank of Seattle. These funds, together with retained earnings and equity, are used to make loans, acquire investment securities and other assets, and fund continuing operations. While maturities and the scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by the level of interest rates, economic conditions and competition. We believe that our current liquidity position is sufficient to fund all of our existing commitments.

Liquidity management is both a daily and long-term function of business management. Excess liquidity is generally invested in short-term investments such as overnight deposits or mortgage-backed securities. On a longer-term basis, we maintain a strategy of investing in loans. At September 30, 2008, the total approved loan origination commitments outstanding amounted to $18.7 million. At the same date, unused lines of credit were $41.8 million.

We use our sources of funds primarily to meet ongoing commitments, to pay maturing certificates of deposit and savings withdrawals, to fund loan commitments and to maintain our portfolio of mortgage-backed securities and investment securities.

Certificates of deposit scheduled to mature in one year or less at September 30, 2008, totaled $133.3 million, which represented 75.2% of our certificates of deposit portfolio at September 30, 2008. Management’s policy is to generally maintain deposit rates at levels that are competitive with other local financial institutions. Historically, the Bank has been able to retain a significant amount of deposits as they mature. However, recent disruptions in the credit markets have resulted in a highly price-competitive market for certificates of deposit. These rates currently exceed alternative costs of borrowings and are high compared to historical spreads to U.S. Treasury note rates. Additionally, since loan demand has slowed in 2008, Management has been reluctant to offer rates in excess of wholesale borrowing costs. This has resulted in some deposit runoff as customers are moving their maturing balances to competitors at a higher pace than the Bank has historically experienced. Nonetheless, management believes the Company has adequate resources to fund all loan commitments through FHLB advances, loan repayments, maturing investment securities, and the sale of mortgage loans in the secondary markets. We had the ability at September 30, 2008, to borrow an additional $133.4 million from the Federal Home Loan Bank of Seattle and $10.0 million thorough a federal funds purchased facility with our correspondent bank. We are also approved at the Discount Window of the Federal Reserve

Bank of San Francisco and could use that facility as a funding source to meet commitments and for liquidity purposes.

We measure our liquidity based on our ability to fund our assets and to meet liability obligations when they come due. Liquidity (and funding) risk occurs when funds cannot be raised at reasonable prices, or in a reasonable time

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frame, to meet our normal or unanticipated obligations. We regularly monitor the mix between our assets and our liabilities to manage effectively our liquidity and funding requirements.

Our primary source of funds is our deposits. When deposits are not available to provide the funds for our assets, we use alternative funding sources. These sources include, but are not limited to: cash management from the Federal Home Loan Bank of Seattle, wholesale funding, brokered deposits, federal funds purchased and dealer repurchase agreements, as well as other short-term alternatives. Alternatively, we may also liquidate assets to meet our funding needs.

We are highly dependent on the FHLB of Seattle to provide the primary source of wholesale funding for immediate liquidity and borrowing needs. The failure of the FHLB of Seattle, or the FHLB system in general, may materially impair our ability to meet our growth plans or to meet short and long term liquidity demands. However, our mortgage backed securities are marketable and could be sold to obtain cash to meet liquidity demands should our access to FHLB funding be impaired.

We do not originate loans under a forward commitment with investors in the secondary market. Many financial institutions encountered liquidity impairment as loans that they securitized for resale were met with an abrupt absence of purchasers. As a result, cash flow was restricted and caused significant contraction in liquidity. Should we encounter a reduction in demand for loans in the secondary market, we can simply discontinue the origination of such loans.

CONTRACTUAL OBLIGATIONS

Through the normal course of operations, we have entered into certain contractual obligations. Our obligations generally relate to funding of operations through deposits and borrowings as well as leases for premises. Lease terms generally cover a five-year period, with options to extend, and are non-cancelable.

At September 30, 2008, scheduled maturities of contractual obligations were as follows:

	Within 1 Year	After 1 year through 3 Years	After 3 through 5 Years	Beyond 5 Years	Total Balance
			(in thousands)		
Certificates of deposit	$133,323	$ 33,452	$10,454	$ 175	$177,404
Federal Home Loan Bank advances	76,882	23,290	33,800	3,000	136,972
Operating leases	474	639	203	1,676	2,992
Total contractual obligations	$210,679	$ 57,381	$44,457	$4,851	$317,368

OFF-BALANCE SHEET ARRANGEMENTS

We are party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the financing needs of our customers. These financial instruments generally include commitments to originate mortgage, commercial and consumer loans, and involve to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. Our maximum exposure to credit loss in the event of nonperformance by the borrower is represented by the contractual amount of those instruments. Because some commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We use the same credit policies in making commitments as we do for on-balance sheet instruments. Collateral is not required to support commitments.

Undisbursed balances of loans closed include funds not disbursed but committed for construction projects. Unused lines of credit include funds not disbursed, but committed to, home equity, commercial and consumer lines of credit.

Commercial letters of credit are conditional commitments issued by us to guarantee the performance of a customer to a third party. Those guarantees are primarily used to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral is required in instances where we deem it necessary.

The following is a summary of commitments and contingent liabilities with off-balance sheet risks as of September 30, 2008:

	Contract or Notional Amount (in thousands)
Commitments to originate loans:	
Fixed rate	$ 6,768
Adjustable rate	11,924
Undisbursed balance of loans closed	8,197
Unused lines of credit	42,470
Total	$ 69,359

CAPITAL

Consistent with our goal to operate a sound and profitable financial organization, we actively seek to maintain a “well capitalized” institution in accordance with regulatory standards. Home Federal Bank’s total equity capital was $146.1 million at September 30, 2008, or 21.6%, of total assets on that date. As of September 30, 2008, we exceeded all regulatory capital requirements. Our regulatory capital ratios at September 30, 2008 were as follows: Tier 1 capital 21.7%; Tier 1 (core) risk-based capital 32.2%; and total risk-based capital 32.8%. The regulatory capital requirements to be considered well capitalized are 5%, 6% and 10%, respectively. See “How We Are Regulated – Regulation and Supervision of Home Federal Bank – Capital Requirements” and Note 13 to the Consolidated Financial Statements under Item 8 to this Annual Report on Form 10-K.

In December 2007, we raised $87.8 million of proceeds from the sale of common stock through the Conversion. We did not apply for government assistance through the Capital Purchase Program under the U.S. Treasury Department’s Troubled Asset Relief Program (“TARP”). We believe our high capital level and liquid balance sheet provides us flexibility in today's environment to execute our growth plans without TARP capital.

IMPACT 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. These principles generally require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation.

Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. The primary impact of inflation is reflected in the increased cost of our operations. 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.

In a period of rapidly rising interest rates, the liquidity and maturity structures of our assets and liabilities are critical to the maintenance of acceptable performance levels.

The principal effect of inflation on earnings, as distinct from levels of interest rates, is in the area of noninterest expense. Expense items such as employee compensation, employee benefits and occupancy and equipment costs may be subject to increases as a result of inflation. An additional effect of inflation is the possible increase in dollar value of the collateral securing loans that we have made. Our management is unable to determine the extent, if any, to which properties securing loans have appreciated in dollar value due to inflation.

Deflation, or a decrease in overall prices from one period to the next, could have a negative impact on the Company's operations and financial condition. Deflationary periods impute a higher borrowing cost to debtors as

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the purchasing power of a dollar increases with time. This may decrease the demand for loan products offered by the Bank.

Inflation also indirectly impacts the Company through the pressure it may place on consumer and commercial borrowers. As commodity prices rose rapidly during late calendar 2007 and for most of calendar year 2008, national delinquency rates on loans increased as the cost of gasoline and food significantly eroded disposable income available to consumers. As a result, they were unable to service their debt obligations as a greater share of their income was used to meet ordinary daily expenditures.

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board issued SFAS No. 157, “Fair Value Measurements.” The statement provides enhanced guidance for measuring assets and liabilities using fair value and applies whenever other standards require or permit assets or liabilities to be measured at fair value. SFAS No. 157 also requires expanded disclosure of items that are measured at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. The Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and is not expected to have a significant impact on our consolidated financial condition or results of operations.

On February 15, 2007, the Financial Accounting Standards Board issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities.” The statement permits entities to choose to measure selected financial assets and liabilities at fair value, with changes in fair value recorded in earnings. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The statement is effective as of the beginning of an entity’s first fiscal year beginning after November 15, 2007 and is not expected to have a significant impact on our consolidated financial condition or results of operations. An entity may elect to early adopt as of the beginning of a fiscal year that begins on or before November 15, 2007.

In December 2007, the FASB issued SFAS No. 141 (Revised), Business Combinations. SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and the goodwill acquired. The standard also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008.

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 - Asset and Liability Management and Market Risk” of this Annual Report on Form 10-K is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data

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Management's Annual Report on Internal Control Over Financial Reporting

The management of Home Federal Bancorp, Inc. (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) of the Securities Exchange Act of 1934. The Company's 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.

This process includes policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions 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, and can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Furthermore, because of changes in conditions, the effectiveness of internal control may vary over time.

The Company's management, with the participation of the Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of the Company's internal control over financial reporting as of September 30, 2008. Management's assessment was based on criteria described in the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on that assessment, the Company's management concluded that the Company's internal control over financial reporting was effective as of September 30, 2008.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of September 30, 2008 has been audited by Moss Adams LLP, the Company's independent registered public accounting firm who audits the Company's consolidated financial statements. The Report of Independent Registered Accounting Firm expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of September 30, 2008.

/s/ Len E. Williams
Len E. Williams
President and
Chief Executive Officer

/s/ Eric S. Nadeau
Eric S. Nadeau
Executive Vice President and
Chief Financial Officer

Dated: December 12, 2008

REPORT OF INDEPENDENT REGISTERED
PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Home Federal Bancorp, Inc. and Subsidiary
Nampa, Idaho

We have audited the accompanying consolidated balance sheets of Home Federal Bancorp, Inc. and Subsidiary (the Company) as of September 30, 2008 and 2007, and the related consolidated statements of income, changes in stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended September 30, 2008. We also have audited the Company's internal control over financial reporting as of September 30, 2008, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Controls over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A Company’s 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. A Company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) 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 (3) 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. 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.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Home Federal Bancorp, Inc. and Subsidiary as of September 30, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended September 30, 2008, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, Home Federal Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of September 30, 2008, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

/s/Moss Adams LLP

Spokane, Washington
December 12, 2008

HOME FEDERAL BANCORP, INC. AND SUBSIDIARY CONSOLIDATED BALANCE SHEETS (In thousands, except share data)	September 30, 2008	September 30, 2007
ASSETS		
Cash and amounts due from depository institutions	$ 23,270	$ 20,588
Certificate of deposit in correspondent bank	5,000	--
Mortgage-backed securities available for sale, at fair value	188,787	162,258
FHLB stock, at cost	9,591	9,591
Loans receivable, net of allowance for loan losses of $4,579 and $2,988	459,813	480,118
Loans held for sale	2,831	4,904
Accrued interest receivable	2,681	2,804
Property and equipment, net	15,246	12,364
Mortgage servicing rights, net	1,707	2,047
Bank owned life insurance	11,590	11,168
Real estate and other property owned	650	549
Deferred tax asset	1,770	1,245
Other assets	2,134	2,318
TOTAL ASSETS	$725,070	$709,954
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposit accounts		
Noninterest-bearing demand deposits	$ 41,398	$ 38,643
Interest-bearing demand deposits	127,714	127,659
Savings deposits	26,409	23,116
Certificates of deposit	177,404	215,191
Total deposit accounts	372,925	404,609
Advances by borrowers for taxes and insurance	1,386	1,605
Interest payable	552	731
Deferred compensation	5,191	4,515
FHLB advances	136,972	180,730
Other liabilities	2,857	5,127
Total liabilities	519,883	597,317
STOCKHOLDERS' EQUITY		
Serial preferred stock, $.01 par value; 10,000,000 authorized, issued and outstanding, none	--	--
Common stock, $.01 par value; 90,000,000 authorized, issued and outstanding:	174	152
Sept. 30, 2008 – 17,412,449 issued, 17,374,161 outstanding		
Sept. 30, 2007 – 15,278,803 issued, 15,232,243 outstanding		

Additional paid-in capital	157,205	59,613
Retained earnings	59,813	58,795
Unearned shares issued to ESOP	(10,605)	(3,698)
Accumulated other comprehensive loss	(1,400)	(2,225)
Total stockholders’ equity	205,187	112,637
TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY	$725,070	$709,954

See accompanying notes.

HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except share and per share data)

	Year Ended September 30,		
	2008	2007	2006
Interest and dividend income:			
Loan interest	$30,686	$33,553	$30,175
Investment interest	1,012	345	140
Mortgage-backed securities interest	8,742	8,692	9,598
FHLB dividends	143	48	--
Total interest and dividend income	40,583	42,638	39,913
Interest expense:			
Deposits	10,685	12,279	8,914
FHLB advances	7,250	9,057	8,003
Total interest expense	17,935	21,336	16,917
Net interest income	22,648	21,302	22,996
Provision for loan losses	2,431	409	138
Net interest income after provision for loan losses	20,217	20,893	22,858
Noninterest income:			
Service charges and fees	9,077	9,308	9,384
Gain on sale of loans	764	1,419	1,056
Increase in cash surrender value of bank owned life insurance	421	405	383
Loan servicing fees	484	549	620
Mortgage servicing rights, net	(340)	(445)	(179)
Other	84	45	(63)
Total noninterest income	10,490	11,281	11,201
Noninterest expense:			
Compensation and benefits	15,211	14,249	15,081
Occupancy and equipment	3,007	2,871	2,759
Data processing	2,198	2,097	1,802
Advertising	1,043	1,427	986
Postage and supplies	617	650	811
Professional services	788	856	917
Insurance and taxes	533	429	431
Other	1,042	1,057	1,250
Total noninterest expense	24,439	23,636	24,037
Income before income taxes	6,268	8,538	10,022
Income tax expense	2,263	3,267	3,810
NET INCOME	$4,005	$ 5,271	$ 6,212
Earnings per share:			
Basic	$0.25(1)	$0.32(1)	$0.38(1)
Diluted	0.25(1)	0.31(1)	0.38(1)

Weighted average number of shares outstanding:			
Basic	16,233,200(1)	16,602,082(1)	16,454,940(1)
Diluted	16,252,747(1)	16,767,219(1)	16,494,468(1)
Dividends declared per share:	$0.213(1)	$0.194(1)	$0.189(1)

(1) Earnings per share, average shares outstanding, and dividends per share have been adjusted to reflect the impact of the Conversion which occurred on December 19, 2007.

See accompanying notes.

HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME
(In thousands, except share data)

	Common Stock				Unearned Shares Issued to Employee Stock Ownership Plan	Accumulated Other Comprehensive Loss	
	Shares	Amount	Additional Paid-In Capital	Retained Earnings			Total
Balance at Sept. 30, 2005	14,910,658	$149	$56,115	$ 49,818	$(4,550)	$(165)	$101,367
Restricted stock issued, net of forfeitures	258,456	3	(3)				--
ESOP shares committed to be released			265		416		681
Share-based compensation expense			845				845
Dividends paid ($0.189 per share) (1) (2)				(1,225)			(1,225)
Comprehensive income:							
Net income				6,212			6,212
Other comprehensive income:							
Change in unrealized holding loss on securities available for sale, net of taxes						(11)	(11)
Comprehensive income:							6,201
Balance at Sept. 30, 2006	15,169,114	152	57,222	54,805	(4,134)	(176)	107,869
Restricted stock issued, net of forfeitures	(6,924)						--
ESOP shares committed to be released			357		436		793
Exercise of stock options	70,053		854				854
Share-based compensation expense			1,036				1,036

Excess tax benefits from equity compensation plans			144				144
Dividends paid ($0.194 per share) (1) (2)				(1,281)			(1,281)
Comprehensive income:							
Net income				5,271			5,271
Other comprehensive income:							
Change in unrealized holding loss on securities available for sale, net of taxes						(100)	(100)
Unrealized holding loss resulting from transfer of securities from held to maturity to available for sale, net of taxes						(1,949)	(1,949)
Comprehensive income:							3,222
Balance at Sept. 30, 2007	15,232,243	152	59,613	58,795	(3,698)	(2,225)	112,637

(continued on next page)

See accompanying notes.

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HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME
(Continued)
(In thousands, except share data)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Unearned Shares Issued to Employee Stock Ownership Plan	Accumulated Other Comprehensive Loss	Total
Balance at Sept. 30, 2007 (balance carried forward)	15,232,243	152	59,613	58,795	(3,698)	(2,225)	112,637
Second Step Conversion(3)	2,073,619	21	95,938		(8,160)		87,799
Dissolution of Mutual Holding Company			50				50
Restricted stock issued, net of forfeitures	13,502						--
ESOP shares committed to be released			(23)		1,253		1,230
Exercise of stock options	54,797	1	605				606
Share-based compensation			1,022				1,022
Dividends paid ($0.213) per share) (1) (2)				(2,987)			(2,987)
Comprehensive income:							
Net income				4,005			4,005
Other comprehensive income:							
Change in unrealized holding loss on securities available for sale, net of taxes						825	825
Comprehensive income:							4,830
Balance at Sept. 30, 2008	17,374,161	$174	$157,205	$59,813	$(10,605)	$(1,400)	$205,187

(1) Home Federal MHC waived its receipt of dividends on the 8,979,246 shares that it owned.

(2) Dividends per share have been adjusted to reflect the impact of the Conversion, which occurred on December 19, 2007.

(3) The total effect on equity accounts from the Conversion has changed from the December 31, 2007 reported numbers due to adjustments such as true-up of total new shares issued in relation to conversion once total affect of fractional shares was known, payment of additional expenses related to conversion, etc.

See accompanying notes.

HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended September 30,		
	2008	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 4,005	$ 5,271	$ 6,212
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	1,699	1,712	1,640
Net accretion of premiums and discounts on investments	(19)	(62)	(90)
Loss on sale of fixed assets and repossessed assets	144	2	137
Gain on sale of securities available for sale	--	(4)	--
ESOP shares committed to be released	1,230	793	681
Equity compensation expense	1,022	1,036	845
Provision for loan losses	2,431	409	138
Accrued deferred compensation expense, net	676	640	826
Net deferred loan fees	132	81	541
Deferred income tax benefit	(1,075)	(535)	(397)
Excess tax benefit from equity compensation plans	--	(144)	--
Net gain on sale of loans	(764)	(1,419)	(1,056)
Proceeds from sale of loans held for sale	48,543	97,503	82,416
Originations of loans held for sale	(45,895)	(97,154)	(80,144)
Net decrease in value of mortgage servicing rights	340	445	179
Net increase in value of bank owned life insurance	(422)	(405)	(383)
Change in assets and liabilities:			
Interest receivable	123	222	(567)
Other assets	176	(801)	(674)
Interest payable	(179)	(240)	(699)
Other liabilities	(2,274)	331	(1,652)
Net cash provided by operating activities	9,893	7,681	7,953
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from maturity of mortgage-backed securities held to maturity	--	13,094	28,065
Purchase of mortgage-backed securities held to maturity	--	--	(30,259)
	31,123	15,013	2,609

Proceeds from sale and maturity of mortgage-backed securities available for sale			
Purchase of mortgage-backed securities available for sale	(56,257)	(2,102)	--
Investment in certificate of deposit	(5,000)	--	--
Proceeds from sale of securities available for sale	--	3,848	--
Purchases of property and equipment	(4,643)	(1,181)	(2,447)
Net decrease/(increase) in loans	17,000	22,190	(33,827)
Purchased loans	--	--	(38,782)
Purchase of bank owned life insurance	--	--	(281)
Proceeds from sale of fixed assets and repossessed assets	759	172	529
Net cash (used) provided by investing activities	(17,018)	51,034	(74,393)

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See accompanying notes.

HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CASH FLOWS (Continued)
(In thousands)

	Year Ended September 30, 2008	2007	2006
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net (decrease)/increase in deposits	(31,684)	(25,672)	33,956
Net decrease in advances by borrowers for taxes and insurance	(219)	(528)	(1,765)
Proceeds from FHLB advances	68,215	153,860	253,425
Repayment of FHLB advances	(111,973)	(183,889)	(218,599)
Proceeds from exercise of stock options	606	854	--
Excess tax benefit from equity compensation plans	--	144	--
Dividends paid	(2,987)	(1,281)	(1,225)
Net proceeds from stock issuance and exchange pursuant to second step conversion	87,849	--	--
Net cash provided (used) by financing activities	9,807	(56,512)	65,792
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	2,682	2,203	(648)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	20,588	18,385	19,033
CASH AND CASH EQUIVALENTS, END OF YEAR	$23,270	$ 20,588	$18,385
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest	$18,115	$21,576	$17,617
Income taxes	3,535	3,800	4,226
NONCASH INVESTING AND FINANCING ACTIVITIES:			
Acquisition of real estate and other assets in settlement of loans	$1,394	$ 703	$ 2
Fair value adjustment to securities available for sale, net of taxes	825	(100)	(11)
Transfer of securities from held to maturity to available for sale	--	171,668	--
	--	(1,949)	--

Fair value adjustment to securities available for sale,
net of taxes as a result of transferring securities from held to
maturity to available for sale

See accompanying notes.

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HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies

Nature of Business and Reorganization. Home Federal Bancorp, Inc. (the “Company”), was formed as the new stock holding company for Home Federal Bank (the “Bank”) in connection with the Bank’s Conversion from the mutual holding company structure to the stock holding company structure, which was completed on December 19, 2007. Prior to the completion of the Conversion, the Bank was the subsidiary of Home Federal Bancorp, Inc., a federally-chartered stock mid-tier holding company (“Mid-Tier”), and the Mid-Tier was a subsidiary of Home Federal MHC, a federally-chartered mutual holding company. The Bank formed the mutual holding company structure in December 2004. As a result of the Conversion, Home Federal MHC and the Mid-Tier ceased to exist and were replaced by the Company as the successor to the Mid-Tier. All references to the number of shares outstanding, including references for purposes of calculating per share amounts, are restated to give retroactive recognition to the exchange ratio applied in the Conversion. See Note 19 below for additional information regarding the Conversion.

The Bank was founded in 1920 as a building and loan association and reorganized as a federal mutual savings and loan association in 1936. The Bank is a community-oriented financial institution dedicated to serving the financial service needs of consumers and businesses within its market area. The Bank’s primary business is attracting deposits from the general public and using these funds to originate loans. It emphasizes the origination of loans secured by first mortgages on owner-occupied, residential real estate, residential development and construction, and commercial real estate. To a lesser extent, it originates other types of real estate loans, commercial business loans and consumer loans.

The Bank serves the Treasure Valley region of southwestern Idaho, which includes Ada, Canyon, Elmore and Gem Counties, through its 15 full-service banking offices and one loan center. Nearly 40% of the state’s population lives and works in the four counties served by Home Federal Bank. Ada County has the largest population and includes the city of Boise, the state capitol. Home Federal Bank maintains its largest branch presence in Ada County with eight locations, followed by Canyon County with five offices, including the Company’s corporate headquarters in Nampa. The two remaining branches are located in Elmore and Gem Counties.

Home Federal Bank has one wholly-owned subsidiary, Idaho Home Service Corporation, which was established in 1981 as Home Service Corporation for the purpose of facilitating various business activities. Since 2000, Idaho Home Service Corporation has been inactive.

Principles of Consolidation. The consolidated financial statements of the Company include the accounts of the Company, the Bank and its wholly-owned subsidiary, Idaho Home Service Corporation. All intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates in the Preparation of Financial Statements. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of certain assets and liabilities as of the date of the statement of financial condition and certain revenues and expenses for the period. Actual results could differ, either positively or negatively, 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 fair market value of capitalized mortgage servicing rights, as well as deferred income taxes.

Management believes that the allowance for loan losses reflects the best estimate of probable incurred losses inherent in the loan portfolio at the balance sheet dates presented and that the valuation of mortgage servicing assets and computation of deferred taxes are proper. While management uses currently available information to recognize losses on loans and impairment of mortgage servicing assets, future additions to the allowance and future impairments may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and valuation of mortgage servicing assets. Such agencies may require the Company to recognize additions to the allowance or an impairment of mortgage servicing assets based on their judgments of information available to them at the time of their examination.

Cash and Cash Equivalents. For the purposes of reporting cash flows, the Company has defined cash and cash equivalents as those amounts included in the consolidated balance sheet caption Cash and amounts due from depository institutions. Cash and cash equivalents, including interest-bearing deposits, are on deposit with other banks and financial institutions in amounts that periodically exceed the federal insurance limit. Management believes that its risk of loss associated with such balances is minimal due to the financial strength of the banks and financial institutions. The Company has not experienced any losses in such accounts.

Cash on Hand and in Banks. The Company is required to maintain an average reserve balance with the Federal Reserve Bank, or maintain such reserve in cash on hand. The amount of this required reserve balance at September 30, 2008 and 2007 was $1.8 million and $1.6 million, respectively.

Securities Held to Maturity. Securities for which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using methods that approximate the interest method over the period to maturity. Securities held to maturity consists only of mortgage-backed securities.

Securities Available for Sale. Available for sale securities consist of mortgage-backed securities, which are not classified as trading securities or as held to maturity securities.

Unrealized holding gains and losses, net of tax, on available for sale securities are reported as a net amount in a separate component of equity until realized. Gains and losses on the sale of available for sale securities are determined using the specific-identification method and are included in earnings.

Declines in the fair value of individual held to maturity and available for sale securities below their cost that are other than temporary result in write-downs of the individual securities to their fair value. In estimating other-than-temporary losses, management considers, among other things, (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospectus of the issuer, and (3) the Company’s ability and intent to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value. Any such write-downs would be included in earnings as realized losses. Management believes that all unrealized losses on investment securities at September 30, 2008 and 2007 are temporary.

FHLB Stock. As a member of the FHLB of Seattle, the Bank is required to maintain a minimum level of investment in capital stock of the FHLB based on specific percentages of its outstanding FHLB advances, total assets and mortgages. The Bank's investment in FHLB of Seattle stock is carried at par value ($100 per share), which reasonably approximates its fair value. The Bank may request redemption at par value of any stock in excess of the amount the Bank is required to hold. FHLB stock is restricted as to purchase, sale, and redemption.

Loans Held for Sale. Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Loan commitments related to the origination of mortgage loans held for sale and the corresponding sales contracts are considered derivative instruments as defined by SFAS 133 (as amended). Pursuant to that Statement, they are recognized on the consolidated balance sheet in other assets and other liabilities at fair value.

Loans Receivable and Allowance for Loan Losses. The Bank grants commercial, real estate, and consumer loans to customers. A substantial portion of the loan portfolio is represented by commercial real estate and residential real estate loans made primarily to borrowers in Idaho. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate market and/or general economic conditions in the Bank's market area.

Loans are stated at the amount of unpaid principal, adjusted for deferred loan fees and related costs and an allowance for loan losses. Interest on loans is calculated by using the simple interest method on daily balances of the principal amount outstanding. Interest income is accrued on the unpaid balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent, or in the opinion of management, the collection of interest is questionable. Thereafter, no interest is taken into income unless received in cash or until such time as the borrower demonstrates the ability to resume payments of principal and interest.

Premiums and discounts on purchased loans are amortized over the estimated life of the loans as an adjustment to yield using the interest method.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for nonhomogeneous loan types and larger balance homogeneous loan types by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Management believes the allowance for loan losses represents our best estimate of known and unknown but probable, incurred losses inherent in our loan portfolio. The allowance is based upon a periodic review of loans which includes consideration of actual net loan loss experience, changes in the size and character of the loan portfolio, identification of individual problem situations that may affect the borrower's ability to pay, and an evaluation of current economic conditions. Loan losses are recognized through charges to the allowance.

Real Estate Acquired in Settlement of Loans. Real estate acquired through foreclosure or deeds in lieu of foreclosure is stated at the lower of cost or estimated fair market value less selling costs. When the property is acquired, any excess of the loan balance over the estimated net realizable value is charged to the reserve for loan losses. Holding costs, subsequent write-downs to estimated fair market value less selling costs, if any, or any disposition gains or losses are included in noninterest income and expenses. Costs of development and improvement of the property are capitalized.

Property and Equipment. Properties and equipment are stated at cost, less accumulated depreciation and amortization. Leasehold improvements are amortized over the term of the lease or the estimated useful life of the improvements, whichever is less. Depreciation and amortization are generally computed using the straight-line method for financial statement purposes over the following estimated useful lives and lease periods:

Buildings and leasehold improvements	15-40 years
Furniture, equipment, and automobiles	3-12 years

The normal costs of maintenance and repairs are charged to expense as incurred.

Mortgage Servicing Rights. Retained mortgage servicing rights are measured at fair values as of the date of the sale of the underlying loan. In addition, mortgage servicing rights are carried in the balance sheet at fair value and the changes in fair value are reported in earnings in the period in which the change occurs. Fair values are estimated using discounted cash flows based on current market interest rates. The Company utilizes an independent third party to assist in assessing the fair value of the servicing rights.

Fees earned for servicing mortgage loans are reported as income when the related mortgage loan payments are collected. Loan servicing costs are charged to expense as incurred.

Income Taxes. Deferred income taxes are reported for temporary differences between items of income or expense reported in the financial statements and those reported for income tax purposes. Deferred taxes are computed using the asset and liability approach as prescribed in SFAS No. 109, Accounting for Income Taxes. Under this method, a deferred tax asset or liability is determined based on the enacted tax rates that will be in effect when the differences between the financial statement carrying amounts and tax basis of existing assets and liabilities are expected to be reported in the Company’s income tax returns. The deferred tax provision for the year is equal to the net change in the net deferred tax liability from the beginning to the end of the year, less amounts applicable to the change in value related to investments available for sale. The effect on deferred taxes of a change in tax rates is recognized as income in the period that includes the enactment date.

At October 1, 2007, the Company adopted Financial Accounting Standards Board ("FASB") Interpretation No. 48, Accounting for Uncertainty in Income Taxes ("FIN 48"). FIN 48 requires recognition and measurement of uncertain tax positions using a "more-likely-than-not" approach. The Company’s approach to adopting FIN 48 consisted of an examination of its financial statements, its income tax provision, and its federal and state income tax returns. The Company analyzed its tax positions including the permanent and temporary differences as well as the major components of income and expense.

As of October 1, 2007, and September 30, 2008, the Company did not believe that it had any uncertain tax positions that would rise to the level of having a material effect on its financial statements. In addition, the Company had no accrued interest or penalties as of October 1, 2007 or September 30, 2008. It is the Company’s policy to record interest and penalties as a component of income tax expense. The adoption of this accounting standard did not have a material impact on the Company’s financial position or results of operations.

Comprehensive Income: Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as separate components of the equity section of the statement of financial condition, such items, along with net income are components of comprehensive income.

The components of other comprehensive income and related tax effects are as follows:

	Year Ended September 30,		
	2008	2007	2006
		(in thousands)	
Unrealized holding gain (loss) on available for sale securities	$1,376	$(3,411)	$(19)
Reclassification adjustment for gain realized in income	--	4	--
Net unrealized gain (loss)	1,376	(3,415)	(19)
Tax effect	(551)	1,366	8
Unrealized gain (loss) net of tax	$ 825	$(2,049)	$(11)

Advertising Costs. Advertising costs are expensed as incurred. Advertising expense for the years ended September 30, 2008, 2007, and 2006, was $1.0 million, $1.4 million and $1.0 million respectively.

Recent Accounting Pronouncements. In September 2006, the Financial Accounting Standards Board issued SFAS No. 157, “Fair Value Measurements.” The statement provides enhanced guidance for measuring assets and liabilities using fair value and applies whenever other standards require or permit assets or liabilities to be measured at fair value. SFAS No. 157 also requires expanded disclosure of items that are measured at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. The Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and is not expected to have a significant impact on our consolidated financial condition or results of operations.

On February 15, 2007, the Financial Accounting Standards Board issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities.” The statement permits entities to choose to measure selected financial assets and liabilities at fair value, with changes in fair value recorded in earnings. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007 and is not expected to have a significant impact on our consolidated financial condition or results of operations. An entity may elect to early adopt as of the beginning of a fiscal year that begins on or before November 15, 2007.

In December 2007, the FASB issued SFAS No. 141 (Revised), Business Combinations. SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and the goodwill acquired. The standard also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008.

Stock-Based Compensation. On June 23, 2005, stockholders approved long-term stock-based benefit plans that enable the Company to grant stock options, stock appreciation rights and restricted stock awards to employees and directors. As of October 1, 2005, the Company adopted SFAS No. 123(R), Share Based Payment, which requires the recognition of compensation costs relating to share based payment transactions in the financial statements. The Company has elected the modified prospective application method of reporting, which provides for no restatement of prior periods and no cumulative adjustment to equity accounts. Prior to the adoption of SFAS No. 123(R), the Company elected to account for its stock-based compensation plans using the intrinsic value-based method of recognizing compensation costs outlined in APB Opinion No. 25, Accounting for Stock Issued to Employees, and adopted the disclosure-only provisions under SFAS No. 123, Accounting for Stock-Based Compensation.

Earnings per share ("EPS") data: The Company displays basic and diluted EPS in the Consolidated Statements of Income. Basic EPS is computed by dividing net income or loss by the weighted average number of shares outstanding during the period. Unallocated shares relating to the ESOP are deducted in the calculation of weighted average shares outstanding. Diluted EPS is computed by dividing net income or loss by the diluted weighted average shares outstanding, which includes common stock equivalent shares outstanding using the treasury stock method, unless such shares are anti-dilutive. Common stock equivalents include stock options and restricted stock awards.

Employee Stock Ownership Plan. The Company accounts for its ESOP in accordance with the AICPA SOP 93-6, Employer's Accounting for Employee Stock Ownership Plans. Dividends on allocated shares are recorded as a reduction of retained earnings and paid to plan participants or distributed to participants' accounts. As shares are released, compensation expense is recorded equal to the then current market price of the shares and the shares become available for earnings per share calculations. The Company records cash dividends on unallocated shares as a reduction of debt or accrued interest.

Concentrations of Credit Risk. The Bank accepts deposits and grants credit primarily within the Treasure Valley region of southwestern Idaho, which includes Ada, Canyon, Elmore and Gem Counties. The Bank has a diversified loan portfolio and grants consumer, residential, commercial, and construction real estate loans, and is not dependent on any industry or group of customers. Although the Bank has a diversified loan portfolio, a substantial portion of its loans are real-estate-related. The ability of the Bank's debtors to honor their contracts is dependant upon the real estate and general economic conditions in the area. The Bank also regularly monitors real-estate related loans that include terms that may give rise to a concentration of credit risk, including high loan-to-value loans and interest-only loans.

Reclassifications. Certain reclassifications have been made to prior year's financial statements in order to conform with the current year presentation. The reclassifications had no effect on previously reported net income or equity.

Note 2 – Securities

Our investment policies are designed to provide and maintain adequate liquidity and to generate favorable rates of return without incurring undue interest rate or credit risk. The investment policies generally limit investments to mortgage-backed securities, U.S. Government and agency securities, municipal bonds, certificates of deposit and marketable corporate debt obligations.

During the quarter ended June 30, 2007, the Company transferred its entire portfolio of held to maturity mortgage-backed securities to available for sale to meet the additional liquidity needs associated with increasing commercial banking activities. As a result, mortgage-backed securities with an amortized cost, gross unrealized gains and gross unrealized losses of $171.7 million, $228,000 and $3.5 million, respectively were transferred to the available for sale category. As part of its liquidity management, the Company does not intend to classify any securities as held to maturity in the foreseeable future.

Mortgage-backed securities available for sale consisted of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in thousands)		
September 30, 2008:				
U.S. Government-sponsored enterprises	$187,730	$669	$(2,669)	$185,730
Other	3,390	-	(333)	3,057
	$191,120	$669	$(3,002)	$188,787
September 30, 2007:				
U.S. Government-sponsored enterprises	$162,503	$191	$(3,823)	$158,871
Other	3,464	-	(77)	3,387
	$165,967	$191	$(3,900)	$162,258

The contractual maturities of mortgage-backed securities available for sale are shown below. Expected maturities may differ from contractual maturities because borrowers have the right to prepay obligations without prepayment penalties.

	September 30, 2008 Amortized Cost	Fair Value
	(in thousands)	
Due within one year	$ 26	$ 26
Due after one year through five years	47	49
Due after five years through ten years	29,249	28,911
Due after ten years	161,798	159,801
Total	$191,120	$188,787

For the years ended September 30, 2008, 2007, and 2006, proceeds from sales of securities available for sale amounted to $0, $3.8 million, and $0 respectively. Gross realized gains for the years ended September 30, 2008, 2007, and 2006 were $0, $4,000, and $0 respectively. There were no gross realized losses for the years ended September 30, 2008, 2007, and 2006, respectively. All gain and losses were included in other noninterest income on the Consolidated Statements of Income.

The fair value of temporarily impaired securities, the amount of unrealized losses and the length of time these unrealized losses existed as of September 30, 2008 are as follows:

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
Mortgage-backed securities, available for sale	$121,626	$(2,166)	$17,699	$(836)	$139,325	$(3,002)

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Management has evaluated these securities and has determined that the decline in the value is temporary and not related to the underlying credit quality of the issuers or an industry specific event. The declines in value are on securities that have contractual maturity dates and future principal payments that will be sufficient to recover the current amortized cost of the securities. The Company has the ability and intent to hold the securities for a reasonable period of time for a forecasted recovery of the amortized cost.

As of September 30, 2008, the Bank had pledged mortgage-backed securities with an amortized cost of $80.5 million and a fair value of $79.6 million as collateral for FHLB advances. In addition, as of September 30, 2008, two mortgage-backed securities with a combined amortized cost of $5.7 million and a fair value of $5.7 million were pledged to the Federal Reserve Bank as collateral for treasury tax and loan funds held by the Bank and for borrowings from the discount window.

Note 3 – Loans Receivable

Loans receivable are summarized as follows:

	September 30,	
	2008	2007
	(in thousands)	
Real Estate:		
One- to four-family residential	$210,302	$249,316
Multi-family residential	8,477	6,864
Commercial	151,733	133,823
Total real estate	370,512	390,003
Real Estate Construction:		
One- to four-family residential	13,448	20,545
Multi-family residential	920	1,770
Commercial and land development	18,674	21,899
Total real estate construction	33,042	44,214
Consumer:		
Home equity	52,954	42,990
Automobile	1,903	2,173
Other consumer	1,370	1,405
Total consumer	56,227	46,568
Commercial business	5,385	3,122
	465,166	483,907
Premium on purchased loans	199	229
Deferred loan fees	(973)	(1,030)
Allowance for loan losses	(4,579)	(2,988)
Loans receivable, net	$459,813	$480,118

The majority of residential mortgage loans are pledged as collateral for FHLB advances (see Note 7).

The interest rates on loans at September 30, 2008, fall into the following fixed and variable components (in thousands):

Fixed rates	$183,242
Variable rates	282,123
Total loans receivable	$465,365

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The contractual maturity of loans receivable at September 30, 2008, are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to prepay loans with or without prepayment penalties.

	Within 1 Year	One Year To 5 Years	After 5 Years	Total
		(in thousands)		
Real estate:				
One- to four-family residential	$ 31	$ 4,255	$206,215	$210,501
Multi-family residential	--	--	8,477	8,477
Commercial	3,896	5,805	142,032	151,733
Total real estate	3,927	10,060	356,724	370,711
Real estate construction:				
One- to four-family residential	13,448	--	--	13,448
Multi-family residential	920	--	--	920
Commercial and land development	12,266	6,408	--	18,674
Total real estate construction	26,634	6,408	--	33,042
Consumer:				
Home equity	348	3,876	48,730	52,954
Automobile	39	1,485	379	1,903
Other consumer	265	1,083	22	1,370
Total consumer	652	6,444	49,131	56,227
Commercial business	2,877	2,305	203	5,385
Total loans receivable	$34,090	$25,217	$406,058	$465,365

An analysis of the changes in the allowance for loan losses is as follows:

	Year Ended September 30,		
	2008	2007	2006
		(in thousands)	
Beginning balance	$2,988	$2,974	$2,882
Provision for loan losses	2,431	409	138
Charge offs	(864)	(219)	(70)
Transfer to unfunded commitments	--	(192)	--
Recoveries	24	16	24
Ending balance	$4,579	$2,988	$2,974

Impaired loan information is as follows:

	Year Ended September 30,		
	2008	2007	2006
		(in thousands)	

Impaired loans with related allowance	$9,215	$833	$ --
Impaired loans with no related allowance	266	2,076	--
Total impaired loans	$9,481	$2,909	--
Specific allowance on impaired loans	$1,729	$ 78	$ --
Average balance of impaired loans	4,041	356	14

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Explanation of Responses:

No interest income was recognized on impaired loans as of September 30, 2008, 2007 and 2006. As of September 30, 2008, 2007, and 2006, the Company had no accruing loans that were contractually past due 90 days or more. The Company is not committed to lend additional funds to debtors whose loans have been modified.

Note 4 – Mortgage Servicing Rights

Mortgage servicing rights represent the fair value of the future loan servicing fees from the right to service loans for others. The unpaid principal balances of loans serviced at September 30, 2008, 2007 and 2006 were $167.0 million, $190.0 million and $216.7 million, respectively. Loans serviced for others are not included in the consolidated statements of financial condition. In general, during periods of falling interest rates, mortgage loans prepay faster and the value of the mortgage servicing rights declines. Conversely, during periods of rising rates, the value of the mortgage servicing rights generally increases as a result of slower rates of prepayments. The Company does not use derivatives to hedge fluctuations in the fair value of the servicing rights.

As of October 1, 2006, the Company adopted SFAS No. 156, Accounting for Servicing of Financial Assets, to measure mortgage servicing rights using the fair value method. As a result, the Company measures each class of mortgage servicing rights at fair value at each reporting date, and reports changes in fair value in earnings in the period in which the change occurs. Prior to the adoption of SFAS No. 156, the Company elected to account for its mortgage servicing rights using the amortization method previously required by SFAS No. 140.

The Company has identified two classes of mortgage servicing assets based upon the nature of the collateral, interest rate mechanism and nature of the loan. The Company uses an independent third party to periodically assist in valuing the residential mortgage servicing rights using information such as anticipated prepayment speeds, discount rates and servicing fees associated with the type of loans sold. The mortgage servicing rights associated with commercial loans, which represent an immaterial portion of total mortgage servicing rights, are evaluated internally on a periodic basis.

Upon the change from the amortization method to fair value accounting under SFAS No. 156, the calculation of amortization and the assessment of impairment were discontinued. Those measurements have been replaced by adjustments to fair value that encompass market-driven valuation changes. Under the fair value method, the changes in fair value are reported in “Mortgage servicing rights, net” on the Consolidated Statements of Income.

The amount of contractually specified servicing fees for one- to four-family residential loans were $484,000, $549,000, and $620,000, for the years ended September 30, 2008, 2007 and 2006 respectively. The servicing fees for one- to four-family residential loans are recorded in “Loan Servicing Fees” on the Consolidated Statements of Income. The amount of contractually specified servicing fees for commercial real estate loans, as well as late fees and other ancillary fees earned for the periods indicated, were immaterial in amount.

The following table lists the classes of servicing rights, activities in the balance of each class and fees earned for the periods indicated:

Servicing Right Classes	2008	Year Ended September 30, 2007 (in thousands)	2006
One- to four-family residential loans:			
Beginning Balance	$2,033	$2,468	$2,615
Additions for new mortgage servicing rights capitalized	-	-	153
Adjustments to fair value	(330)	(435)	(437)
Write-up (impairment)	-	-	137
Ending Balance	$1,703	$2,033	$2,468
Commercial real estate loans:			
Beginning Balance	$ 14	$ 24	$ 56
Additions for new mortgage servicing rights capitalized	-	-	-
Adjustments to fair value	-	(10)	-
Amortization of servicing rights	(10)	-	(32)
Ending Balance	$ 4	$ 14	$ 24

On August 28, 2008, Home Federal Bank entered into a binding agreement with another bank whereby Home Federal Bank would sell its remaining servicing rights. The purchase price was 1.02% of the unpaid principal balance of all loans in the servicing portfolio, except for those loans that are 60 days or more past due, in litigation, in bankruptcy or in foreclosure as of October 31, 2008. The transfer is to be completed by December 16, 2008. At September 30, 2008, our residential loan servicing portfolio was $167.0 million.

Note 5 - Properties and Equipment

Properties and equipment at September 30, 2008 and 2007 are summarized as follows:

	September 30, 2008	2007
	(in thousands)	
Land	$ 3,254	$ 2,875
Buildings and leasehold improvements	11,020	9,810
Construction in progress	1,938	561
Furniture and equipment	9,335	8,964
Automobiles	90	74
Total cost	25,637	22,284
Less accumulated depreciation and amortization	(10,391)	(9,920)

Net book value	$15,246	$12,364

Repairs and maintenance are charged against income as incurred; major remodels and improvements are capitalized. Depreciation and amortization charged against operations for the years ended September 30, 2008, 2007, and 2006, was $1.7 million, $1.6 million and $1.6 million, respectively.

Capitalized interest expense related to construction of banking offices for the year ending September 30, 2008, was $23,564.

Note 6 - Deposit Accounts

Deposit information by type and weighted average rates are summarized as follows:

	Rate	September 30, 2008	Rate	September 30, 2007
		(in thousands)		
Savings deposits	0.84%	$ 26,409	0.64%	$ 23,116
Demand deposits	0.75	169,112	1.34	166,302
		195,521		189,418
Certificates of deposit	0.00-0.99	11	0.00-0.99	374
	1.00-1.99	-	1.00-1.99	5
	2.00-2.99	49,598	2.00-2.99	2,257
	3.00-3.99	54,669	3.00-3.99	24,012
	4.00-4.99	55,050	4.00-4.99	63,632
	5.00-5.99	16,234	5.00-5.99	123,617
	6.00-8.99	1,842	6.00-6.99	1,294
Total certificates of deposit		177,404		215,191
Total deposits		$372,925		$ 404,609

Scheduled maturities of certificates of deposits are as follows during the fiscal years presented:

	September 30, 2008	2007
	(in thousands)	
Fiscal year ending September 30,		
2008	$ --	$172,584
2009	133,323	25,047
2010	25,694	10,575
2011	7,758	5,349
2012	8,649	1,441
2013	1,805	--
Thereafter	175	195
	$177,404	$215,191

At September 30, 2008 and 2007, certificates of deposits of $100,000 or greater were $54.5 million and $64.9 million, respectively. We had no brokered certificates of deposit at September 30, 2008 or 2007.

Interest expense by type of deposit account is summarized as follows:

Year Ended September 30, 2008	2007	2006
	(in thousands)	

Savings deposits	$ 177	$ 103	$ 51
Demand deposits	1,912	1,783	1,000
Certificates of deposit	8,596	10,393	7,863
Total	$10,685	$12,279	$ 8,914

There was no accrued interest on deposit accounts at September 30, 2008 or 2007.

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Note 7 - Federal Home Loan Bank Advances

The Bank has the ability to borrow up to 40% of its total assets from the FHLB of Seattle, limited by available collateral. Advances are collateralized by all FHLB stock owned by the Bank, deposits with the FHLB of Seattle, and certain residential mortgages and mortgage-backed securities. The outstanding balances on FHLB advances at September 30, 2008 and 2007 were $137.0 million and $180.7 million, respectively, with interest rates ranging from 3.56% to 5.33% as of September 30, 2008.

The Bank’s borrowings consisted of the following:

	September 30, 2008	2007
	(in thousands)	
FHLB advances		
Maximum outstanding at any month end	$181,000	$223,000
Average outstanding	158,000	202,000
Weighted average interest rates		
For the period	4.60%	4.49%
At end of period	4.68	4.55

Scheduled maturities of the fixed rate FHLB borrowings are as follows during the fiscal years presented:

	September 30, 2008		2007	
	Average Interest Rates	Amount	Average Interest Rates	Amount
	(in thousands)			
Fiscal Year:				
2008	--%	$ --	4.14%	$43,758
2009	4.60	76,882	4.60	76,882
2010	4.69	15,240	4.69	15,240
2011	5.16	8,050	5.16	8,050
2012	4.91	15,100	4.91	15,100
2013	4.62	18,700	--	--
Thereafter	4.83	3,000	4.64	21,700
Total		$136,972		$180,730

Included in the Bank’s borrowing capacity with the FHLB is a cash management advance account. No amounts were drawn under the cash management advance account at September 30, 2008 or 2007.

Note 8 - Employee Retirement Plans

401(k) Plan. The Company has a 401(k) retirement plan covering substantially all of its employees. The Company matches 50% of employee contributions up to the employee’s first 10% contributed to the Plan. For the years ended September 30, 2008, 2007, and 2006, total Company contributions were $237,000, $214,000 and $192,000, respectively.

Salary Continuation Plan. As a supplement to the 401(k) retirement plan, the Company has adopted a Salary Continuation Plan pursuant to agreements with certain executive officers of the Company and its subsidiaries. Under the Salary Continuation Plan, an executive will be entitled to a stated annual benefit for a period of 15 years (i) upon retirement from the Company after attaining age 65, or (ii) upon attaining age 65 if his or her employment had been previously terminated due to disability. In the event the executive dies while in active service, the Company shall pay the beneficiary the normal retirement projected benefit for a period of 15 years commencing with the month following the executive's death. In the event the executive dies after age 65, but before receiving the full 15 years of annual benefits, the remaining payments shall be paid to his or her beneficiaries. Upon termination of employment, the annual benefit amount is 50% of the officer's average final 36 months base salary. Benefits under the Plan vest over ten years. Upon early retirement, the Company shall pay the executive the vested accrual balance as of the end of the month prior to the early retirement date. The Company shall pay the early retirement benefit in 180 equal installments.

The accrued liability for the salary continuation plan was $2.3 million and $1.9 million at September 30, 2008 and 2007, respectively. The amounts recognized in compensation expense were $389,000, $403,000 and $311,000 for the years ended September 30, 2008, 2007, and 2006, respectively.

Deferred Incentive Compensation. The Company has deferred incentive compensation agreements with certain former executive officers and the Board of Directors. Under the agreements, the Company is obligated to provide payments for each such former executive and board member or his beneficiaries during a period of fifteen or ten years after the death, disability, or retirement of the executive or board member. The estimated present value of future benefits to be paid is being accrued over the period from the effective date of the agreement until the expected retirement dates of the participants. Participants are not permitted to contribute compensation into this plan.

The Company accrues annual interest on the unfunded liability under the plan based upon a formula relating to the change in retained earnings, which amounted to 5.79%, 8.50%, and 12.0% for the years ended September 30, 2008, 2007 and 2006, respectively. The accrued liability for the deferred incentive compensation agreements was $2.3 million and $2.1 million at September 30, 2008 and 2007, respectively. The amounts recognized in compensation expense were $189,000, $124,000, and $422,000 for the years ended September 30, 2008, 2007, and 2006, respectively.

Director Retirement Plan. Home Federal Bancorp adopted a director retirement plan, effective January 1, 2005, that replaced prior plans. The plan is an unfunded nonqualified retirement plan for directors. Upon the later of attaining age 72 or termination of service, the director will receive an annual benefit equal to 50 percent of the fees paid to the director for the preceding year, payable in monthly installments over 15 years. The accrued benefit vests at a rate of 10 percent per year, except in the event of disability, in which case the vested percentage is 100 percent. If the director terminates service within 24 months following a change in control, he will receive 100 percent of his accrued benefit, plus a change in control benefit equal to 2.99 times his prior years directors fees. Change in control payments are subject to reduction to avoid excise taxes under Section 280G of the Internal Revenue Code. In the event a director dies before termination of service, his beneficiary would receive his projected benefit, which is the final benefit the director would have received had he attained age 72, assuming a 4% annual increase in the directors' fees. In the event the director dies after separation from service, but before receiving the full 15 years of annual benefits, the remaining payments shall be paid to his or her beneficiaries. In-service distributions are permitted in limited circumstances.

The accrued liability for the director retirement plans was $572,000 and $513,000 at September 30, 2008 and 2007, respectively. The amounts recognized in compensation expense were $84,000, $51,000 and $50,000 for the years ended September 30, 2008, 2007, and 2006, respectively.

The Company's deferred compensation agreements and supplemental executive retirement plans are unfunded plans and have no plan assets. The following table reconciles the accumulated liability for the benefit obligation of these contracts. The benefit obligation represents the net present value of future payments to individuals under the agreements.

Year ended September 30,

	2008	2007
	(in thousands)	
Beginning balance	$4,515	$3,875
Benefit expense	710	660
Benefit payments	(34)	(20)
Ending Balance	$5,191	$4,515

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Note 9 - Stock-Based Compensation

On June 23, 2005, stockholders approved long-term stock-based benefit plans that enable the Company to grant stock options, stock appreciation rights and restricted stock awards to employees and directors. As of October 1, 2005, the Company adopted SFAS No. 123(R), Share Based Payment, which requires the recognition of compensation costs relating to share based payment transactions in the financial statements. The Company has elected the modified prospective application method of reporting, which provides for no restatement of prior periods and no cumulative adjustment to equity accounts. Prior to the adoption of SFAS No. 123(R), the Company elected to account for its stock-based compensation plans using the intrinsic value-based method of recognizing compensation costs outlined in APB Opinion No. 25, Accounting for Stock Issued to Employees, and adopted the disclosure-only provisions under SFAS No. 123, Accounting for Stock-Based Compensation.

Recognition and Retention Plan ("RRP"). The purpose of the RRP is to promote the long-term interests of the Company and its stockholders by providing restricted stock as a means for attracting and retaining directors and key employees. The maximum number of shares that may be awarded under the RRP is 338,633. The fair value of restricted stock awards are accrued ratably as compensation expense over the vesting period of the award. The amounts recognized in compensation expense were $657,000, $640,000, and $617,000 for the years ended September 30, 2008, 2007, and 2006 respectively. As of September 30, 2008, restricted stock awards of 300,344 shares of common stock were outstanding. The Company has an aggregate of 38,291 restricted shares available for future issuance under the RRP.

Restricted stock activity is summarized in the following table:

	Number of Shares	Weighted Average Fair Value at Date of Grant
Nonvested at September 30, 2005	--	$ --
Granted	307,152	11.31
Forfeited	(13,546)	12.70
Nonvested at September 30, 2006	293,606	11.31
Vested	(58,723)	11.31
Granted	5,680	15.34
Forfeited	(29,800)	11.18
Nonvested at September 30, 2007	210,763	11.44
Vested	(56,471)	11.40
Granted	30,858	11.98
Nonvested at September 30, 2008	185,150	$11.54

Stock Option and Incentive Plan ("SOP"). The Company implemented the SOP to promote the long-term interests of the Company and its stockholders by providing an incentive to directors and key employees who contribute to the operating success of the Company. The maximum number of stock options and stock appreciation rights that may be issued under the SOP is 846,580. The exercise price of each option equals the fair market value of the Company's stock on the date of grant. The options typically vest over five years and expire ten years from the date of grant. The Company has an aggregate of 54,658 stock options available for future issuance under the SOP.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the following table. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected life of options granted represents the period of time that options granted are expected to be outstanding. Expected volatilities are based on historical volatility of the Company’s stock. Expected forfeiture rate is the estimated forfeiture rate based upon the circumstances of the individuals that

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received stock options. Expected dividends represent the Company's estimated annual dividend rate over the expected life.

	Risk Free Interest Rate	Expected Life (yrs)	Expected Volatility	Expected Forfeiture Rate	Expected Dividend Yield
Options granted in 2006	4.72%	7.50	16.76%	--%	2.00%
Options granted in 2007	4.57	7.50	17.43	--	2.00
Options granted in 2008	3.85	7.50	25.41	--	2.02

Stock option activity is summarized in the following table:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Fair Value
Outstanding at September 30, 2005	660,332	$10.74	$1.83
Granted	205,059	12.94	3.02
Forfeited	(99,896)	10.74	1.83
Exercised	--	--	--
Outstanding at September 30, 2006	765,495	11.33	2.15
Granted	28,400	15.34	3.57
Forfeited	(85,848)	10.80	1.91
Exercised	(79,580)	10.74	1.83
Outstanding at September 30, 2007	628,467	11.65	2.29
Granted	83,875	11.28	3.11
Forfeited	(13,546)	10.74	1.83
Exercised	(56,420)	10.76	1.85
Outstanding at September 30, 2008	642,376	$11.71	$2.44

Options outstanding at September 30, 2008 were as follows:

	Options Outstanding				Options Exercisable		
Range of Exercise Price	Weighted Average Remaining Contractual Life (years)	Number Outstanding	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number Exercisable	Weighted Average Exercise Price	Aggregate Intrinsic Value
$10.09-10.74	7.0	364,803	$10.69	$751,960	207,724	$10.74	$417,643
11.05-11.71	8.5	64,080	11.24	96,720	13,632	11.31	19,608
12.76	9.1	25,475	12.76	--	--	--	--
13.32-13.47	7.9	159,618	13.40	--	34,048	13.47	--

15.34	8.2	28,400	15.34	--	5,680	15.34	--
		642,376		$848,680	261,084		$437,251

Cash proceeds received from the exercise of stock options were $607,000 and $854,000 for the years ended September 30, 2008 and 2007 respectively. The total intrinsic value of stock options exercised were $66,000 and $339,000 for the years ended September 30, 2008 and 2007 respectively. The amounts recognized in compensation expense were $366,000, $396,000 and $228,000 for the years ended September 30, 2008, 2007, and 2006 respectively. Tax benefits related to stock option exercises were $43,000 and $55,000 for the years ended September 30, 2008 and 2007 respectively. It is the Company’s general policy to issue new shares for the exercise of stock options.

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As of September 30, 2008, the compensation expense yet to be recognized for stock-based awards that have been awarded but not vested is as follows:

	Stock Options	Restricted Stock (in thousands)	Total Awards
2009	$325	$ 692	$1,017
2010	267	692	959
2011	134	95	229
2012	57	27	84
2013	21	10	31
Total	$804	$1,516	$2,320

Note 10 - Employee Stock Ownership Plan

In connection with the minority stock offering in 2004, the Company established an ESOP for the benefit of its employees. The ESOP covers all employees with at least one year and 1000 hours of service. Shares are released for allocation at the discretion of the Board of Directors. In 2004, the Company issued 566,137 shares of common stock to the ESOP in exchange for a ten-year note of approximately $5.0 million. These shares are expected to be released over a ten-year period. In 2007, the ESOP acquired an additional 816,000 shares of the Company's common stock in exchange for a fifteen-year note of approximately $8.2 million. These shares are expected to be released over a fifteen-year period. As shares are released from collateral, the Company will report compensation expense equal to the average market price of the shares. ESOP compensation expense included in salaries and benefits was $1.2 million, $793,000 and $681,000 for the years ended September 30, 2008, 2007, and 2006, respectively. Dividends on allocated ESOP shares reduce retained earnings; dividends on unallocated ESOP shares reduce principal or interest on the ESOP loan.

ESOP share activity is summarized in the following table:

	Unallocated ESOP Shares	Fair Value of Unallocated Shares	Allocated and Released Shares	Total ESOP Shares
Balance at September 30, 2005	509,523	$5,696,300	56,614	566,137
Allocation on September 30, 2006	(56,614)		56,614	--
Balance at September 30, 2006	452,909	6,199,600	113,228	566,137
Allocation on September 30, 2007	(56,614)		56,614	--
Balance at September 30, 2007	396,295	4,643,200	169,842	566,137
ESOP shares issued in December 2007	816,000		--	816,000
Allocation on September 30, 2008	(111,014)		111,014	--
	1,101,281	14,041,333	280,856	1,382,137

Balance at September 30,
2008 (unaudited)

From the inception of the ESOP through September 30, 2008, 22,376 shares have been taken out of the ESOP via distributions to former employees. At September 30, 2008, a total of 1,359,761 shares remained in the ESOP.

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Note 11 – Commitments and Contingencies

Lease commitments:
The Company has entered into noncancelable operating leases for land and buildings that require future minimum rental payments in excess of one year as of September 30, 2008. Certain lease payments may be adjusted periodically in accordance with changes in the Consumer Price Index. The estimated future minimum annual rental payments, exclusive of taxes and other charges, are summarized as follows:

	Year ending September 30, (in thousands)
2009	$ 474
2010	453
2011	186
2012	122
2013	81
Thereafter	1,676
Total	$ 2,992

Total rent expense for the years ended September 30, 2008, 2007, and 2006, was $509,000, $463,000 and $434,000, respectively. The Company also leases office space to others on a month-to-month basis. Total rental income was $33,000, $33,000 and $34,000 for the years ended September 30, 2008, 2007, and 2006, respectively.

Commitments to extend credit:
In the normal course of business, the Company makes various commitments and incurs certain contingent liabilities that are not presented in the accompanying financial statements. The commitments and contingent liabilities include various guarantees and commitments to extend credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the agreement. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Company upon extension of the credit, is based on management's credit evaluation of the borrower. Collateral held varies but may include securities, accounts receivable, inventory, fixed assets, and/or real estate properties. The distribution of commitments to extend credit approximates the distribution of loans outstanding.

At September 30, 2008 and 2007, commitments to extend credit were as follows:

	September 30, 2008 (in thousands)	September 30, 2007 (in thousands)
Unfunded commitments under lines of credit and letters of credit	$42,470	$37,386
Undisbursed balance of loans closed	8,197	10,324
Commitments to originate loans:		

Fixed rate	6,768	9,229
Adjustable rate	11,924	5,743
Total commitments	$69,359	$62,682

The Company estimates a reserve related to unfunded loan commitments. In assessing the adequacy of the reserve, the Company uses a similar approach used in the development of the allowance for loan losses. At September 30, 2008, the reserve for unfunded loan commitments was $170,000, which was included in other liabilities on the Consolidated Balance Sheets.

Most of the Bank’s business activity is with customers located in the State of Idaho. Loans to one borrower are generally limited, by federal banking regulation, to 15% of the Bank's regulatory capital. As of September 30, 2008 and 2007, the Bank had no individual industry concentrations of credit risk.

In connection with certain asset sales, the Bank typically makes representations and warranties about the underlying assets conforming to specified guidelines. If the underlying assets do not conform to the specifications, the Bank may have an obligation to repurchase the assets or indemnify the purchaser against loss. As of September 30, 2008, loans under warranty totaled $167.0 million, which substantially represents the unpaid principal balance of the Company's residential mortgage loans serviced for investors. The Bank believes that the potential for loss under these arrangements is remote. Accordingly, no contingent liability is recorded in the financial statements.

Note 12 - Related Party Transactions

In the normal course of business, the Company makes loans to its executive officers, directors and companies affiliated with these individuals. It is management’s opinion that loans to the Company’s officers and directors have been made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated parties and have not involved more than normal risk of collectibility. An analysis of activity with respect to loans receivable from directors, executive officers and their affiliates is as follows:

	September 30,	
	2008	2007
	(in thousands)	
Beginning balance	$872	$919
Principal advances	--	--
Principal repayments	(192)	(47)
Other changes	(620)	--
Balance, end of year	$ 60	$872

“Other changes” in the table above refers to a loan to an employee whose status was changed from an executive officer during the year.

The Company also accepts deposits from its executive officers, directors, and affiliated companies on substantially the same terms as unrelated parties. The aggregate dollar amounts of these deposits were $1.2 million and $1.4 million at September 2008 and 2007, respectively.

Note 13 - Capital Requirements

The Bank is subject to various regulatory capital requirements administered by its primary federal regulator, the Office of Thrift Supervision (“OTS”). Failure to meet the minimum regulatory capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators, that if undertaken, could have a direct material effect on the Bank and the consolidated financial statements. Under the regulatory capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines involving quantitative measures of the Bank’s assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank’s capital amounts and classifications under the prompt corrective action guidelines are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total risk-based capital and Tier 1 capital to risk-weighted assets (as defined in the regulations), Tier 1 capital to adjusted total assets (as defined), and tangible capital to adjusted total assets (as defined). As of September 2008, the Bank meets all of the capital adequacy requirements to which it is subject.

The actual and required minimum capital amounts and ratios are presented in the following table:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(in thousands)			
September 30, 2008:						
Total risk-based capital (to risk-weighted assets)	$149,803	32.84%	$36,491	≥ 8.0%	$45,614	≥ 10.0%
Tier 1 (core) capital	146,854	21.66	27,116	≥ 4.0	33,895	≥ 5.0
Tangible capital (to tangible assets)	146,854	21.66	13,558	≥ 2.0	N/A	N/A
Tier 1 risk-based capital (to risk-weighted assets)	146,783	32.18	18,245	≥ 4.0	27,368	≥ 6.0
September 30, 2007:						
Total risk-based capital (to risk-weighted assets)	$96,805	21.38%	$36,224	≥ 8.0%	$45,280	≥ 10.0%
Tier 1 (core) capital	93,736	13.56	27,654	≥ 4.0	34,568	≥ 5.0
Tangible capital (to tangible assets)	93,736	13.56	13,827	≥ 2.0	N/A	N/A
Tier 1 risk-based capital (to risk-weighted assets)	93,678	20.69	18,112	≥ 4.0	27,168	≥ 6.0

The following table is a reconciliation of the Bank's capital, calculated according to generally accepted accounting principles, to total Tier 1 capital:

	September 30, 2008	September 30, 2007
	(in thousands)	
Equity	$146,058	$91,908
Other comprehensive income – unrealized loss on securities	967	2,033
Mortgage servicing rights, net	(171)	(205)
Total Tier 1 capital	$146,854	$93,736

OTS regulations place certain restrictions on dividends paid by the Bank to the Company. Generally, savings institutions, such as the Bank, that before and after the proposed distribution are well-capitalized, may make capital distributions during any calendar year equal to up to 100% of net income for the year-to-date plus retained net income for the two preceding years. Savings institutions proposing to make any capital distribution need not submit written notice to the OTS prior to such distribution unless they are a subsidiary of a holding company or would not remain well-capitalized following the distribution.

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Note 14 - Income Taxes

The provision for income tax expense consisted of the following:

	Year Ended September 30,		
	2008	2007	2006
	(in thousands)		
Current tax expense			
Federal	$3,004	$3,461	$3,723
State	334	485	484
Deferred tax benefit			
Federal	(873)	(557)	(316)
State	(202)	(122)	(81)
Income tax expense	$2,263	$3,267	$3,810

The provision for income tax expense differs from that computed at the statutory corporate tax rate as follows:

	Year Ended September 30,		
	2008	2007	2006
	(in thousands)		
Federal income tax at statutory rates	$2,131	$2,904	$3,407
State income taxes, net of federal benefit	275	410	450
Effect of permanent differences	(143)	(47)	(47)
Income tax expense	$2,263	$3,267	$3,810

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities consist of the following:

	September 30,	
	2008	2007
	(in thousands)	
Deferred tax asset:		
Deferred compensation	$ 2,160	$ 1,878
Unrealized loss on securities available for sale	933	1,484
Allowance for loan losses	1,976	1,301
Equity compensation	476	373
Accrued expenses	191	186
Other	16	32
Total deferred tax asset	5,752	5,254
Deferred tax liability:		
Fixed asset basis	(516)	(365)
Deferred loan costs	(471)	(532)
Prepaid expenses	(172)	(139)
Mortgage servicing rights	(710)	(851)

FHLB stock dividends	(1,960)	(1,960)
Other	(153)	(162)
Total deferred tax liability	(3,982)	(4,009)
Net deferred tax asset	$ 1,770	$ 1,245

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Included in retained earnings at September 2008 and 2007 is approximately $2.1 million in bad debt reserves for which no deferred income tax liability has been recorded. This amount represents allocations of income to bad debt deductions for tax purposes only. Reduction of these reserves for purposes other than tax bad debt losses or adjustments arising from carryback of net operating losses would create income for tax purposes, which would be subject to the then-current corporate income tax rate. The unrecorded deferred liability on this amount was approximately $900,000 at September 2008 and 2007.

Note 15 – Earnings Per Share

Earnings per share ("EPS") is computed using the basic and diluted weighted average number of common shares outstanding during the period. Basic EPS is computed by dividing the Company's net income or loss by the weighted average number of common shares outstanding for the period. Diluted EPS is computed by dividing net income or loss by diluted weighted average shares outstanding, which include common stock equivalent shares outstanding using the treasury stock method, unless such shares are anti-dilutive. Common stock equivalents arise from assumed conversion of outstanding stock options and from assumed vesting of shares awarded but not released under the Company's RRP plan. ESOP shares are not considered outstanding for earnings per share purposes until they are committed to be released.

The following table presents the computation of basic and diluted earnings per share for the periods indicated:

	Year Ended September 30,		
	2008	2007	2006
	(in thousands, except share data)		
Basic earnings per share:			
Net income	$4,005	$5,271	$6,212
Weighted-average common shares outstanding	16,233,200	16,602,082	16,454,940
Basic earnings per share	$0.25	$0.32	$0.38
Diluted earnings per share:			
Net income	$4,005	$5,271	$6,212
Weighted-average common shares outstanding	16,233,200	16,602,082	16,454,940
Net effect of dilutive stock options	--	104,598	--
Net effect of dilutive RRP awards	19,547	60,539	39,528
Weighted-average common shares outstanding and common stock equivalents	16,252,747	16,767,219	16,494,468
Diluted earnings per share	$0.25	$0.31	$0.38

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Explanation of Responses:

Note 16 - Fair Value of Financial Instruments

The estimated fair values of the Company's financial instruments are as follows:

	At September 30,			
	2008		2007	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(in thousands)			
Financial Assets:				
Cash and cash equivalents	$ 23,270	$ 23,270	$ 20,588	$ 20,588
Investment in certificate of deposit	5,000	4,993	--	--
Mortgage-backed securities available for sale	188,787	188,787	162,258	162,258
Loans held for sale	2,831	2,831	4,904	4,904
Loans receivable, net	459,813	469,989	480,118	487,754
FHLB stock	9,591	9,591	9,591	9,591
Financial Liabilities:				
Demand and savings deposits	195,521	195,521	189,418	189,418
Certificates of deposit	177,404	177,550	215,191	215,576
FHLB advances	136,972	143,219	180,730	181,598

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents:
The carrying amount approximates fair value.

Mortgage-backed securities available for sale:
The fair values of mortgage-backed securities are based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans held for sale:
The carrying amount approximates fair value.

Federal Home Loan Bank stock:
The carrying value of FHLB stock approximates fair value based on the respective redemption provisions.

Loans receivable:
For variable-rate loans that re-price frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for commercial real estate and commercial loans with maturities beyond one year are estimated using a discounted cash flow analysis, utilizing interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loans with maturities less than one year are estimated to have a fair value equal to the carrying value. Fair values for impaired loans are estimated using discounted cash flow analysis or underlying collateral values, where applicable.

Deposits:
The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit maturing beyond one year is estimated using discounted cash flow analysis using the rates currently offered for deposits of similar remaining maturities. Certificates with maturities less than one year are valued at carrying values.

FHLB advances:

The fair value of the borrowings is estimated by discounting the future cash flows using the current rate at which similar borrowings with similar remaining maturities could be made.

Off-balance-sheet instruments:
Fair values of off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the borrower's credit standing. The fair value of the fees at September 30, 2008 and 2007 were insignificant.

Note 17 - Parent Only Financial Information

Home Federal Bancorp was formed to serve as the stock holding company for the Bank. The following are the condensed financial statements for Home Federal Bancorp (parent company only):

HOME FEDERAL BANCORP, INC. PARENT-ONLY BALANCE SHEETS (In thousands)	September 30, 2008	September 30, 2007
ASSETS		
Cash and amounts due from depository institutions	$ 19,707	$ 3,504
Certificate of deposit in correspondent bank	5,000	--
Mortgage-backed securities available for sale, at fair value	33,385	16,405
Investment in the Bank	146,058	91,908
Other assets	1,055	879
TOTAL ASSETS	$205,205	$112,696
LIABILITIES AND STOCKHOLDERS' EQUITY		
Other liabilities	$ 18	$ 59
Stockholder's equity	205,187	112,637
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$205,205	$112,696

HOME FEDERAL BANCORP, INC. PARENT-ONLY STATEMENTS OF INCOME (In thousands)	Year Ended September 30, 2008	Year Ended September 30, 2007	Year Ended September 30, 2006
Income:			
Investment interest	$ 526	$ 95	$ 36
Mortgage-backed security interest	1,220	768	773
Other income	347	108	119
Dividend income from the Bank	--	--	--
Total income	2,093	971	928

Expense:			
Professional services	124	125	156
Other	1,443	220	228
Total expense	1,567	345	384
Income before income taxes and equity in undistributed earnings in the Bank	526	626	544
Income tax expense	100	188	154
INCOME OF PARENT COMPANY	426	438	390
EQUITY IN UNDISTRIBUTED INCOME OF THE BANK	3,579	4,833	5,822
NET INCOME	$4,005	$5,271	$6,212

HOME FEDERAL BANCORP, INC. PARENT-ONLY STATEMENTS OF CASH FLOWS (In thousands)	Year Ended September 30, 2008	Year Ended September 30, 2007	Year Ended September 30, 2006
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 4,005	$ 5,271	$ 6,212
Adjustments to reconcile net income to cash provided by operating activities:			
Equity in undistributed earnings of the Bank	(3,579)	(4,833)	(5,822)
Net amortization of premiums on investments	29	15	17
Provision for deferred income taxes	--	--	343
ESOP shares committed to be released	1,090	436	416
Change in assets and liabilities:			
Other assets	(20)	(102)	218
Other liabilities	(41)	(8)	--
Net cash provided by operating activities	1,484	779	1,384
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from maturity of mortgage-backed securities held to maturity	--	854	1,810
Proceeds from maturity of mortgage-backed securities available for sale	4,715	2,298	1,250
Purchase of mortgage-backed securities available for sale	(22,123)	(2,102)	--
Investment in certificate of deposit	(5,000)	--	--
Loan originations and principal collections, net	4	3	3
Net cash provided (used) by investing activities	(22,404)	1,053	3,063
CASH FLOWS FROM FINANCING ACTIVITIES:			
Dividends paid	(2,987)	(1,281)	(1,225)
Intercompany borrowing, net	--	--	(1,300)
Investment in subsidiary	(48,345)	--	--
Net proceeds from stock issuance and exchange pursuant to second step conversion	87,849	--	--
Proceeds from exercise of stock options	606	854	--
Net cash provided (used) by financing activities	37,123	(427)	(2,525)
NET INCREASE IN CASH AND CASH EQUIVALENTS	16,203	1,405	1,922
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	3,504	2,099	177
CASH AND CASH EQUIVALENTS, END OF PERIOD	$19,707	$3,504	$ 2,099

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Note 18 – Selected Quarterly Financial Data (unaudited)
(In thousands, except share data)

	Quarter Ended			
	December 31, 2007	March 31, 2008	June 30, 2008	September 30, 2008
Interest and dividend income	$10,302	$10,459	$10,092	$9,730
Interest expense	5,246			