

Washington Federal.
invested here.

**Washington Federal, Inc.
Annual Report 2016.**

WASHINGTON FEDERAL, INC. AND SUBSIDIARIES
2016 ANNUAL REPORT

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BUSINESS DESCRIPTION

Washington Federal, Inc. (“Company” or “Washington Federal”) is a bank holding company headquartered in Seattle, Washington that conducts its operations through Washington Federal, National Association (“Bank”), a federally chartered national bank subsidiary.

The Company had its origins on April 24, 1917 in Ballard, Washington and this year is celebrating its *First 100 Years* in business. Washington Federal is engaged primarily in providing lending, depository, insurance and other banking services to consumers, mid-sized to large businesses, and owners and developers of commercial real estate. On November 9, 1982 the Company listed and began trading on the NASDAQ. Profitable operations have been recorded every year since and the Company is often leading the industry in important measures of financial performance such as efficiency and capital strength. Today the stock trades at 85 times its original 1982 offering price, has paid 135 consecutive quarterly cash dividends and, with cash dividends reinvested, has returned 12,177% total shareholder return to those who invested 34 years ago.

Over the years, the Company has expanded to serve banking clients in eight western states. While much has changed since its founding, one constant has been the commitment to doing business with integrity and treating employees, clients and investors fairly. Our tagline “invested here” is intended to reflect our people-first values and express the Company’s dedication to helping our neighborhoods and communities thrive.

FINANCIAL HIGHLIGHTS

As of and for the year end September 30,

| | 2016 | 2015 | % Change |
|--|---------------------------------------|---------------|----------|
| | (In thousands, except per share data) | | |
| Assets | \$14,888,063 | \$ 14,568,324 | +2.2% |
| Cash and cash equivalents | 450,368 | 284,049 | +58.6 |
| Investment securities | 849,983 | 1,117,339 | (23.9) |
| Loans receivable, net | 9,910,920 | 9,170,634 | +8.1 |
| Mortgage-backed securities | 2,490,510 | 2,906,440 | (14.3) |
| Customer accounts | 10,600,852 | 10,631,703 | (0.3) |
| FHLB advances and other borrowings | 2,080,000 | 1,830,000 | +13.7 |
| Stockholders’ equity | 1,975,731 | 1,955,679 | +1.0 |
| Net income | 164,049 | 160,316 | +2.3 |
| Diluted earnings per share | 1.78 | 1.67 | +6.6 |
| Dividends per share | 0.55 | 0.54 | +1.9 |
| Stockholders’ equity per share | 22.03 | 21.04 | +4.7 |
| Shares outstanding | 89,681 | 92,936 | (3.5) |
| Return on average stockholders’ equity | 8.33% | 8.21% | +1.5 |
| Return on average assets | 1.12 | 1.10 | 1.8 |
| Efficiency ratio (1) | 50.80 | 49.54 | +2.5 |

(1) Calculated as total operating costs divided by net interest income, plus other income (excluding non-operating gains).

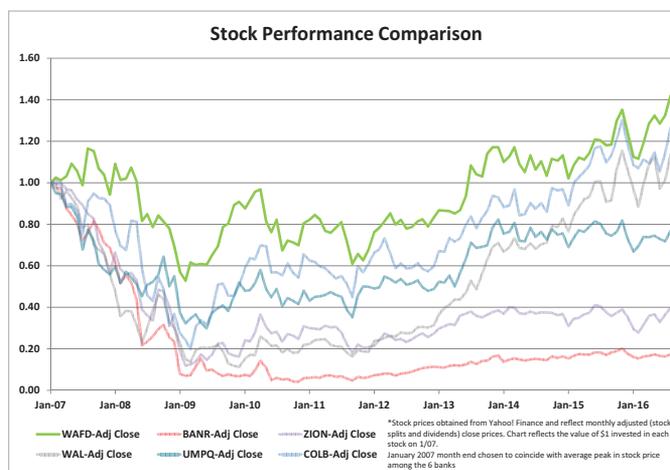
TO OUR STOCKHOLDERS

Fellow Stockholder,

It is my privilege to report that in 2016 your Company completed its ninety-ninth year in business with record results. Net income for the year totaled \$164,049,000, a 2.3% increase over prior year earnings of \$160,316,000. Earnings per share improved for the sixth year in succession to \$1.78 from \$1.67, a 6.6% increase from fiscal 2015 and also the highest in our history. It was a great year in virtually all regards. Washington Federal has now reported profitable operations to shareholders for 34 consecutive years since our initial public offering in 1982.

The strong financial performance of the Company translated to healthy rewards for shareholders, with total return for the year of 19.69%. In January, the cash dividend increased by 7.7% to fourteen cents per share. Contributing to increasing shareholder returns over the last few years has been our disciplined approach to repurchasing shares. During the fiscal year, 3,867,563 shares, representing 4.16% of those outstanding, were repurchased at a weighted average price of \$22.72, and in September the Board of Directors approved an additional five million shares for the program. We believe that repurchase of our stock continues to be a viable alternative for excess capital, although investment in growth is always preferable. I'd like to call your attention to the accompanying chart that compares the performance of the Company's stock to some of the peer banks within our market going back to the onset of the last recession. The chart visually displays the value of long-term thinking and our conservative approach to financial management.

Several operational accomplishments contributed to our good results. For example, one of our key strategies is to diversify the loan portfolio by increasing the volume of loans originated for business purposes. I am pleased to report that management delivered on the strategy as commercial loans represented nearly 70% of all new loan originations, which totaled a record \$3.9 billion. We favor commercial over consumer loans at present for two reasons: 1) Reduced exposure to rising interest rates due to shorter terms and floating rates, and 2) Fewer regulatory burdens as commercial borrowers are presumed by the government to be sophisticated. Consumer loans outstanding are centered in plain vanilla, thirty-year fixed-rate mortgages that we originate for our own portfolio. Mortgage lending is still a large part of our business and remains very important to our long-term prosperity. That portfolio is composed of the highest quality loans we place on the books, and has historically been a source of earnings stability during recessionary periods. We are in the mortgage business for the long haul.



We also made substantial progress toward the goal of improving the bank's deposit mix. Ten years ago certificates of deposit ("CDs") represented nearly 80% of total deposits. At September 30th, the funding concentration in CDs had been reduced to 43%. Our goal is to increase transaction accounts until CDs represent 20% or less of total deposits. While more expensive to service, transaction accounts are a more stable source of funds over time and through business cycles.

A strong capital position is the keystone of our financial management philosophy. Like equity in your own home, the capital on our balance sheet allows us to operate with less debt and enhances our financial stability. Our conservative approach has always led us to hold more capital than other banks of similar size. We know that there is a measurable cost of underleveraged capital during periods of economic prosperity, but we have yet to develop a formula that can tell us exactly the right amount of cushion needed to get through the next recession. We gladly pay a reasonable opportunity cost in times of economic expansion to insure that Washington Federal will be standing strong after the next crisis passes, just as we were after the Great Recession. At fiscal year-end, SNL, an independent bank rating agency, listed Washington Federal as having the strongest capital position among the 100 largest banks in the United States after adjusting for the riskiness of assets.

TO OUR STOCKHOLDERS (CONTINUED)

The primary driver of profits in our business is known as Net Interest Income, which is the net difference between interest income from earning assets and interest expense paid for funding. Despite ultra low yields on loans and investments, Net interest Income improved by \$6.8 million over the prior year. The improvement was accomplished largely by shifting funds from lower yielding investments to higher yielding loans. We have also worked tenaciously over the last several years to position the Company to benefit somewhat from higher interest rates. Should both long and short term rates move higher in tandem, we expect that Net Interest Income would improve.

Our business model has historically focused on margin and therefore has not generated a prodigious amount of fee income. Although Other Income increased during the past year, this is one area that holds prospects for improved performance. One strategic initiative will add significant economic value to our consumer checking products that we believe clients will welcome with a willingness to pay. Another opportunity is to begin collecting fees that we chose to forego last year due to the impact to clients of the system conversion described below. Lastly, we hope to continue to grow our insurance revenues.

Expenses increased from the prior year by \$10.6 million, generally due to higher spending on technology early in the fiscal year, although costs are now trending lower. Our efficiency ratio, a measure of pennies spent to produce one dollar of revenue, amounted to 50.8%; a high ratio by our standards yet still among the best in the industry. We expect the efficiency ratio to improve this year, although investors should know that cost pressures, particularly labor related expenses, are increasing.

Finally, net income was bolstered by several events, including a \$10 million pre-tax gain on the sale of real estate owned. Improved asset quality also enabled the Company to recapture \$6.3 million in expense previously taken for expected loan losses that did not materialize. It seems each year we experience some unexpected gains and that may continue; however, investors should be aware that there is always the potential for non-recurrence. The sum of the parts enabled Return on Assets to increase to 1.12%, versus 1.10% in the prior year, while Return on Equity increased from 8.21% to 8.33%.

Financial results were especially impressive given that the first half of the fiscal year found management attention laser-focused on the conversion of virtually all of the Company's operating systems. Planning, implementation and the subsequent cleanup activities were incredibly intense and did not really abate until the end of the second fiscal quarter, leaving many of my colleagues in need of a well-earned vacation. The project was a terrific team building experience though that created great confidence in our ability to execute on even the biggest and most complex tasks. Improving our competitiveness, the new systems provide real time processing consistent with the expectation of today's market, and should also provide growth capacity for at least a generation. The total upgrade investment amounted to approximately \$40 million and will increase the baseline cost of information technology expense by \$2-3 million per year. Technology continues to advance, so ongoing investment will be needed to maintain competitive products and provide for ever-improving security measures to protect sensitive client information. The conversion did entail some disruption and we are ever so thankful to our clients for their patience with this process.

Although we wish that the endless rulemaking driven by Congress would stop, we appreciate our regulators and believe that over time we have built a relationship of mutual trust that makes it easier for all of us to function within an amazingly complex environment. This year a brief comment on our consumer sales practices is necessary in light of well-publicized shortcomings found at another institution. Investors and clients alike should know that our branch personnel have never operated on commission, and do not face hard cross-selling goals. Rather, they are trained to have conversations with our clients to identify needs that can be matched against the benefits of our products. They are also trained that accounts are to be opened and fee services provided only when the client both wants *and* needs them. Our view has always been that if we simply treat people fairly and conduct business with integrity, in the long run the world will find a path to our door. For the sake of society, I hope that we're right.

This year there have been some executive management changes that deserve acknowledgement. Executive Vice Presidents Linda Brower, Tom Kasanders and Jack Jacobson have been virtually indispensable in building our capabilities over the past many years. As Chief Administrative Officer, Linda transformed our back office operations to support a much larger and more complex institution than she found, while Tom and Jack led unprecedented growth in the Business Banking and Commercial Real Estate segments, respectively. Their retirements come too soon for me, but are healthy for the organization as they open new opportunities for those they have trained so well for succession. On behalf of everyone at Washington Federal, I thank them for their professionalism, hard work, support and friendship and wish them the very best futures. I also wish to acknowledge and congratulate Brent Beardall for his title promotion. In July, he became only the sixth person in nearly a century to be awarded the title of President.



We also continue to update and diversify the Board of Directors. In September we added Erin Lantz to the Board. Erin is Vice President and General Manager of Mortgages at Zillow Group, Inc. She brings deep knowledge of the entire home buying and financing process, along with a keen understanding of consumer behaviors and the value of big data. I look forward to introducing her to you at the upcoming Annual Meeting.

Looking to the future, prospects for growth in our core business are as promising as they've been in some time. The Company is in great shape financially, with the deepest management bench in our long history. New systems are stable and being steadily enhanced, asset quality is nearing historic highs, the pipeline for lending activity is robust and most of our Western U.S markets are prosperous and experiencing faster than average growth. While we haven't forgotten the hard lessons of the last economic downturn, it's exciting to have the systems, leadership and financial wherewithal to be once again focused on growth and service to our clients as we celebrate our First 100 Years. We won't be here to see it, but as always we'll go about our business with a spirit of stewardship intended to enable a future generation to have a chance at celebrating the Second 100 Years.

In closing, allow me to thank the Board of Directors and my colleagues on the Executive Management Committee and throughout our eight state territory for their hard work and support of the Company's values throughout a very interesting, challenging and in the end, a most rewarding year.

I look forward to seeing you at the Sheraton Hotel in downtown Seattle on January 18, 2017 at 2:00 P.M for the Annual Meeting of Shareholders. In the meantime, you can help our business grow and prosper by referring your friends, neighbors and the businesses you associate with to Washington Federal for all their banking needs.

Sincerely,

Roy M. Whitehead

Roy M. Whitehead
Chairman of the Board and Chief Executive Officer

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

We make statements in this Annual Report that constitute forward-looking statements. Words such as “expects,” “anticipates,” “believes,” “estimates,” “intends,” “forecasts,” “projects” and other similar expressions as well as future or conditional verbs such as “will,” “should,” “would” and “could” are intended to help identify such forward-looking statements. These statements are not historical facts, but instead represent current expectations, plans or forecasts of the Company and are based on the beliefs and assumptions of the management of the Company and the information available to management at the time that these disclosures were prepared. The Company intends for all such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and the provisions of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are not guarantees of future results or performance and involve certain risks, uncertainties and assumptions that are difficult to predict and often are beyond the Company’s control. Actual outcomes and results may differ materially from those expressed in, or implied by, the Company’s forward-looking statements.

You should not place undue reliance on any forward-looking statement and should consider the following uncertainties and risks, as well as the risks and uncertainties discussed elsewhere in this report, including under “Item 1A. Risk Factors” contained in our Form 10-K and in any of the Company’s other subsequent Securities and Exchange Commission filings, which could cause our future results to differ materially from the plans, objectives, goals, estimates, intentions, and expectations expressed in forward-looking statements:

- a deterioration in economic conditions, including declines in the real estate market and home sale volumes and financial stress on borrowers as a result of the uncertain economic environment;
- economic downturn, including high unemployment rates and declines in housing prices and property values;
- the effects of and changes in monetary and fiscal policies of the Board of Governors of the Federal Reserve System and the U.S. Government;
- fluctuations in interest rate risk and changes in market interest rates;
- the Company’s ability to make accurate assumptions and judgments about the collectability of its loan portfolio, including the creditworthiness of its borrowers and the value of the assets securing these loans;
- the Company’s ability to successfully complete merger and acquisition activities and realize expected strategic and operating efficiencies associated with such activities;
- the Company’s ability to manage its expenses to remain at levels that are appropriate for its business activities and their level of complexity;
- legislative and regulatory limitations, including those arising under the Dodd-Frank Wall Street Reform Act and potential limitations in the manner in which we conduct our business and undertake new investments and activities;
- the ability of the Company to obtain external financing, including client deposits and wholesale borrowing sources, to fund its operations or obtain this financing on favorable terms;
- changes in other economic, competitive, governmental, regulatory, and technological factors affecting the Company’s markets, operations, pricing, products, services and fees;
- the ability of the Company to identify and mitigate information security risks;
- the success of the Company at managing the risks involved in the foregoing and managing its business; and
- the timing and occurrence or non-occurrence of events that may be subject to circumstances beyond the Company’s control.

All forward-looking statements speak only as of the date on which such statements are made, and Washington Federal undertakes no obligation to update or revise any forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events, changes to future operating results over time, or the impact of circumstances arising after the date the forward-looking statement was made.

GENERAL

Washington Federal, Inc. is a Washington corporation headquartered in Seattle, Washington. The Company is a bank holding company that conducts its operations through a national bank subsidiary, Washington Federal, National Association. The Bank is principally engaged in the business of attracting deposits from the general public and investing these funds, together with borrowings and other funds, in commercial and consumer loans. As used throughout this document, the terms “Washington Federal” or the “Company” refer to Washington Federal, Inc. and its consolidated subsidiaries and the term “Bank” refers to the operating subsidiary Washington Federal, National Association.

The Company’s fiscal year end is September 30th. All references to 2016, 2015 and 2014 represent balances as of September 30, 2016, September 30, 2015 and September 30, 2014, or activity for the fiscal years then ended.

CRITICAL ACCOUNTING POLICIES

Preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions that affect reported amounts of certain assets, liabilities, revenues and expenses in the Company’s consolidated financial statements. Accordingly, estimated amounts may fluctuate from one reporting period to another due to changes in assumptions underlying estimated values.

The Company has determined that the only accounting policy critical to an understanding of the consolidated financial statements of Washington Federal relates to the methodology for determining the amount of the allowance for loan losses. The Company maintains an allowance to absorb losses inherent in the loan portfolio. The allowance is based on ongoing, quarterly assessments of the probable and estimable losses inherent in the loan portfolio.

The general loan loss allowance is established by applying a loss percentage factor to the different loan types. For example, residential real estate loans are not individually analyzed for impairment and loss exposure because of the significant number of loans, their relatively small balances and their historically low level of losses. See the “Asset Quality and Allowance for Loan Losses” section below for additional information about establishing the loss factors. Specific allowances may be established for loans that are individually evaluated.

INTEREST RATE RISK

The primary source of income for the Company is net interest income, which is the difference between the interest income generated by interest-earning assets and the interest expense incurred for interest-bearing liabilities. The level of net interest income is a function of the average balance of interest-earning assets and interest-bearing liabilities and the difference between the yield on earning assets and the cost of interest-bearing liabilities. Both the pricing and mix of the Company’s interest-earning assets and interest-bearing liabilities influence these factors. All else being equal, if the interest rates on the Company’s interest-bearing liabilities increase at a faster pace than the interest rates on its interest-earning assets, the result would be a reduction in net interest income and with it, a reduction in net earnings.

Based on Management’s assessment of the current interest rate environment, the Company has taken steps, including growing shorter-term loans and transaction deposit accounts, investing in variable-rate securities and extending the maturity on borrowings, to position the Company for changing interest rates.

The Company’s balance sheet strategy, in conjunction with low operating costs, has allowed the Company to manage interest rate risk, within guidelines established by the Board, through all interest rate cycles. It is management’s objective to grow the dollar amount of net interest income, through the rate cycles, acknowledging that there will be some periods of time when that will not be feasible.

Management relies on various measures of interest rate risk, including modeling of changes in the Company’s forecasted net interest income under various rate change scenarios, the impact of interest rate changes on the net portfolio value (“NPV”) and an asset/liability maturity gap analysis.

Net Interest Income Sensitivity. We estimate the sensitivity of our net interest income to changes in market interest rates using an interest rate simulation model that includes assumptions related to the level of balance sheet growth, deposit repricing characteristics and the rate of prepayments for multiple interest rate change scenarios. Interest rate sensitivity depends on certain repricing characteristics in our interest-earnings assets and interest-bearing liabilities, including the maturity structure of assets and liabilities and their repricing characteristics during the periods of changes in market interest rates. The analysis assumes a constant balance sheet. Actual results would differ from the assumptions used in this model, as Management monitors and adjusts loan and deposit pricing and the size and composition of the balance sheet to respond to changing interest rates.

In the event of an immediate and parallel increase of 200 basis points in both short and long-term interest rates, the model estimates that net interest income would increase by 3.2% in the next year. This compares to an estimated decrease of 2.2% as of the September 30, 2015 analysis. It is noted that a flattening yield curve where the spread between short-term rates and long-term rates decreases would likely result in lower net interest income. However, Management estimates that a gradual increase of 300 basis points in short term rates and 100 basis points in long term rates over two years would result in a net interest income increase of 2.1% in the first year and increase of 4.4% in the second year assuming a constant balance sheet and no management intervention.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

NPV Sensitivity. The NPV is an estimate of the market value of shareholders' equity at a point in time. It is derived by calculating the difference between the present value of expected cash flows from interest-earning assets and the present value of expected cash flows from interest-paying liabilities and off-balance-sheet contracts. The sensitivity of the NPV to changes in interest rates provides a longer term view of interest rate risk as it incorporates all future expected cash flows. As of September 30, 2016, in the event of an immediate and parallel increase of 200 basis points in interest rates, the NPV is estimated to decline by \$479 million or 18.6% and the NPV to total assets ratio to decline to 14.8% from a base of 16.9%. As of September 30, 2015, the NPV in the event of a 200 basis point increase in rates was estimated to decline by \$536 million or 19.7% and the NPV to total assets ratio to decline to 15.9% from a base of 18.4%. The decreased NPV sensitivity and lower base NPV ratio is primarily due to lower interest rates as of September 30, 2016.

Repricing Gap Analysis. At September 30, 2016, the Company had approximately \$1.5 billion more in liabilities subject to maturity or repricing in the next year than assets, which resulted in a one-year repricing gap of (10.1)% of total assets. This compares to the (13.4)% gap as of September 30, 2015. A negative repricing gap implies that funding costs will change more rapidly than interest income on earning assets with movements in interest rates. A negative repricing gap typically results in lower margins when interest rates rise and higher margins when interest rates decline. The interest rate gap analysis provides management with a high-level indication of interest rate risk, but it is considered less reliable than more detailed modeling. Cash and cash equivalents of \$450 million and stockholders' equity of \$2.0 billion provide management with additional flexibility in managing interest rate risk going forward.

The following table shows the estimated repricing periods for earning assets and paying liabilities:

| September 30, 2016 | Repricing Period | | | Total |
|--|------------------|-------------------------------|--------------|---------------|
| | Within One Year | After 1 year - before 6 Years | Thereafter | |
| | (In thousands) | | | |
| Earning Assets (1) | \$ 5,095,776 | \$ 4,885,359 | \$ 3,763,346 | \$ 13,744,481 |
| Paying Liabilities (2) | (6,599,318) | (3,922,868) | (2,174,161) | (12,696,347) |
| Excess (Liabilities) Assets | \$ (1,503,542) | \$ 962,491 | \$ 1,589,185 | |
| Excess as % of Total Assets | (10.10)% | | | |
| Policy limit for one year excess | (20.00)% | | | |

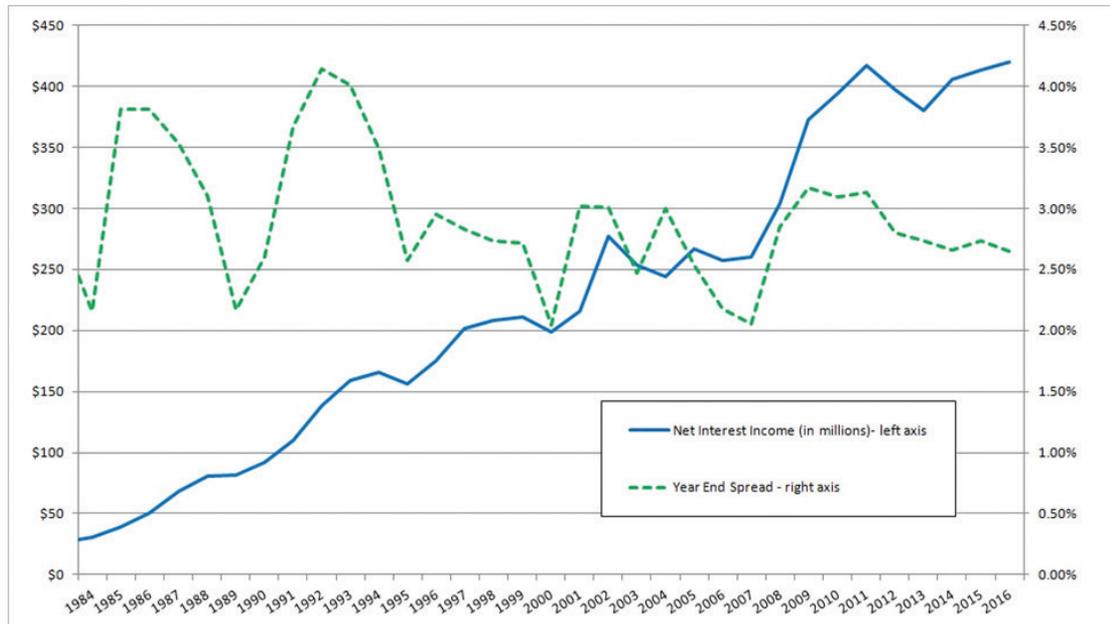
(1) Asset repricing period includes estimated prepayments based on historical activity.

(2) Liability repricing includes estimated duration of non-maturity deposits.

Interest Rate Spread. The interest rate spread is measured as the difference between the rate on total loans and investments and the rate on costing liabilities at the end of each period. The interest rate spread decreased to 2.65% at September 30, 2016 from 2.73% at September 30, 2015. The spread decrease of 8 basis points is primarily due to payoffs of loans at generally higher interest rates and new loan originations being at lower interest rates, as well as an increase in the proportion of funding provided by FHLB advances at rates higher than the average cost of customer deposits. As of September 30, 2016, the weighted average rate on loans, mortgage backed securities and investments decreased by 5 basis points to 3.58% compared to September 30, 2015, while the weighted average cost of funds increased by 3 basis point to 0.93%.

| | SEP 2016 | JUN 2016 | MAR 2016 | DEC 2015 | SEP 2015 | JUN 2015 | MAR 2015 | DEC 2014 |
|---|----------|----------|----------|----------|----------|----------|----------|----------|
| Interest rate on loans and mortgage-backed securities | 3.86% | 3.92% | 3.94% | 3.90% | 3.94% | 3.96% | 4.10% | 4.14% |
| Interest rate on investment securities | 1.25 | 1.17 | 1.29 | 1.25 | 1.19 | 1.12 | 0.94 | 1.02 |
| Combined earning assets | 3.58 | 3.61 | 3.69 | 3.61 | 3.63 | 3.61 | 3.63 | 3.68 |
| Interest rate on customer accounts | 0.50 | 0.51 | 0.50 | 0.48 | 0.48 | 0.48 | 0.48 | 0.50 |
| Interest rate on borrowings | 3.15 | 3.13 | 3.23 | 3.20 | 3.35 | 3.43 | 3.49 | 3.49 |
| Combined cost of funds | 0.93 | 0.94 | 0.93 | 0.90 | 0.90 | 0.90 | 0.92 | 0.94 |
| Interest rate spread | 2.65% | 2.67% | 2.76% | 2.71% | 2.73% | 2.71% | 2.71% | 2.74% |

The chart below shows the volatility of our period end net interest spread (dashed line measured against the right axis) compared to the relatively consistent growth in net interest income (solid line measured against the left axis). The relative consistency of net interest income is accomplished by actively managing the size and composition of the balance sheet through different rate cycles.



Net Interest Margin. The net interest margin is measured using the interest income and expense over the average assets and liabilities for the period. The net interest margin increased to 3.11% for the year ended September 30, 2016 from 3.08% for the year ended September 30, 2015. The yield on earning assets increased 2 basis points to 3.97% and the cost of interest bearing liabilities declined by 1 basis point to 0.93%. The higher yield on earning assets is the result of changes in the asset mix as the average balance of mortgage-backed securities and other investment securities decreased while the average balance of loans receivable increased. The decrease in interest cost was due to changes in the mix of customer deposits and FHLB advances.

For the year ended September 30, 2016, average earning assets increased by 0.6% to \$13,530,558,000, up from \$13,444,499,000 for the year ended September 30, 2015. During 2016, average loans receivable increased \$912,916,000 or 10.6%, while the combined average balances of mortgage backed securities, other investment securities and cash decreased by \$802,078,000 or 17.0%. Management views organic loan growth as the highest and best use of capital, thus the shift in earning assets away from investment securities and into loans receivable is seen as beneficial.

During 2016, average customer deposit accounts decreased \$66,870,000 or 0.6% and the average balance of borrowings increased by \$143,530,000 or 7.8% from 2015.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

The following table sets forth the information explaining the changes in the net interest income and net interest margin for 2016 compared to the prior year.

| | Twelve Months Ended September 30, 2016 | | | Twelve Months Ended September 30, 2015 | | |
|--|---|-------------------|-----------------|---|-------------------|-----------------|
| | Average Balance | Interest | Average Rate | Average Balance | Interest | Average Rate |
| | (In thousands) | | | (In thousands) | | |
| Assets | | | | | | |
| Loans and covered loans | \$ 9,511,351 | \$ 454,085 | 4.77% | \$ 8,598,435 | \$ 437,002 | 5.08% |
| Mortgaged-backed securities . . . | 2,737,947 | 62,949 | 2.30 | 3,073,180 | 71,392 | 2.32 |
| Cash & Investments | 1,167,596 | 16,282 | 1.39 | 1,634,441 | 20,363 | 1.25 |
| FHLB & FRB stock | 113,664 | 3,477 | 3.06 | 138,443 | 1,796 | 1.30 |
| Total interest-earning assets . . . | 13,530,558 | 536,793 | 3.97% | 13,444,499 | 530,553 | 3.95% |
| Other assets | 1,181,975 | | | 1,102,827 | | |
| Total assets | <u>\$ 14,712,533</u> | | | <u>\$ 14,547,326</u> | | |
| Liabilities and Equity | | | | | | |
| Customer accounts | \$ 10,589,817 | \$ 52,485 | 0.50% | \$ 10,656,687 | \$ 51,054 | 0.48% |
| FHLB advances | 1,992,434 | 64,059 | 3.22 | 1,848,904 | 66,018 | 3.57 |
| Total interest-bearing liabilities | 12,582,251 | 116,544 | 0.93% | 12,505,591 | 117,072 | 0.94% |
| Other liabilities | 161,446 | | | 89,140 | | |
| Total liabilities | 12,743,697 | | | 12,594,731 | | |
| Stockholders' equity | 1,968,836 | | | 1,952,595 | | |
| Total liabilities and equity | <u>\$ 14,712,533</u> | | | <u>\$ 14,547,326</u> | | |
| Net interest income | | <u>\$ 420,249</u> | | | <u>\$ 413,481</u> | |
| Net interest margin | | | <u>3.11%</u> | | | <u>3.08%</u> |

ASSET QUALITY & ALLOWANCE FOR LOAN LOSSES

The Company maintains an allowance to absorb losses inherent in the loan portfolio. The amount of the allowance is based on ongoing, quarterly assessments of the probable and estimable losses inherent in the loan portfolio. The Company's methodology for determining the appropriateness of the allowance is primarily based on a general allowance methodology and also includes specific allowances. The Company also has a reserve for unfunded commitments.

The loan loss allowance is primarily established by applying a loss percentage factor to the different loan types. Management believes loan types are the most relevant factor in the allowance calculation for groups of homogeneous loans as the risk characteristics within these groups are similar. The loss percentage factor is made up of two parts - the historical loss factor ("HLF") and the qualitative loss factor ("QLF").

The HLF takes into account historical charge-offs by loan type. The Company uses a 10 year average of historical loss rates for each loan category multiplied by an estimated loss emergence period. The loss emergence period is the likely period of time during which a residential or commercial loan borrower experiencing financial difficulties might be utilizing their cash reserves prior to becoming delinquent on their loan, plus the period of time that it takes the bank to work out the loans. The Company's use of a 10 year average is intended to encompass a full credit cycle.

The QLF is based on management's continuing evaluation of the pertinent factors underlying the quality of the loan portfolio, including changes in the size and composition of the loan portfolio, actual loan loss experience, delinquency trends, current economic conditions, collateral values, geographic concentrations, seasoning of the loan portfolio, specific industry conditions, and the duration of the current business cycle. These factors are considered by loan type. Single family residential loan sub-types are evaluated in groups by loan to value, non-owner or owner-occupied, and delinquency status. Credit quality has been improving in most loan categories during the year, but at different paces. In addition, loan growth or declines for each loan category are taken into consideration.

The total allowance for loan loss increased by \$6,665,000, or 6.2% from \$106,829,000 as of September 30, 2015 to \$113,494,000 at September 30, 2016. As of September 30, 2016, the Company had \$366,000 of specific reserves for individually evaluated loans and the remaining balance of \$113,128,000 is general allowance, which was comprised of \$89,918,000 related to HLF and \$23,210,000 related to qualitative factors. The Company released \$6,400,000 of allowance for loan losses in 2016 due in large part to net recoveries of previously charged off loans of \$13,065,000. This was comprised of \$19,065,000 in recoveries and \$6,000,000 in charge offs in 2016.

The ratio of the allowance for loan losses and reserves for unfunded commitments to total gross loans decreased to 1.07% as of September 30, 2016 from 1.13% as of September 30, 2015 due to the combination of improving credit quality and loan growth.

The reserve for unfunded commitments was \$3,235,000 as of September 30, 2016 compared to \$3,085,000 as of September 30, 2015.

The recovery of the carrying value of loans is susceptible to future market conditions beyond the Company's control, which may result in losses or recoveries differing from those estimated.

Restructured loans. Restructured single-family residential loans are reserved for under the Company's loan loss reserve methodology. Most troubled debt restructured ("TDR") loans are accruing and performing loans where the borrower has proactively approached the Company about modifications due to temporary financial difficulties. Each request is individually evaluated for merit and likelihood of success. As of September 30, 2016, single-family residential loans comprised 87.2% of restructured loans. The concession for these loans is typically a payment reduction through a rate reduction of 100 to 200 bps for a specific term, usually six to twelve months. Interest-only payments may also be approved during the modification period.

Outstanding TDRs decreased to \$261,531,000 as of September 30, 2016 from \$302,713,000 as of the prior year end. As of September 30, 2016, 96.2% of the restructured loans were performing. During 2016, there were additions of \$27,184,000 and reductions of \$68,366,000 due to prepayments and transfers to real estate owned ("REO").

Concessions for construction, land A&D and multi-family loans are typically an extension of maturity combined with a rate reduction of normally 100 bps. Before granting approval to modify a loan in a TDR, a borrower's ability to repay is considered by evaluating its current income levels, debt to income ratio, credit score, loan payment history, and an updated evaluation of the secondary repayment source.

If a loan is on non-accrual status before becoming a TDR it will stay on non-accrual status following restructuring until it has been performing for at least six months, at which point it may be moved to accrual status. If a loan is on accrual status before it becomes a TDR, and it is concluded that a full repayment is highly probable, it will remain on accrual status following restructuring. If the homogeneous restructured loan does not perform, it is placed in non-accrual status when it is 90 days delinquent. For commercial loans, six consecutive payments on newly restructured loan terms are required prior to returning the loan to accrual status. After the required six consecutive payments are made, a management assessment may conclude that collection of the entire principal and interest due is still in doubt. In those instances, the loan will remain on non-accrual. A loan that defaults and is subsequently modified would impact the Company's delinquency trend, which is part of the QLF component of the general reserve calculation. Any modified loan that re-defaults and is charged-off would impact the HLF component of our general reserve calculation.

Non-performing assets. Non-performing assets were \$71,441,000, or 0.48% of total assets, at September 30, 2016 compared to \$128,908,000, or 0.88% of total assets, at September 30, 2015.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

The following table provides detail related to the Company's non-performing assets.

| Non-Performing Assets | September 30, | | \$ Change | % Change |
|--|---------------|------------|-------------|----------|
| | 2016 | 2015 | | |
| (In thousands) | | | | |
| Non-accrual loans: | | | | |
| Single-family residential | \$ 33,148 | \$ 59,074 | \$ (25,926) | (43.9)% |
| Construction | — | 754 | (754) | (100.0) |
| Construction – custom | — | 732 | (732) | (100.0) |
| Land – acquisition & development (A&D) | 58 | — | 58 | N/M |
| Land – consumer lot loans | 510 | 1,273 | (763) | (59.9) |
| Multi-Family | 776 | 2,558 | (1,782) | (69.7) |
| Commercial real estate | 7,100 | 2,176 | 4,924 | 226.3 |
| Commercial & industrial | 583 | — | 583 | N/M |
| HELOC | 239 | 563 | (324) | (57.5) |
| Consumer | — | 680 | (680) | (100.0) |
| Total non-accrual loans | 42,414 | 67,810 | (25,396) | (37.5) |
| Real estate owned | 29,027 | 61,098 | (32,071) | (52.5) |
| Total non-performing assets | \$ 71,441 | \$ 128,908 | \$ (57,467) | (44.6)% |

The ratio of the allowance for loan losses to non-accrual loans increased to 267.59% as of September 30, 2016 from 157.54% as of September 30, 2015. This is primarily due to the 37.5% decrease in non-accrual loans.

LIQUIDITY AND CAPITAL RESOURCES

The principal sources of funds for the Company's activities are loan repayments, net deposit inflows, repayments and sales of investments, borrowings and retained earnings. Washington Federal's principal sources of revenue are interest on loans and interest and dividends on investments.

The Company's net worth at September 30, 2016 was \$1,975,731,000 or 13.27% of total assets as compared to \$1,955,679,000 or 13.42% of total assets at September 30, 2015. The Company's net worth was impacted in the year by net income of \$164,049,000, the payment of \$49,926,000 in cash dividends, treasury stock purchases that totaled \$87,850,000, as well as a decrease in accumulated other comprehensive income (loss) of \$11,509,000. The Company paid out 30.4% of its 2016 earnings in cash dividends to common shareholders, compared with 31.9% last year. For the year ended September 30, 2016, the Company returned 88.7% of net income to shareholders in the form of cash dividends, stock repurchases and warrant repurchases as compared to 110.9% for the year ended September 30, 2015. Management believes the Company's strong net worth position allows it to manage balance sheet risk and provide the capital support needed for controlled growth in a regulated environment.

The Bank has a credit line with the Federal Home Loan Bank of Des Moines ("FHLB") equal to 49.0% of total assets, providing a substantial source of additional liquidity if needed. The level of FHLB stock held varies depending on the amount of advances and other activities with the FHLB. As of September 30, 2016, the Bank had \$2,391,411,000 of additional borrowing capacity at the FHLB.

The Bank has entered into borrowing agreements with the FHLB to borrow funds under a short-term floating rate cash management advance program and fixed-rate term loan agreements. All borrowings are secured by stock of the FHLB, deposits with the FHLB, and a blanket pledge of qualifying loans receivable as provided in the agreements with the FHLB.

The Company's cash and cash equivalents were \$450,368,000 at September 30, 2016, which is an 58.6% increase from the balance of \$284,049,000 as of the prior year end. See "Interest Rate Risk" above and the "Statement of Cash Flows" included in the financial statements for details regarding this change.

CHANGES IN FINANCIAL CONDITION

Available-for-sale and held-to-maturity securities. Available-for-sale securities decreased \$457,669,000, or 19.23%, during the year ended September 30, 2016 to \$1,922,894,000 due to principal repayments of \$537,255,000 and the sale of \$50,741,000 of available-for-sale securities that were partially offset by purchases of \$137,591,000 of available-for-sale securities. As of September 30, 2016, the Company had a net unrealized gain on available-for-sale securities of \$13,710,000, which is recorded net of tax as part of stockholders' equity.

Held-to-maturity securities declined by \$225,617,000, or 13.73%, during the year ended September 30, 2016 to \$1,417,599,000 due to paydowns and maturities. There were no held to maturity securities purchased or sold during the year ended September 30, 2016. Rising interest rates may cause these securities to be subject to unrealized losses. As of September 30, 2016, the net unrealized gain on held-to-maturity securities was \$23,957,000, which management attributes to the change of interest rates since acquisition.

Loans receivable. Loans receivable, net of related contra accounts, increased \$740,286,000, or 8.1%, to \$9,910,920,000 at September 30, 2016, from \$9,170,634,000 one year earlier. This increase resulted primarily from record high originations of \$3,948,534,000, which represented a 27.2% increase over originations in the prior year. There were also loan purchases of \$105,420,000 during the year ended September 30, 2016. Commercial loan originations accounted for 69.1% of total originations and consumer originations were 30.9%. The significant increase in loan origination resulted from a strategic emphasis on commercial lending, coupled with growing economies in all major markets. Loan repayments for 2016 totaled \$2,935,167,000, a \$516,620,000 or 21.4% increase from the total repayments of \$2,418,547,000 in 2015. Loan repayments continue to be relatively high due to the ongoing historically low interest rate environment.

The following table presents the gross loan balances by category and the year over year change.

| | September 30, 2016 | | September 30, 2015 | | Change | |
|---|---------------------|--------------|---------------------|--------------|-------------------|---------------|
| | (In thousands) | | (In thousands) | | \$ | % |
| Non-Acquired loans | | | | | | |
| Single-family residential | \$ 5,621,066 | 51.3% | \$ 5,651,845 | 57.5% | \$ (30,779) | (0.5)% |
| Construction | 1,110,411 | 10.1 | 200,509 | 2.0 | 909,902 | 453.8 |
| Construction - custom | 473,069 | 4.3 | 396,307 | 4.0 | 76,762 | 19.4 |
| Land - acquisition & development | 116,156 | 1.1 | 94,208 | 1.0 | 21,948 | 23.3 |
| Land - consumer lot loans | 101,853 | 0.9 | 103,989 | 1.1 | (2,136) | (2.1) |
| Multi-family | 1,118,801 | 10.2 | 1,125,722 | 11.5 | (6,921) | (0.6) |
| Commercial real estate | 956,164 | 8.7 | 986,270 | 10.0 | (30,106) | (3.1) |
| Commercial & industrial | 946,648 | 8.6 | 612,836 | 6.2 | 333,812 | 54.5 |
| HELOC | 134,785 | 1.2 | 127,646 | 1.3 | 7,139 | 5.6 |
| Consumer | 137,450 | 1.3 | 194,655 | 2.0 | (57,205) | (29.4) |
| Total non-acquired loans | 10,716,403 | 97.9% | 9,493,987 | 96.6% | 1,222,416 | 12.9% |
| Acquired loans | 115,394 | 1.1 | 166,293 | 1.7 | (50,899) | (30.6) |
| Credit impaired acquired loans | 89,837 | 0.8 | 87,081 | 0.9 | 2,756 | 3.2 |
| Covered loans | 28,974 | 0.3 | 75,909 | 0.8 | (46,935) | (61.8) |
| Total gross loans | 10,950,608 | 100% | 9,823,270 | 100% | 1,127,338 | 11.5% |
| Less: | | | | | | |
| Allowance for probable losses . . . | 113,494 | | 106,829 | | 6,665 | 6.2 |
| Loans in process | 879,484 | | 476,796 | | 402,688 | 84.5 |
| Discount on acquired loans | 11,306 | | 30,095 | | (18,789) | (62.4) |
| Deferred net origination fees | 35,404 | | 38,916 | | (3,512) | (9.0) |
| Total loan contra accounts | 1,039,688 | | 652,636 | | 387,052 | 59.3 |
| Net Loans | \$ 9,910,920 | | \$ 9,170,634 | | \$ 740,286 | 8.1% |

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

The following table shows the change in the geographic distribution by state of the gross loan portfolio.

| September 30, | 2016 | 2015 | Change |
|------------------|-------------|-------------|--------|
| Washington | 47.6% | 49.8% | (2.2) |
| Oregon | 14.5 | 15.6 | (1.1) |
| Arizona | 9.5 | 10.7 | (1.2) |
| Other (1) | 7.5 | 3.3 | 4.2 |
| Utah | 7.0 | 6.8 | 0.2 |
| Idaho | 4.2 | 4.2 | — |
| New Mexico | 4.2 | 4.8 | (0.6) |
| Texas | 3.8 | 3.1 | 0.7 |
| Nevada | 1.7 | 1.7 | — |
| | <u>100%</u> | <u>100%</u> | |

(1) Includes loans in other states and purchased loan pools and other loans without state property information.

As of September 30, 2016, FDIC covered loans net of related discounts were \$28,974,000, a decrease of \$46,935,000 or 61.8%, from \$75,909,000 as of September 30, 2015. The decrease is attributable to FDIC loss share coverage on commercial loans from the former Home Valley Bank that expired after September 30, 2015. The FDIC loss share coverage for single family residential loans will continue for another four years. The remaining portfolio of covered loans is expected to continue to decline over time, absent another FDIC assisted transaction. When FDIC loss share agreements expire, any remaining loans will be transferred to the non covered portfolio. The Company continues to accrue a liability for the termination of the loss share agreements for what is known as the clawback provision of the agreement with the FDIC. The Company estimates the amount of this liability based on actual loss experience and projected future losses and recoveries. Contractually, the amount that will have to be paid to the FDIC for a clawback liability, if any, will be determined in 2020, after full expiry of the loss share agreements.

Non-performing assets. NPAs (excludes discounted acquired assets) decreased to \$71,441,000 as of September 30, 2016 from \$128,908,000 at September 30, 2015, a 44.6% decrease. The decrease is due to improving credit conditions and credit quality as well as sales of REO. Non-performing assets as a percentage of total assets was 0.48% at September 30, 2016 compared to 0.88% at September 30, 2015.

Restructured Loans. Total restructured loans declined to \$261,531,000 as of September 30, 2016 from \$302,713,000 as of September 30, 2015. As of September 30, 2016, 96.2% of the restructured loans were performing. The \$9,948,000 of non-performing restructured loans are included in the NPAs total. Total non-performing assets and restructured loans as a percent of total assets has declined to 2.17% as of September 30, 2016 from 2.89% as of September 30, 2015.

Real estate owned. As of September 30, 2016, real estate owned totaled \$29,027,000, a decrease of \$32,071,000 or 52.5% from \$61,098,000 as of September 30, 2015 as the Bank continued to liquidate foreclosed properties. During 2016, the Company sold real estate owned properties for total net proceeds of \$61,132,000.

Interest Receivable. Interest receivable was \$37,669,000 as of September 30, 2016, a decrease of \$2,760,000 or 6.83% since September 30, 2015. The change is primarily due to lower yields on earning assets.

Bank Owned Life Insurance. Bank owned life insurance increased to \$208,123,000 as of September 30, 2016 from \$102,496,000 as of September 30, 2015. The Company purchased another \$100,000,000 in bank-owned life insurance during 2016 to assist in funding the growth of employee benefit costs.

Intangible assets. The Company's intangible assets are made up of \$291,503,000 of goodwill and the unamortized balance of the core deposit intangible of \$5,486,000 at September 30, 2016.

Customer deposits. As of September 30, 2016, customer deposits totaled \$10,600,852,000 compared with \$10,631,703,000 at September 30, 2015, a \$30,851,000 or 0.29% decrease due primarily to a reduction in time deposits. Consistent with its management strategy, the Company was able to increase transaction accounts by \$184,714,000 or 3.2%, while time deposits decreased by \$215,565,000 or 4.5%. The weighted average rate paid on customer deposits during the year was 0.50%, an increase of 2 basis points from 2015, as a result of the low interest rate environment.

FHLB advances and other borrowings. Total FHLB advances were \$2,080,000,000 at September 30, 2016 as compared to \$1,830,000,000 at September 30, 2015. During 2016, new FHLB advances totaling \$300,000,000 were executed coterminously with interest rate swaps to effectively fix the weighted average interest rate at 1.38% for 6.7 years as a hedge against rising interest rates. Partially offsetting these additional borrowings was the maturity of \$50,000,000 of short term borrowings with a rate of 0.61%.

Contractual obligations. The following table presents the Company's significant fixed and determinable contractual obligations, within the categories described below, by contractual maturity or payment amount.

| September 30, 2016 | Total | Less than 1 Year | 1 to 5 Years | Over 5 Years |
|---------------------------------------|----------------------|---------------------|---------------------|-------------------|
| (In thousands) | | | | |
| Customer accounts (1) | \$ 10,600,852 | \$ 8,900,492 | \$ 1,694,398 | \$ 5,962 |
| Debt obligations (2) | 2,080,000 | 200,000 | 1,480,000 | 400,000 |
| Operating lease obligations | 31,191 | 4,902 | 13,130 | 13,159 |
| | <u>\$ 12,712,043</u> | <u>\$ 9,105,394</u> | <u>\$ 3,187,528</u> | <u>\$ 419,121</u> |

(1) Includes non-maturing customer transaction accounts.

(2) Represents final maturities of debt obligations.

These obligations, except for the operating leases, are included in the Consolidated Statements of Financial Condition. The payment amounts of the operating lease obligations represent those amounts contractually due.

For highlights of the quarter-by-quarter results for the years ended September 30, 2016 and 2015, see Note Q, "Selected Quarterly Financial Data (Unaudited)".

COMPARISON OF 2016 RESULTS WITH 2015

Net Income: Net income increased \$3,733,000, or 2.3%, to \$164,049,000 for the year ended September 30, 2016 as compared to \$160,316,000 for the year ended September 30, 2015.

Net Interest Income: For the year ended September 30, 2016, net interest income was \$420,249,000, an increase of \$6,768,000 from the year ended September 30, 2015. The increase was primarily driven by a higher average balance on loans receivable. For the year ended September 30, 2016, average earning assets increased by 0.6% to \$13,530,558,000, up from \$13,444,499,000 for the year ended September 30, 2015. During 2016, average loans receivable increased \$912,916,000 or 10.6%, while the combined average balances of mortgage backed securities, other investment securities and cash decreased by \$802,078,000 or 17.0%. The net interest margin increased to 3.11% for the year ended September 30, 2016 from 3.08% for the year ended September 30, 2015. The yield on earning assets increased 2 basis points to 3.97% and the cost of interest bearing liabilities declined by 1 basis point to 0.93%. The higher yield on earning assets is the result of changes in the asset mix as the average balance of mortgage-backed securities and other investment securities decreased while the average balance of loans receivable increased. The decrease in interest cost was due to changes in the mix of customer deposits and FHLB advances.

RESULTS OF OPERATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

The following table sets forth certain information explaining changes in interest income and interest expense for the period indicated compared to the same period one year ago. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to (1) changes in volume (changes in volume multiplied by old rate) and (2) changes in rate (changes in rate multiplied by old volume). The change in interest income and interest expense attributable to changes in both volume and rate has been allocated proportionately to the change due to volume and the change due to rate.

Rate / Volume Analysis:

| (\$ in thousands) | Comparison of Year Ended September 30, 2016 and September 30, 2015 | | |
|------------------------------------|--|-------------|-----------|
| | Volume | Rate | Total |
| Interest income: | | | |
| Loans receivable | \$ 44,395 | \$ (27,312) | \$ 17,083 |
| Mortgaged-backed securities | (7,824) | (619) | (8,443) |
| Investments (1) | (7,283) | 4,883 | (2,400) |
| All interest-earning assets | 29,288 | (23,048) | 6,240 |
| Interest expense: | | | |
| Customer accounts | (370) | 1,801 | 1,431 |
| FHLB advances and other borrowings | 3,900 | (5,859) | (1,959) |
| All interest-bearing liabilities | 3,530 | (4,058) | (528) |
| Change in net interest income | \$ 25,758 | \$ (18,990) | \$ 6,768 |

(1) Includes interest on cash equivalents and dividends on FHLB & FRB stock.

Provision (Release) for Loan Losses: The Company recorded a release of allowance for loan losses of \$6,400,000 for the year ended September 30, 2016, which compares to a release of \$11,162,000 for the year ended September 30, 2015. The releases recorded for both periods was a result of continued improvement in credit quality of the loan portfolio offset by net growth in the loan portfolio. The related improvement in the credit quality of the loan portfolio relates to the following factors.

The Company had recoveries, net of charge-offs, of \$13,065,000 for the year ended September 30, 2016, compared with \$5,370,000 of net recoveries for the year ended September 30, 2015. Non-accrual loans were \$42,414,000, or 0.28% of total assets, at September 30, 2016, as compared to \$67,810,000, or 0.47% of total assets, at September 30, 2015, representing a decrease of 37.5%.

Unfunded commitments tend to vary depending on our loan mix and the proportion share of commercial loans. The reserve for unfunded commitments was \$3,235,000 as of September 30, 2016, which is an increase from \$3,085,000 at September 30, 2015. Management believes the allowance for loan losses plus the reserve for unfunded commitments, totaling \$116,729,000, or 1.07% of gross loans, is sufficient to absorb estimated losses inherent in the portfolio. See Note E for further discussion and analysis of the allowance for loan losses as of and for the year ended September 30, 2016.

Other Income: Other income was \$47,036,000 for the year ended September 30, 2016, an increase of \$6,613,000 or 16.4% from the \$40,423,000 for the year ended September 30, 2015. The increase is primarily because 2016 included a gain of \$3,800,000 resulting from the sale-leaseback of a branch property. During 2015, the Company sold available-for-sale securities for \$246,826,000 and recognized a \$9,641,000 gain on sale and recorded \$10,554,000 of expense related to prepayment of a Federal Home Loan Bank advance. Deposit fee income was \$21,738,000 for the year ended September 30, 2016 compared to \$22,459,000 for the year ended September 30, 2015.

Other Expense: Operating expense was \$235,447,000 for the year ended September 30, 2016, an increase of \$10,596,000 or 4.7% from the \$224,851,000 for the year ended September 30, 2015. The increase in 2016 is primarily due to higher information technology costs, which increased by \$15,006,000, and other expense, which increased by \$4,390,000. These expenses were elevated due to the Company's implementation of new core systems in November 2015. Management believes that the new technology and systems better position the Company to support future growth and expansion. These increases were partially offset by lower compensation and benefits expense, which declined by \$7,055,000. The number of staff, including part-time employees on a full-time equivalent basis, was 1,806 and 1,838 at September 30, 2016 and 2015, respectively. Total operating expense for the years ended September 30, 2016 and 2015 equaled 1.60% and 1.55%, respectively, of average assets.

Gain (Loss) on Real Estate Owned: Net gain on real estate owned was \$10,046,000 for the year ended September 30, 2016, an increase of \$742,000 or 8.0% from the \$9,304,000 for the year ended September 30, 2015. This amount includes ongoing maintenance expense, periodic valuation adjustments, and gains (losses) on sales of REO.

Income Tax Expense: Income tax expense was \$84,085,000 for the year ended September 30, 2016, a decrease of \$5,118,000 or 5.74% from the \$89,203,000 for the year ended September 30, 2015. The effective tax rate for 2016 was 33.89% as compared to 35.75% for the year ended September 30, 2015. The lower effective tax rate is primarily due to the effects of the addition of bank owned life insurance and increased investment in low income housing tax credit partnerships as well as tax free loans.

COMPARISON OF 2015 RESULTS WITH 2014

Net income increased \$2,952,000, or 1.9%, to \$160,316,000 for the year ended September 30, 2015 as compared to \$157,364,000 for the year ended September 30, 2014. Net interest income was higher in 2015 by \$7,861,000 primarily due to loan growth and reduced cost of funds. Increases in operating expenses were attributable to a full year of operations of 74 branches that were acquired in fiscal 2014 and the related increase in customer transactions. Other income increased by \$9,764,000 or 31.8% driven by increased volume of fee generating services related to the acquired branches and transaction deposit accounts. Net income for the year ended September 30, 2015 continued to benefit from improving credit quality. The release of allowance for loan losses amounted to \$11,162,000 for the year ended September 30, 2015 as compared to a release of \$15,401,000 for the year ended September 30, 2014.

The following table sets forth certain information explaining changes in interest income and interest expense for the period indicated compared to the same period one year ago. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to (1) changes in volume (changes in volume multiplied by old rate) and (2) changes in rate (changes in rate multiplied by old volume). The change in interest income and interest expense attributable to changes in both volume and rate has been allocated proportionately to the change due to volume and the change due to rate.

Rate / Volume Analysis:

| (\$ in thousands) | Comparison of Year Ended September 30, 2015 and September 30, 2014 | | |
|--|--|-------------|----------|
| | Volume | Rate | Total |
| Interest income: | | | |
| Loans receivable | \$ 30,507 | \$ (24,355) | \$ 6,152 |
| Mortgaged-backed securities | (4,941) | (3,927) | (8,868) |
| Investments (1) | (2,594) | 2,166 | (428) |
| All interest-earning assets | 22,972 | (26,116) | (3,144) |
| Interest expense: | | | |
| Customer accounts | 1,879 | (9,349) | (7,470) |
| FHLB advances and other borrowings | (3,358) | (177) | (3,535) |
| All interest-bearing liabilities | (1,479) | (9,526) | (11,005) |
| Change in net interest income | \$ 24,451 | \$ (16,590) | \$ 7,861 |

(1) Includes interest on cash equivalents and dividends on FHLB & FRB stock.

Provision (Release) for Loan Losses: The Company recorded a release of allowance for loan losses of \$11,162,000 for the year ended September 30, 2015, which compares to a release of \$15,401,000 for the year ended September 30, 2014. The releases recorded for both periods was a result of continued improvement in credit quality of the loan portfolio offset by net growth in the loan portfolio. The related improvement in the credit quality of the loan portfolio relates to the following factors.

The Company had recoveries, net of charge-offs, of \$5,370,000 for the year ended September 30, 2015, compared with \$14,365,000 of net recoveries for the year ended September 30, 2014. Non-accrual loans were \$67,810,000, or 0.47% of total assets, at September 30, 2015, as compared to \$87,431,000, or 0.59% of total assets, at September 30, 2014, representing a decrease of 37.5%.

Unfunded commitments tend to vary depending on our loan mix and the proportion share of commercial loans. The reserve for unfunded commitments was \$3,085,000 at September 30, 2015, which is an increase from \$2,910,000 at September 30, 2014.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Other Income: Other income was \$40,423,000 for the year ended September 30, 2015, an increase of \$9,764,000 or 31.8% from the \$30,659,000 for the year ended September 30, 2014. The increase is primarily due to deposit fee income rising by \$8,153,000 in 2015 as compared to 2014 because of an increase in the number of transaction accounts and higher fees from client derivatives. In 2015, the Company had a \$9,641,000 gain on sales of investment securities and \$10,554,000 of expense related to prepayment of a Federal Home Loan Bank advance.

Other Expense: Operating expense was \$224,851,000 for the year ended September 30, 2015, an increase of \$20,842,000 or 10.22% from the \$204,009,000 for the year ended September 30, 2014. The increase is primarily due to an increase of \$10,209,000 for compensation expense and \$7,352,000 for product delivery expense. These increases mostly relate to the addition of the employees from branches acquired during 2014 as they were with the Company for a full year in 2015 and also from growth in our commercial banking business. The number of staff, including part-time employees on a full-time equivalent basis, was 1,838 and 1,909 at September 30, 2015 and 2014, respectively. The decline in full-time equivalent employees occurred as the Company continues to consolidate under-performing branches and streamline back-office operations. Total operating expense for the years ended September 30, 2015 and 2014 equaled 1.55% and 1.43%, respectively, of average assets.

Gain (Loss) on Real Estate Owned: Net gain on real estate owned was \$9,304,000 for the year ended September 30, 2015, compared to a loss of \$2,743,000 for the year ended September 30, 2014. This amount includes ongoing maintenance expense, periodic valuation adjustments, and gains (losses) on sales of REO.

Income Tax Expense: Income tax expense was \$89,203,000 for the year ended September 30, 2015, an increase of \$1,639,000 or 1.9% from the \$87,564,000 for the year ended September 30, 2014. The effective tax rate for was 35.75% for the years ended September 30, 2015 and 2014.

SELECTED FINANCIAL DATA

| Year ended September 30, | 2016 | 2015 | 2014 | 2013 | 2012 |
|--|---------------------------------------|---------------|---------------|---------------|---------------|
| | (In thousands, except per share data) | | | | |
| Interest income | \$ 536,793 | \$ 530,553 | \$ 533,697 | \$ 516,291 | \$ 590,271 |
| Interest expense | 116,544 | 117,072 | 128,077 | 136,159 | 193,249 |
| Net interest income | 420,249 | 413,481 | 405,620 | 380,132 | 397,022 |
| Provision (reversal) for loan losses | (6,250) | (11,162) | (15,401) | 1,350 | 44,955 |
| Other income | 57,082 | 49,727 | 27,916 | 20,074 | 6,698 |
| Other expense | 235,447 | 224,851 | 204,009 | 164,240 | 142,854 |
| Income before income taxes | 248,134 | 249,519 | 244,928 | 234,616 | 215,911 |
| Income taxes | 84,085 | 89,203 | 87,564 | 83,111 | 77,728 |
| Net income | \$ 164,049 | \$ 160,316 | \$ 157,364 | \$ 151,505 | \$ 138,183 |
| Per share data | | | | | |
| Basic earnings | \$ 1.79 | \$ 1.68 | \$ 1.56 | \$ 1.45 | \$ 1.29 |
| Diluted earnings | 1.78 | 1.67 | 1.55 | 1.45 | 1.29 |
| Cash dividends | 0.55 | 0.54 | 0.41 | 0.36 | 0.32 |
| September 30, | 2016 | 2015 | 2014 | 2013 | 2012 |
| Total assets | \$ 14,888,063 | \$ 14,568,324 | \$ 14,756,041 | \$ 13,082,859 | \$ 12,472,944 |
| Loans receivable, net | 9,910,920 | 9,170,634 | 8,324,798 | 7,823,977 | 7,740,374 |
| Mortgage-backed securities | 2,490,510 | 2,906,440 | 3,231,691 | 2,902,655 | 2,360,668 |
| Investment securities | 849,983 | 1,117,339 | 1,366,018 | 1,109,772 | 612,524 |
| Cash and cash equivalents | 450,368 | 284,049 | 781,843 | 203,563 | 751,430 |
| Customer accounts | 10,600,852 | 10,631,703 | 10,716,928 | 9,090,271 | 8,576,618 |
| FHLB advances | 2,080,000 | 1,830,000 | 1,930,000 | 1,930,000 | 1,880,000 |
| Stockholders' equity | 1,975,731 | 1,955,679 | 1,973,283 | 1,937,635 | 1,899,752 |
| Number of | | | | | |
| Customer accounts | 491,098 | 517,871 | 548,872 | 332,177 | 308,282 |
| Loans | 41,418 | 41,036 | 43,569 | 44,838 | 48,030 |
| Offices | 238 | 247 | 251 | 182 | 166 |

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

| | September 30, 2016 | September 30, 2015 |
|--|--------------------------------------|-----------------------|
| | (In thousands, except share data) | |
| ASSETS | | |
| Cash and cash equivalents | \$ 450,368 | \$ 284,049 |
| Available-for-sale securities, at fair value | 1,922,894 | 2,380,563 |
| Held-to-maturity securities, at amortized cost | 1,417,599 | 1,643,216 |
| Loans receivable, net of allowance for loan losses of \$113,494 and \$106,829 | 9,910,920 | 9,170,634 |
| Interest receivable | 37,669 | 40,429 |
| Premises and equipment, net | 281,951 | 276,247 |
| Real estate owned | 29,027 | 61,098 |
| FHLB & FRB stock | 117,205 | 107,198 |
| Bank owned life insurance | 208,123 | 102,496 |
| Intangible assets, including goodwill of \$291,503 | 296,989 | 299,358 |
| Federal and state income tax assets, net | 16,047 | 14,513 |
| Other assets | 199,271 | 188,523 |
| | <u>\$ 14,888,063</u> | <u>\$ 14,568,324</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities | | |
| Customer accounts | | |
| Transaction deposit accounts | \$ 6,005,592 | \$ 5,820,878 |
| Time deposit accounts | 4,595,260 | 4,810,825 |
| | <u>10,600,852</u> | <u>10,631,703</u> |
| FHLB advances | 2,080,000 | 1,830,000 |
| Advance payments by borrowers for taxes and insurance | 42,898 | 50,224 |
| Accrued expenses and other liabilities | 188,582 | 100,718 |
| | <u>12,912,332</u> | <u>12,612,645</u> |
| Stockholders' equity | | |
| Common stock, \$1.00 par value, 300,000,000 shares authorized; 134,307,818 and 133,695,803 shares issued; 89,680,847 and 92,936,395 shares outstanding | 134,308 | 133,696 |
| Paid-in capital | 1,648,388 | 1,643,712 |
| Accumulated other comprehensive income (loss), net of taxes | (11,156) | 353 |
| Treasury stock, at cost; 44,626,971 and 40,759,408 shares | (739,686) | (651,836) |
| Retained earnings | 943,877 | 829,754 |
| | <u>1,975,731</u> | <u>1,955,679</u> |
| | <u>\$ 14,888,063</u> | <u>\$ 14,568,324</u> |

CONSOLIDATED STATEMENTS OF OPERATIONS

| Year ended September 30, | 2016 | 2015 | 2014 |
|--|-----------------------------------|-------------------|-------------------|
| | (In thousands, except share data) | | |
| INTEREST INCOME | | | |
| Loans receivable | \$ 454,085 | \$ 437,002 | \$ 430,850 |
| Mortgage-backed securities | 62,949 | 71,392 | 80,260 |
| Investment securities and cash equivalents | 19,759 | 22,159 | 22,587 |
| | <u>536,793</u> | <u>530,553</u> | <u>533,697</u> |
| INTEREST EXPENSE | | | |
| Customer accounts | 52,485 | 51,054 | 58,524 |
| FHLB advances and other borrowings | 64,059 | 66,018 | 69,553 |
| | <u>116,544</u> | <u>117,072</u> | <u>128,077</u> |
| Net interest income | 420,249 | 413,481 | 405,620 |
| Provision (release) for loan losses | (6,250) | (11,162) | (15,401) |
| Net interest income after provision (release) for loan losses | 426,499 | 424,643 | 421,021 |
| OTHER INCOME | | | |
| Gain on sale of investment securities | — | 9,641 | — |
| Prepayment penalty on long-term debt | — | (10,554) | — |
| Loan fee income | 5,548 | 8,788 | 7,706 |
| Deposit fee income | 21,738 | 22,459 | 14,306 |
| Other income | 19,750 | 10,089 | 8,647 |
| | <u>47,036</u> | <u>40,423</u> | <u>30,659</u> |
| OTHER EXPENSE | | | |
| Compensation and benefits | 112,884 | 119,939 | 109,730 |
| Occupancy | 33,568 | 33,956 | 30,452 |
| FDIC insurance premiums | 11,824 | 7,916 | 11,009 |
| Product delivery | 17,060 | 22,325 | 14,973 |
| Information technology | 30,982 | 15,976 | 14,303 |
| Other expense | 29,129 | 24,739 | 23,542 |
| | <u>235,447</u> | <u>224,851</u> | <u>204,009</u> |
| Gain (loss) on real estate owned, net | 10,046 | 9,304 | (2,743) |
| Income before income taxes | 248,134 | 249,519 | 244,928 |
| Income tax expense | | | |
| Current | 60,773 | 86,477 | 75,784 |
| Deferred | 23,312 | 2,726 | 11,780 |
| | <u>84,085</u> | <u>89,203</u> | <u>87,564</u> |
| NET INCOME | \$ 164,049 | \$ 160,316 | \$ 157,364 |
| PER SHARE DATA | | | |
| Basic earnings per share | \$ 1.79 | \$ 1.68 | \$ 1.56 |
| Diluted earnings per share | 1.78 | 1.67 | 1.55 |
| Dividends paid on common stock per share | 0.55 | 0.54 | 0.41 |
| Basic weighted average number of shares outstanding | 91,399,038 | 95,644,639 | 101,154,030 |
| Diluted weighted average number of shares outstanding | 91,912,918 | 96,053,959 | 101,590,351 |

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| Year ended September 30, | 2016 | 2015 | 2014 |
|--|----------------|------------|------------|
| | (In thousands) | | |
| Net income | \$ 164,049 | \$ 160,316 | \$ 157,364 |
| Other comprehensive income (loss) net of tax: | | | |
| Net unrealized gains (losses) on available-for-sale securities | (1,403) | (27,536) | 22,924 |
| Reclassification adjustment of net gains from sale of available-for-sale securities included in net income | — | 9,641 | — |
| Related tax benefit (expense) | 516 | 6,577 | (8,425) |
| | (887) | (11,318) | 14,499 |
| Net unrealized gain (loss) on long-term borrowing hedges | (16,793) | (14,287) | (268) |
| Related tax benefit (expense) | 6,171 | 5,250 | 99 |
| | (10,622) | (9,037) | (169) |
| Other comprehensive income (loss) | (11,509) | (20,355) | 14,330 |
| Comprehensive income | \$ 152,540 | \$ 139,961 | \$ 171,694 |

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

| (In thousands) | Common Stock | Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total |
|---|-------------------|---------------------|----------------------|--|---------------------|---------------------|
| Balance at September 30, 2013 | <u>\$ 132,573</u> | <u>\$ 1,625,051</u> | <u>\$ 594,450</u> | <u>\$ 6,378</u> | <u>\$ (420,817)</u> | <u>\$ 1,937,635</u> |
| Net income | | | 157,364 | | | 157,364 |
| Other comprehensive income (loss) | | | | 14,330 | | 14,330 |
| Dividends on common stock | | | (45,665) | | | (45,665) |
| Compensation expense related to common stock options | | 324 | | | | 324 |
| Proceeds from exercise of common stock options . . | 501 | 9,641 | | | | 10,142 |
| Restricted stock expense | 249 | 3,195 | | | | 3,444 |
| Treasury stock purchased | | | | | (104,291) | (104,291) |
| Balance at September 30, 2014 | <u>\$ 133,323</u> | <u>\$ 1,638,211</u> | <u>\$ 706,149</u> | <u>\$ 20,708</u> | <u>\$ (525,108)</u> | <u>\$ 1,973,283</u> |
| Net income | | | 160,316 | | | 160,316 |
| Other comprehensive income (loss) | | | | (20,355) | | (20,355) |
| Dividends on common stock | | | (36,711) | | | (36,711) |
| Compensation expense related to common stock options | | 231 | | | | 231 |
| Proceeds from exercise of common stock options . . | 129 | 1,941 | | | | 2,070 |
| Restricted stock expense | 244 | 3,329 | | | | 3,573 |
| Treasury stock purchased | | | | | (126,728) | (126,728) |
| Balance at September 30, 2015 | <u>\$ 133,696</u> | <u>\$ 1,643,712</u> | <u>\$ 829,754</u> | <u>\$ 353</u> | <u>\$ (651,836)</u> | <u>\$ 1,955,679</u> |
| Net income | | | 164,049 | | | 164,049 |
| Other comprehensive income (loss) | | | | (11,509) | | (11,509) |
| Dividends on common stock | | | (49,926) | | | (49,926) |
| Compensation expense related to common stock options | | 90 | | | | 90 |
| Proceeds from exercise of common stock options . . | 433 | 8,850 | | | | 9,283 |
| Restricted stock expense | 179 | 3,480 | | | | 3,659 |
| Repurchase of stock warrants | | (7,744) | | | | (7,744) |
| Treasury stock purchased | | | | | (87,850) | (87,850) |
| Balance at September 30, 2016 | <u>\$ 134,308</u> | <u>\$ 1,648,388</u> | <u>\$ 943,877</u> | <u>\$ (11,156)</u> | <u>\$ (739,686)</u> | <u>\$ 1,975,731</u> |

CONSOLIDATED STATEMENTS OF CASH FLOWS

| Year ended September 30, | 2016 | 2015 | 2014 |
|--|-------------------|-------------------|-------------------|
| | (In thousands) | | |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net income | \$ 164,049 | \$ 160,316 | \$ 157,364 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation, amortization, accretion and restricted stock expense | 22,988 | 21,217 | 17,347 |
| Cash received from (paid to) FDIC under loss share | 1,730 | 720 | 2,502 |
| Stock option compensation expense | 90 | 231 | 324 |
| Provision (release) for loan losses | (6,250) | (11,162) | (15,401) |
| Loss (gain) on sale of investment securities and real estate owned, net | (16,476) | (28,527) | (2,510) |
| Loss on extinguishment of debt | — | 10,554 | — |
| Decrease (increase) in accrued interest receivable | 2,760 | 11,608 | (2,819) |
| Decrease (increase) in FDIC loss share receivable | — | 1,795 | (1,795) |
| Decrease (increase) in federal and state income tax receivable | 5,153 | 13,829 | 18,890 |
| Decrease (increase) in cash surrender value of bank owned life insurance | (5,627) | (2,496) | — |
| Net realized (gain) loss on sales of premises and equipment | (3,563) | — | — |
| Decrease (increase) in other assets | (14,204) | (29,220) | (17,799) |
| Increase (decrease) in accrued expenses and other liabilities | 71,071 | (5,994) | 17,612 |
| Net cash provided (used) by operating activities | 221,721 | 142,871 | 173,715 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Origination of loans and principal repayments, net | (622,884) | (554,350) | (261,401) |
| Loans purchased | (105,420) | (279,936) | (218,544) |
| FHLB & FRB stock purchase | (36,347) | (4,067) | — |
| FHLB & FRB stock redeemed | 26,340 | 55,708 | 14,017 |
| Available-for-sale securities purchased | (137,591) | (315,114) | (1,280,477) |
| Principal payments and maturities of available-for-sale securities | 537,255 | 721,951 | 609,395 |
| Proceeds from sales of available-for-sale investment securities | 50,741 | 246,826 | — |
| Held-to-maturity securities purchased | — | (259,489) | — |
| Principal payments and maturities of held-to-maturity securities | 218,958 | 159,947 | 103,617 |
| Net cash received from mergers and acquisitions | — | — | 1,776,660 |
| Proceeds from sales of real estate owned | 61,132 | 74,895 | 89,549 |
| Purchase of bank owned life insurance | (100,000) | (100,000) | — |
| Proceeds from sales of premises and equipment | 14,685 | — | — |
| Premises and equipment purchased and REO improvements | (37,933) | (36,860) | (51,794) |
| Net cash provided (used) by investing activities | (131,064) | (290,489) | 781,022 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Net increase (decrease) in customer accounts | (30,775) | (85,073) | (226,914) |
| Proceeds from borrowings | 1,118,000 | 100,000 | — |
| Repayments of borrowings | (868,000) | (210,554) | — |
| Proceeds from exercise of common stock options and related tax benefit | 9,283 | 2,070 | 10,252 |
| Dividends paid on common stock | (49,926) | (51,111) | (42,065) |
| Repurchase of warrants | (7,744) | — | — |
| Treasury stock purchased | (87,850) | (126,728) | (104,291) |
| Increase (decrease) in advance payments by borrowers for taxes and insurance | (7,326) | 21,220 | (13,439) |
| Net cash provided (used) by financing activities | 75,662 | (350,176) | (376,457) |
| Increase (decrease) in cash and cash equivalents | 166,319 | (497,794) | 578,280 |
| Cash and cash equivalents at beginning of year | 284,049 | 781,843 | 203,563 |
| Cash and cash equivalents at end of year | \$ 450,368 | \$ 284,049 | \$ 781,843 |

| Year ended September 30, | 2016 | 2015 | 2014 |
|---|----------------|-------------|-----------------------|
| | (In thousands) | | |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | | |
| Non-cash investing activities | | | |
| Real estate acquired through foreclosure | \$ 16,535 | \$ 31,916 | \$ 46,469 |
| Cash paid during the year for | | | |
| Interest | \$ 114,506 | \$ 116,226 | \$ 128,733 |
| Income taxes | | 65,720 | 64,372 |
| Summary of non-cash activities related to acquisitions | | | |
| Fair value of assets and intangibles acquired, including goodwill | \$ — | \$ — | \$ 80,242 |
| Fair value of liabilities assumed | — | — | (1,856,902) |
| Net fair value of acquired assets (liabilities) | \$ — | \$ — | \$ (1,776,660) |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED SEPTEMBER 30, 2016, 2015 AND 2014

NOTE A

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Company and nature of operations. Washington Federal, Inc. is a Washington corporation headquartered in Seattle, Washington. The Company is a bank holding company that conducts its operations through a national bank subsidiary, Washington Federal, National Association. The Bank is principally engaged in the business of attracting deposits from the general public and investing these funds, together with borrowings and other funds, in one-to-four family residential real estate loans, multi-family real estate loans and commercial loans. As used throughout this document, the terms “Washington Federal” or the “Company” refer to Washington Federal, Inc. and its consolidated subsidiaries and the term “Bank” refers to the operating subsidiary Washington Federal, National Association. The Bank conducts its activities through a network of 238 offices located in Washington, Oregon, Idaho, Utah, Arizona, Nevada, New Mexico, and Texas.

Basis of presentation and use of estimates. The Company’s accounting and financial reporting policies conform to accounting principles generally accepted in the United States of America (U.S. GAAP). Inter-company balances and transactions have been eliminated in consolidation. In preparing the consolidated financial statements, the Company makes estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and revenues and expenses during the reporting periods and related disclosures. The areas that require application of significant management judgments often result in the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods. Actual results could differ materially from those estimates. In certain instances, amounts in text are presented by rounding to the nearest thousand.

The Company’s fiscal year end is September 30th. All references to 2016, 2015 and 2014 represent balances as of September 30, 2016, September 30, 2015 and September 30, 2014, or activity for the fiscal years then ended.

Acquisitions. *Certain Branches of Bank of America, National Association.* During the 2014 fiscal year, the Bank acquired 74 branches from Bank of America, National Association. This included: effective as of the close of business on October 31, 2013, 11 branches located in New Mexico; effective as of the close of business on December 6, 2013, 40 branches located in Washington, Oregon, and Idaho; and effective as of the close of business on May 2, 2014, 23 branches located in Arizona and Nevada. The combined acquisitions provided \$1.9 billion in deposit accounts, \$13 million of loans, and \$25 million in branch properties. The Bank paid a 1.99% premium on the total deposits and received \$1.8 billion in cash from the transactions. The acquisition method of accounting was used to account for the acquisitions. The purchased assets and assumed liabilities are recorded at their respective acquisition date estimated fair values. The Bank recorded \$11 million in core deposit intangible and \$31 million in goodwill related to these transactions. The operating results of the Company include the operating results produced by the first 11 branches beginning November 1, 2013, for the additional 40 branches beginning December 7, 2013, and for the most recent 23 branches from May 3, 2014 forward.

Cash and cash equivalents. Cash and cash equivalents include cash on hand, amounts due from banks, overnight investments and repurchase agreements with an initial maturity of three months or less.

Investments and mortgage-backed securities. The Company accounts for investments and mortgage-backed securities in two categories: held-to-maturity and available-for-sale. Premiums and discounts on investments are deferred and recognized into income over the life of the asset using the effective interest method.

Held-to-maturity securities are accounted for at amortized cost, but the Company must have both the positive intent and the ability to hold those securities to maturity. There are very limited circumstances under which securities in the held-to-maturity category can be sold without jeopardizing the cost basis of accounting for the remainder of the securities in this category.

Available-for-sale securities are accounted for at fair value. Gains and losses realized on the sale of these securities are accounted for based on the specific identification method. Unrealized gains and losses for available-for-sale securities are excluded from earnings and reported net of the related tax effect in the accumulated other comprehensive income component of stockholders’ equity.

Realized gains and losses on securities sold as well as other than temporary impairment charges, if any, are shown on the Consolidated Statements of Operations under the Other Income heading. Management evaluates debt and equity securities for other than temporary impairment on a quarterly basis based on the securities’ current credit quality, market interest rates, term to maturity and management’s intent and ability to hold the securities until the net book value is recovered.

Loans receivable. Loans that are performing in accordance with their contractual terms are carried at their amortized cost and expected interest is accrued. The Bank also receives fees for originating loans in addition to various fees and charges related to existing loans, which may include prepayment charges, late charges and assumption fees.

When a borrower fails to make a required payment on a loan, the Bank attempts to cure the deficiency by contacting the borrower. Contact is made after a payment is 30 days past its grace period. In most cases, deficiencies are cured promptly. If the delinquency is not cured within 90 days, the Bank may institute appropriate action to foreclose on the property. If foreclosed, the property is sold at a public sale and may be purchased by the Bank.

Restructured loans. The Bank will consider modifying the interest rates and terms of a loan if it determines that a modification is a better alternative to foreclosure. Most troubled debt restructured (“TDR”) loans are accruing and performing loans where the borrower has proactively approached the Bank about modifications due to temporary financial difficulties. Each request is individually evaluated for merit and likelihood of success. The concession for these loans is typically a payment reduction through a rate reduction of 100 to 200 bps for a specific term, usually six to twelve months. Interest-only payments may also be approved during the modification period. Principal forgiveness is generally not an available option for restructured loans. Before granting approval to modify a loan in a TDR, the borrower’s ability to repay is evaluated, including: current income levels and debt to income ratio, borrower’s credit score, payment history of the loan, and updated evaluation of the secondary repayment source. The Bank also modifies some loans that are not classified as TDRs as the modification is due to a restructuring where the effective interest rate on the debt is reduced to reflect a decrease in market interest rates.

Non accrual loans. Loans are placed on nonaccrual status when, in the judgment of management, the probability of collection of interest is deemed to be insufficient to warrant further accrual. When a loan is placed on nonaccrual status, previously accrued but unpaid interest is deducted from interest income. The Bank does not accrue interest on loans 90 days or more past due. If payment is made on a loan so that the loan becomes less than 90 days past due, and the Bank expects full collection of principal and interest, the loan is returned to full accrual status. Any interest ultimately collected is credited to income in the period of recovery. A loan is charged-off when the loss is estimable and it is confirmed that the borrower is not expected to be able to meet contractual obligations.

If a consumer loan is on non-accrual status before becoming a TDR it will stay on non-accrual status following restructuring until it has been performing for at least six months, at which point it may be moved to accrual status. If a loan is on accrual status before it becomes a TDR, and management concludes that full repayment is probable based on internal evaluation, it will remain on accrual status following restructuring. If the restructured consumer loan does not perform, it is placed on non-accrual status when it is 90 days delinquent. For commercial loans, six consecutive payments on newly restructured loan terms are required prior to returning the loan to accrual status. In some instances after the required six consecutive payments are made management will conclude that collection of the entire principal and interest due is still in doubt. In those instances, the loan will remain on non-accrual.

Impaired loans. Impaired loans consist of loans receivable that are not expected to have their principal and interest repaid in accordance with their contractual terms. This includes TDRs that are on non-accrual status. Collateral dependent impaired loans are measured using the fair value of the collateral less selling costs. Non-collateral dependent loans are measured at the present value of expected future cash flows.

Deferred fees and discounts on loans. Loan discounts and loan fees are deferred and recognized over the life of the loans using the effective interest method.

Allowance for loan losses. The Bank maintains an allowance for loan losses to absorb losses inherent in the loan portfolio. The allowance is based on ongoing, quarterly assessments of the probable and estimable losses inherent in the loan portfolio. The Bank’s general methodology for assessing the appropriateness of the allowance is to apply a loss percentage factor to the different loan types. The loss percentage factor is made up of two parts - the historical loss factor (“HLF”) and the qualitative loss factor (“QLF”). The HLF takes into account historical charge-offs by loan type. The Bank uses an average of historical loss rates for each loan category multiplied by a loss emergence period. This is the likely period of time during which a residential or commercial loan borrower experiencing financial difficulties might deplete their cash prior to becoming delinquent on their loan, plus the period of time that it takes the bank to work out the loans. The QLF are based on management’s continuing evaluation of the pertinent factors underlying the quality of the loan portfolio, including changes in the size and composition of the loan portfolio, actual loan loss experience, current economic conditions, collateral values, geographic concentrations, seasoning of the loan portfolio, specific industry conditions, and the duration of the current business cycle. These factors are considered by loan type.

Specific allowances are established for loans which are individually evaluated, in cases where management has identified significant conditions or circumstances related to a loan that management believes indicate the probability that a loss has been incurred. The Bank has also established a reserve for unfunded commitments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The recovery of the carrying value of loans is susceptible to future market conditions beyond the Bank's control, which may result in losses or recoveries differing from those estimated.

Acquired credit impaired loans. Acquired credit impaired loans are accounted for under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 310-30 when there is evidence of credit deterioration since origination and for which it is probable, at acquisition, that the Company would be unable to collect all contractually required payments. Interest income, through accretion of the difference between the carrying amount of the loans and the expected cash flows, are recognized on all acquired loans.

Covered assets. Covered loans consist of single family loans acquired from Horizon Bank in 2010 and certain loans acquired from South Valley Bank and Trust ("SVBT") in fiscal 2013 that were originally recorded at their estimated fair value at the time acquired. Loans that were classified as non-performing loans by Horizon Bank and SVBT are no longer classified as non-performing because, at acquisition, the carrying value of these loans was adjusted to reflect fair value and are covered under the FDIC loss sharing agreements. Management believes that the book value reflects an amount that will ultimately be collected. Covered real estate held for sale represents the foreclosed properties that were originally Horizon Bank loans or certain SVBT loans. Covered real estate held for sale is carried at the estimated fair value of the repossessed real estate. The covered loans and covered real estate held for sale are collectively referred to as "covered assets." When FDIC loss share agreements expire, any remaining loans will be transferred to the non covered portfolio. Covered loans are included within loans receivable on the statement of financial condition. Covered real estate owned are included within real estate owned on the statement of financial condition.

FDIC indemnification asset. FDIC indemnification asset is the receivable recorded due to the guarantee provided by the FDIC on the covered assets. This asset declines due to collections from the FDIC on claims or the eventual expiration of the FDIC loss share agreements. The FDIC indemnification asset is included within other assets on the statement of financial condition.

Client derivatives. Interest rate swap agreements are provided to certain clients who desire to convert their obligations from variable to fixed interest rates. Under these agreements, the Bank enters into a variable-rate loan agreement with a customer in addition to a swap agreement, and then enters into a corresponding swap agreement with a third party in order to offset its exposure on the customer swap agreement. As the interest rate swap agreements with the customers and third parties are not designated as hedges under FASB ASC 815, Derivatives and Hedging, the instruments are marked to market in earnings. The change in fair value of the offsetting swaps are included in interest income and interest expense and there is no impact on net income. There is fee income earned on the swaps that is included in loan fee income.

Long term borrowing hedges. The Company has entered into interest rate swaps to convert a series of future short-term borrowings to fixed-rate payments. These interest rate swaps qualify as cash flow hedging instruments under ASC 815 so gains and losses are recorded in Other Comprehensive Income to the extent the hedge is effective. Gains and losses on the interest rate swaps are reclassified from OCI to earnings in the period the hedged transaction affects earnings and are included in the same income statement line item that the hedged transaction is recorded.

Commercial loan hedges. The Company has entered into interest rate swaps to hedge long term fixed rate commercial loans. These hedges qualify as fair value hedges under ASC 815 and provide for matching of the recognition of the gains and losses on the interest rate swap and the related hedged loan.

Premises and equipment. Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the respective assets. Expenditures are capitalized for betterments and major renewals. Charges for ordinary maintenance and repairs are expensed to operations as incurred.

Real estate owned. Real estate properties acquired through foreclosure of loans or through acquisitions are recorded initially at fair value less selling costs and are subsequent recorded at lower of cost or fair value. Any gains (losses) are shown on the real estate acquired through foreclosure line item.

Intangible assets. Goodwill represents the excess of the cost of businesses acquired over the fair value of the net assets acquired. The core deposit intangibles are acquired assets that lack physical substance but can be distinguished from goodwill. Goodwill is evaluated for impairment on an annual basis during the fourth quarter. Other intangible assets are amortized over their estimated lives and are subject to impairment testing when events or circumstances change. If circumstances indicate that the carrying value of the assets may not be recoverable, an impairment charge could be recorded. The Bank amortizes the core deposit intangibles over their estimated lives using an accelerated method.

The table below provides detail regarding the Company's intangible assets.

| | Goodwill | Core Deposit Intangible | Total |
|--------------------------------------|------------------|-------------------------------|------------------|
| | (In thousands) | | |
| Balance at September 30, 2014 | \$291,503 | \$11,406 | \$302,909 |
| Amortization | — | (3,551) | (3,551) |
| Balance at September 30, 2015 | 291,503 | 7,855 | 299,358 |
| Amortization | — | (2,369) | (2,369) |
| Balance at September 30, 2016 | \$291,503 | \$ 5,486 | \$296,989 |

The table below presents the estimated core deposit intangible asset amortization expense for the next five years.

| Fiscal Year | Expense |
|-------------|----------------|
| | (In thousands) |
| 2017 | \$1,648 |
| 2018 | 1,204 |
| 2019 | 1,157 |
| 2020 | 1,157 |
| 2021 | 320 |

Income taxes. Income taxes are accounted for using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, a deferred tax asset or liability is determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The provision for income taxes includes current and deferred income tax expense based on net income adjusted for temporary and permanent differences such as depreciation, interest on state and municipal securities, and affordable housing tax credits. Income tax related interest and penalties, if applicable, and amortization of affordable housing tax credit investments are recorded within income tax expense.

Accounting for stock-based compensation. We recognize in the statement of operations the grant-date fair value of stock options and other equity-based forms of compensation issued to employees over the employees' requisite service period (generally the vesting period). The requisite service period may be subject to performance conditions. Stock options and restricted stock awards generally vest ratably over three to ten years and are recognized as expense over that same period of time. The exercise price of each option equals the market price of the Company's common stock on the date of the grant, and the maximum term is ten years. No stock options were granted in 2016, 2015 or 2014.

Certain grants of restricted stock are subject to performance-based and market-based vesting as well as other approved vesting conditions and cliff vest based on those conditions. Compensation expense is recognized over the service period to the extent restricted stock awards are expected to vest. See Note N for additional information.

Business segments. As the Company manages its business and operations on a consolidated basis, management has determined that there is one reportable business segment.

Subsequent events. The Company has evaluated subsequent events for adjustment to or disclosure in the Company's consolidated financial statements through the date of this report, and the Company has not identified any recordable or disclosable events, not otherwise reported in these consolidated financial statements or the notes thereto, except for the following:

The Company paid its 135th consecutive quarterly cash dividend totaling \$12,421,733 on November 18, 2016 to common stockholders of record on November 4, 2016.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE B

NEW ACCOUNTING PRONOUNCEMENTS

In August 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-15, *Classification of Certain Cash Receipts and Cash Payments*. The amendments in this ASU address eight specific cash flow issues with the objective of reducing diversity in practice. The specific issues identified include: debt prepayments or extinguishment costs; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (including bank-owned life insurance policies); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. This ASU is effective for fiscal years beginning after December 15, 2017 including interim periods within that reporting period; however, early adoption is permitted. The Company is currently evaluating the guidance to determine its adoption method and does not expect this guidance to have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses*. The amendments in this ASU were issued to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investments in leases and other commitments to extend credit held by a reporting entity at each reporting date. The amendments require that financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The ASU eliminates the current framework of recognizing probable incurred losses and instead requires an entity to use its current estimate of all expected credit losses over the contractual life. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the financial assets.

For purchased financial assets with a more-than-insignificant amount of credit deterioration since origination (“PCD assets”) that are measured at amortized cost, an allowance for expected credit losses is recorded as an adjustment to the cost basis of the asset. Subsequent changes in estimated cash flows would be recorded as an adjustment to the allowance and through the statement of income.

Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security’s cost basis.

The amendments in this ASU are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For most debt securities, the transition approach requires a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period the guidance is effective. For other-than-temporarily impaired debt securities and PCD assets, the guidance will be applied prospectively. The Company is currently evaluating the provisions of this ASU to determine the impact the new standard will have on the Company’s consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, *Compensation-Stock Compensation-Improvements to Employee Share-Based Payment Accounting*, which involves several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Under the guidance, income tax benefits and deficiencies are to be recognized as income tax expense or benefit in the income statement and the tax effects of exercised or vested awards should be treated as discrete items in the reporting period in which they occur. An entity should also recognize excess tax benefits regardless of whether the benefit reduces taxes payable in the current period. Excess tax benefits should be classified along with other income tax cash flows as an operating activity. In regards to forfeitures, the entity may make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures when they occur. This ASU is effective for fiscal years beginning after December 15, 2016 including interim periods within that reporting period; however, early adoption is permitted. The Company is currently evaluating the guidance to determine its adoption method and does not expect this guidance to have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*. The amendments require lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. The guidance also simplifies the accounting for sale and leaseback transactions. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently evaluating the provisions of this ASU to determine the impact the new standard will have on the Company's consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, to require all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). The amendments in this ASU also require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. This ASU is effective for fiscal years beginning after December 15, 2017 including interim periods within that reporting period. The Company does not expect this guidance to have a material impact on its consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, *Simplifying the Accounting for Measurement-Period Adjustments*, which will require that the acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amount is determined. The acquirer is required to also record, in the same period's financial statements, the effect on earnings as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. In addition, an entity is required to present separately on the face of the income statement or disclose in the notes to the financial statements the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The amendments in ASU 2015-16 are effective for years beginning after December 15, 2015. Early adoption is permitted for reporting periods for which financial statements have not been issued. The Company does not expect this guidance to have a material impact on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, *Customer's Accounting for Fees Paid in Cloud Computing Arrangement*. The ASU was issued to clarify a customer's accounting for fees paid in a cloud computing arrangement. The amendments provide guidance to customers in determining whether a cloud computing arrangement includes a software license that should be accounted for as internal-use software. If the arrangement does not contain a software license, it would be accounted for as a service contract. The guidance in this ASU is effective for interim and annual periods beginning after December 15, 2015 and can be adopted either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. The Company does not expect this guidance to have a material impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The guidance in this update supersedes the revenue recognition requirements in ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the industry topics of the codification. For public companies, this update was to be effective for interim and annual periods beginning after December 15, 2016. However, in August 2015, the FASB issued ASU 2015-14, which delayed the effective date of ASU 2014-09 by one year and permits companies to voluntarily adopt the new standard as of the original effective date. The Company does not expect this guidance to have a material impact on its consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE C

INVESTMENT SECURITIES

The tables below provide detail regarding the amortized cost and fair value of available-for-sale and held-to-maturity investment securities.

| September 30, | 2016 | | | | |
|---|--------------------|------------------|-------------------|--------------------|--------------|
| | Amortized Cost | Gross Unrealized | | Fair Value | Yield |
| | (In thousands) | | | | |
| Available-for-sale securities | | | | | |
| U.S. government and agency securities due | | | | | |
| Within 1 year | \$ 21,284 | \$ — | \$ (59) | \$ 21,225 | 0.81% |
| 1 to 5 years | 12,477 | 1,027 | (11) | 13,493 | 7.94 |
| 5 to 10 years | 48,134 | — | (1,589) | 46,545 | 1.14 |
| Over 10 years | 182,051 | 27 | (3,990) | 178,088 | 1.33 |
| Equity Securities | | | | | |
| Within 1 year | — | — | — | — | — |
| 1 to 5 years | 100,422 | 1,402 | — | 101,824 | 1.90 |
| Corporate debt securities due | | | | | |
| Within 1 year | 278,094 | 325 | (53) | 278,366 | 1.33 |
| 1 to 5 years | 63,481 | 928 | (113) | 64,296 | 2.47 |
| 5 to 10 years | 69,955 | — | (2,417) | 67,538 | 1.96 |
| Over 10 years | 50,000 | 938 | — | 50,938 | 3.00 |
| Municipal bonds due | | | | | |
| 1 to 5 years | 2,315 | 2 | — | 2,317 | 1.23 |
| 5 to 10 years | 1,335 | 38 | — | 1,373 | 2.05 |
| Over 10 years | 20,363 | 3,617 | — | 23,980 | 6.45 |
| Mortgage-backed securities | | | | | |
| Agency pass-through certificates | 978,955 | 17,118 | (3,032) | 993,041 | 2.58 |
| Commercial MBS | 80,318 | — | (448) | 79,870 | 1.91 |
| | <u>1,909,184</u> | <u>25,422</u> | <u>(11,712)</u> | <u>1,922,894</u> | <u>2.22</u> |
| Held-to-maturity securities | | | | | |
| Mortgage-backed securities | | | | | |
| Agency pass-through certificates | 1,417,599 | 24,171 | (214) | 1,441,556 | 3.18 |
| | <u>1,417,599</u> | <u>24,171</u> | <u>(214)</u> | <u>1,441,556</u> | <u>3.18</u> |
| | <u>\$3,326,783</u> | <u>\$49,593</u> | <u>\$(11,926)</u> | <u>\$3,364,450</u> | <u>2.62%</u> |
| September 30, | | | | | |
| | 2015 | | | | |
| | Amortized Cost | Gross Unrealized | | Fair Value | Yield |
| | (In thousands) | | | | |
| Available-for-sale securities | | | | | |
| U.S. government and agency securities due | | | | | |
| 1 to 5 years | \$ 105,065 | \$ 1,923 | \$ (274) | \$ 106,714 | 1.74% |
| 5 to 10 years | 119,071 | 35 | (1,247) | 117,859 | 1.54 |
| Over 10 years | 262,832 | — | (4,941) | 257,891 | 1.23 |
| Equity Securities | | | | | |
| Within 1 year | 500 | 17 | — | 517 | 1.80 |
| 1 to 5 years | 99,922 | 1,513 | — | 101,435 | 1.90 |
| Corporate debt securities due | | | | | |
| Within 1 year | 24,787 | 191 | — | 24,978 | 0.53 |
| 1 to 5 years | 311,435 | 1,190 | (58) | 312,567 | 0.88 |
| 5 to 10 years | 100,000 | 876 | (3,524) | 97,352 | 1.47 |
| Over 10 years | 69,950 | 953 | — | 70,903 | 3.00 |
| Municipal bonds due | | | | | |
| 1 to 5 years | 2,285 | 8 | — | 2,293 | 1.23 |
| 5 to 10 years | 1,303 | 7 | — | 1,310 | 2.05 |
| Over 10 years | 20,382 | 3,138 | — | 23,520 | 6.45 |
| Mortgage-backed securities | | | | | |
| Agency pass-through certificates | 1,144,787 | 18,222 | (2,491) | 1,160,518 | 2.48 |
| Commercial MBS | 103,131 | 85 | (510) | 102,706 | 1.51 |
| | <u>2,365,450</u> | <u>28,158</u> | <u>(13,045)</u> | <u>2,380,563</u> | <u>1.97</u> |
| Held-to-maturity securities | | | | | |
| Mortgage-backed securities | | | | | |
| Agency pass-through certificates | 1,643,216 | 10,516 | (16,312) | 1,637,420 | 3.19 |
| | <u>1,643,216</u> | <u>10,516</u> | <u>(16,312)</u> | <u>1,637,420</u> | <u>3.19</u> |
| | <u>\$4,008,666</u> | <u>\$38,674</u> | <u>\$(29,357)</u> | <u>\$4,017,983</u> | <u>2.46%</u> |

The Company purchased \$137,591,000 of available-for-sale investment securities and no held-to-maturity investment securities during 2016. The Company sold \$50,741,000 of available-for-sale securities and there were no sales of held-to-maturity investment securities in 2016. Substantially all mortgage-backed securities have contractual due dates that exceed twenty-five years.

The following table shows the gross unrealized losses and fair value of securities at September 30, 2016 and September 30, 2015, by length of time that individual securities in each category have been in a continuous loss position. Management believes that the declines in fair value of these investments are not an other than temporary impairment as these losses are due to a change in interest rates rather than any credit deterioration. The impairment is also deemed to be temporary because: 1) the Bank does not intend to sell the security, and 2) it is not more likely than not that it will be required to sell the security before recovery of the entire amortized cost basis of the security.

| September 30, | 2016 | | | | | |
|---|----------------------------|------------------|----------------------------|--------------------|----------------------------|--------------------|
| | Less than 12 months | | 12 months or more | | Total | |
| | Unrealized Gross Losses | Fair Value | Unrealized Gross Losses | Fair Value | Unrealized Gross Losses | Fair Value |
| | (In thousands) | | | | | |
| Corporate debt securities | \$ — | \$ — | \$ (2,582) | \$ 100,467 | \$ (2,582) | \$ 100,467 |
| U.S. agency securities | (11) | 3,167 | (5,638) | 220,613 | (5,649) | 223,780 |
| Agency pass-through certificates | (1,278) | 301,030 | (2,417) | 232,407 | (3,695) | 533,437 |
| | <u>\$(1,289)</u> | <u>\$304,197</u> | <u>\$(10,637)</u> | <u>\$ 553,487</u> | <u>\$(11,926)</u> | <u>\$ 857,684</u> |
| September 30, | 2015 | | | | | |
| | Less than 12 months | | 12 months or more | | Total | |
| | Unrealized Gross Losses | Fair Value | Unrealized Gross Losses | Fair Value | Unrealized Gross Losses | Fair Value |
| | (In thousands) | | | | | |
| Corporate debt securities | \$ (183) | \$ 72,862 | \$ (3,399) | \$ 46,601 | \$ (3,582) | \$ 119,463 |
| U.S. agency securities | (5,010) | 336,243 | (1,452) | 57,344 | (6,462) | 393,587 |
| Agency pass-through certificates | (1,036) | 169,541 | (18,277) | 1,193,463 | (19,313) | 1,363,004 |
| | <u>\$(6,229)</u> | <u>\$578,646</u> | <u>\$(23,128)</u> | <u>\$1,297,408</u> | <u>\$(29,357)</u> | <u>\$1,876,054</u> |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE D

LOANS RECEIVABLE

The following table is a summary of loans receivable.

| | September 30, 2016 | | September 30, 2015 | |
|---|---------------------|--------------|--------------------|--------------|
| | (In thousands) | | (In thousands) | |
| Non-Acquired loans | | | | |
| Single-family residential | \$ 5,621,066 | 51.3% | \$5,651,845 | 57.5% |
| Construction | 1,110,411 | 10.1 | 200,509 | 2.0 |
| Construction - custom | 473,069 | 4.3 | 396,307 | 4.0 |
| Land - acquisition & development | 116,156 | 1.1 | 94,208 | 1.0 |
| Land - consumer lot loans | 101,853 | 0.9 | 103,989 | 1.1 |
| Multi-family | 1,118,801 | 10.2 | 1,125,722 | 11.5 |
| Commercial real estate | 956,164 | 8.7 | 986,270 | 10.0 |
| Commercial & industrial | 946,648 | 8.6 | 612,836 | 6.2 |
| HELOC | 134,785 | 1.2 | 127,646 | 1.3 |
| Consumer | 137,450 | 1.3 | 194,655 | 2.0 |
| Total non-acquired loans | 10,716,403 | 97.9% | 9,493,987 | 96.6% |
| Acquired loans | 115,394 | 1.1 | 166,293 | 1.7 |
| Credit impaired acquired loans | 89,837 | 0.8 | 87,081 | 0.9 |
| Covered loans | 28,974 | 0.3 | 75,909 | 0.8 |
| Total gross loans | 10,950,608 | 100% | 9,823,270 | 100% |
| Less: | | | | |
| Allowance for probable losses | 113,494 | | 106,829 | |
| Loans in process | 879,484 | | 476,796 | |
| Discount on acquired loans | 11,306 | | 30,095 | |
| Deferred net origination fees | 35,404 | | 38,916 | |
| Total loan contra accounts | 1,039,688 | | 652,636 | |
| Net Loans | \$ 9,910,920 | | \$9,170,634 | |

The following summary breaks down the Company's fixed rate and adjustable rate loans by time to maturity or to rate adjustment.

September 30, 2016

| Fixed-Rate | | Adjustable-Rate | |
|------------------|--------------------|-------------------------|--------------------|
| Term To Maturity | Gross Loans | Term To Rate Adjustment | Gross Loans |
| (In thousands) | | (In thousands) | |
| Within 1 year | \$ 29,428 | Less than 1 year | \$1,362,480 |
| 1 to 3 years | 326,859 | 1 to 3 years | 1,457,584 |
| 3 to 5 years | 192,202 | 3 to 5 years | 552,402 |
| 5 to 10 years | 693,099 | 5 to 10 years | 625,852 |
| 10 to 20 years | 1,020,654 | 10 to 20 years | — |
| Over 20 years | 4,690,048 | Over 20 years | — |
| | <u>\$6,952,290</u> | | <u>\$3,998,318</u> |

The following tables provide information regarding loans receivable by loan category and geography.

| September 30, 2016 | Single-family residential | Multi-family | Land - A & D | Land - lot loans | Construction - custom | Construction | Commercial real estate | Commercial and industrial | Consumer | HELOC | Total |
|--------------------|---------------------------|--------------------|------------------|------------------|-----------------------|--------------------|------------------------|---------------------------|------------------|------------------|---------------------|
| (In thousands) | | | | | | | | | | | |
| Washington | \$2,926,555 | \$ 287,999 | \$ 74,017 | \$ 59,371 | \$277,877 | \$ 470,720 | \$ 482,802 | \$500,540 | \$ 41,212 | \$ 88,681 | \$ 5,209,774 |
| Oregon | 664,932 | 332,311 | 310,953 | 12,403 | 52,709 | 122,958 | 171,093 | 203,377 | 3,152 | 13,711 | 1,587,599 |
| Arizona | 546,080 | 292,830 | 4,142 | 9,014 | 45,536 | 43,300 | 38,302 | 47,584 | 309 | 15,838 | 1,042,935 |
| Other | 216,902 | 2,448 | 443 | 11,157 | 11,228 | 110,843 | 277,438 | 94,215 | 91,874 | 1,030 | 817,578 |
| Utah | 474,390 | 47,374 | 958 | 3,448 | 33,036 | 143,246 | 11,499 | 46,497 | 39 | 7,573 | 768,060 |
| Idaho | 284,212 | 33,043 | 4,761 | 3,910 | 17,120 | 64,510 | 34,075 | 16,627 | 141 | 6,973 | 465,372 |
| New Mexico | 186,061 | 97,699 | 12,417 | 1,274 | 18,128 | 47,763 | 68,385 | 10,860 | 1,110 | 13,790 | 457,487 |
| Texas | 202,541 | 29,458 | 10,806 | 979 | 10,610 | 107,071 | 6,151 | 42,594 | 1,085 | 305 | 411,600 |
| Nevada | 157,154 | 1,127 | — | 3,012 | 6,825 | — | 3,894 | 16,295 | 80 | 1,816 | 190,203 |
| | <u>\$5,658,827</u> | <u>\$1,124,289</u> | <u>\$118,497</u> | <u>\$104,568</u> | <u>\$473,069</u> | <u>\$1,110,411</u> | <u>\$1,093,639</u> | <u>\$978,589</u> | <u>\$139,002</u> | <u>\$149,717</u> | <u>\$10,950,608</u> |

Percentage by geographic area

| September 30, 2016 | Single-family residential | Multi-family | Land - A & D | Land - lot loans | Construction - custom | Construction | Commercial real estate | Commercial and industrial | Consumer | HELOC | Total |
|---------------------------|---------------------------|--------------|--------------|------------------|-----------------------|--------------|------------------------|---------------------------|-------------|-------------|-------------|
| As % of total gross loans | | | | | | | | | | | |
| Washington | 26.8% | 2.6% | 0.7% | 0.5% | 2.5% | 4.3% | 4.4% | 4.6% | 0.4% | 0.8% | 47.6% |
| Oregon | 6.1 | 3.0 | 0.1 | 0.1 | 0.5 | 1.1 | 1.6 | 1.9 | — | 0.1 | 14.5 |
| Arizona | 5.0 | 2.7 | — | 0.1 | 0.4 | 0.4 | 0.3 | 0.4 | — | 0.2 | 9.5 |
| Other | 2.0 | — | — | 0.2 | 0.1 | 1.0 | 2.5 | 0.9 | 0.8 | — | 7.5 |
| Utah | 4.3 | 0.5 | — | — | 0.3 | 1.3 | 0.1 | 0.4 | — | 0.1 | 7.0 |
| Idaho | 2.5 | 0.3 | — | — | 0.2 | 0.6 | 0.3 | 0.2 | — | 0.1 | 4.2 |
| New Mexico | 1.8 | 0.9 | 0.1 | — | 0.2 | 0.4 | 0.6 | 0.1 | — | 0.1 | 4.2 |
| Texas | 1.8 | 0.3 | 0.1 | — | 0.1 | 1.0 | 0.1 | 0.4 | — | — | 3.8 |
| Nevada | 1.4 | — | 0.1 | — | 0.1 | — | — | 0.1 | — | — | 1.7 |
| | <u>51.7%</u> | <u>10.3%</u> | <u>1.1%</u> | <u>0.9%</u> | <u>4.4%</u> | <u>10.1%</u> | <u>9.9%</u> | <u>9.0%</u> | <u>1.2%</u> | <u>1.4%</u> | <u>100%</u> |

Percentage by geographic area as a % of each loan type

| September 30, 2016 | Single-family residential | Multi-family | Land - A & D | Land - lot loans | Construction - custom | Construction | Commercial real estate | Commercial and industrial | Consumer | HELOC |
|---------------------------|---------------------------|--------------|--------------|------------------|-----------------------|--------------|------------------------|---------------------------|-------------|-------------|
| As % of total gross loans | | | | | | | | | | |
| Washington | 51.6% | 25.7% | 62.5% | 56.8% | 58.9% | 42.4% | 44.0% | 51.0% | 29.6% | 59.1% |
| Oregon | 11.8 | 29.6 | 9.2 | 11.9 | 11.1 | 11.1 | 15.6 | 20.8 | 2.3 | 9.2 |
| Arizona | 9.7 | 26.0 | 3.5 | 8.6 | 9.6 | 3.9 | 3.5 | 4.9 | 0.2 | 10.6 |
| Other | 3.8 | 0.2 | 0.4 | 10.7 | 2.4 | 10.0 | 25.4 | 9.6 | 66.1 | 0.7 |
| Utah | 8.4 | 4.2 | 0.8 | 3.3 | 7.0 | 12.9 | 1.1 | 4.8 | — | 5.1 |
| Idaho | 5.0 | 2.9 | 4.0 | 3.7 | 3.6 | 5.8 | 3.1 | 1.7 | 0.1 | 4.7 |
| New Mexico | 3.3 | 8.7 | 10.5 | 1.2 | 3.8 | 4.3 | 6.3 | 1.1 | 0.8 | 9.2 |
| Texas | 3.6 | 2.6 | 9.1 | 0.9 | 2.2 | 9.6 | 0.6 | 4.4 | 0.8 | 0.2 |
| Nevada | 2.8 | 0.1 | — | 2.9 | 1.4 | — | 0.4 | 1.7 | 0.1 | 1.2 |
| | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Company has granted loans to officers and directors of the Company and related interests. These loans are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectability. The aggregate dollar amount of these loans, including unfunded commitments to lend, was \$57,153,000 and \$55,965,000 at September 30, 2016 and 2015, respectively.

The following table provides additional information on impaired loans, loan commitments and loans serviced for others.

| | September 30, 2016 | September 30, 2015 |
|--|--------------------|--------------------|
| | (In thousands) | |
| Recorded investment in impaired loans | \$285,243 | \$341,579 |
| TDRs included in impaired loans | 261,531 | 302,713 |
| Allocated reserves on impaired loans | 1,980 | 2,323 |
| Specific reserves on impaired loans | 366 | 275 |
| Average balance of impaired loans for year ended | 265,771 | 333,815 |
| Interest income from impaired loans for year ended | 11,314 | 14,855 |
| Outstanding fixed-rate origination commitments | 331,947 | 230,869 |
| Gross loans serviced for others | 80,896 | 72,083 |

The following table sets forth information regarding non-accrual loans.

| | September 30, 2016 | | September 30, 2015 | |
|--|--------------------|-------------|--------------------|-------------|
| | (In thousands) | | | |
| Non-accrual loans: | | | | |
| Single-family residential | \$33,148 | 78.2% | \$59,074 | 87.1% |
| Construction | — | — | 754 | 1.1 |
| Construction - custom | — | — | 732 | 1.1 |
| Land - acquisition & development | 58 | 0.1 | — | — |
| Land - consumer lot loans | 510 | 1.2 | 1,273 | 1.9 |
| Multi-family | 776 | 1.8 | 2,558 | 3.8 |
| Commercial real estate | 7,100 | 16.7 | 2,176 | 3.2 |
| Commercial & industrial | 583 | 1.4 | — | — |
| HELOC | 239 | 0.6 | 563 | 0.8 |
| Consumer | — | — | 680 | 1.0 |
| Total non-accrual loans | <u>\$42,414</u> | <u>100%</u> | <u>\$67,810</u> | <u>100%</u> |

The following table breaks down delinquent loans by loan category and delinquency bucket.

| September 30, 2016 Type of Loan | Amount of Loans Net of Loans in Process | Days Delinquent Based on \$ Amount of Loans | | | | | % based on \$ |
|---|---|---|------------------|----------------|-----------------|-----------------|------------------|
| | | Current | 30 | 60 | 90 | Total | |
| (In thousands) | | | | | | | |
| Non-acquired loans | | | | | | | |
| Single-family residential | \$ 5,624,783 | \$ 5,574,384 | \$ 20,917 | \$ 5,173 | \$ 24,309 | \$ 50,399 | 0.90% |
| Construction | 497,393 | 497,393 | — | — | — | — | — |
| Construction - custom | 229,957 | 229,419 | 538 | — | — | 538 | 0.23 |
| Land - acquisition & development | 88,662 | 88,662 | — | — | — | — | — |
| Land - consumer lot loans | 102,386 | 100,373 | 816 | 687 | 510 | 2,013 | 1.97 |
| Multi-family | 1,119,042 | 1,117,453 | 1,190 | 399 | — | 1,589 | 0.14 |
| Commercial real estate | 955,944 | 955,604 | — | 183 | 157 | 340 | 0.04 |
| Commercial & industrial | 947,703 | 947,661 | — | 42 | — | 42 | — |
| HELOC | 134,214 | 133,683 | 490 | — | 41 | 531 | 0.40 |
| Consumer | 136,835 | 135,926 | 705 | 124 | 80 | 909 | 0.66 |
| | 9,836,919 | 9,780,558 | 24,656 | 6,608 | 25,097 | 56,361 | 0.57 |
| Acquired loans | 115,394 | 114,770 | 124 | 2 | 498 | 624 | 0.54 |
| Credit impaired acquired loans | 89,837 | 84,625 | 227 | 142 | 4,843 | 5,212 | 5.80 |
| Covered loans | 28,974 | 22,891 | — | 262 | 5,821 | 6,083 | 20.99 |
| Total Loans | \$10,071,124 | \$10,002,844 | \$ 25,007 | \$7,014 | \$36,259 | \$68,280 | 0.68% |
| Delinquency % | | 99.32% | 0.25% | 0.07% | 0.36% | 0.68% | |

The percentage of total delinquent loans was 0.68% as of September 30, 2016, as compared to 0.88% as of September 30, 2015.

Most loans restructured in troubled debt restructurings (“TDRs”) are accruing and performing loans where the borrower has proactively approached the Company about modifications due to temporary financial difficulties. Each request is individually evaluated for merit and likelihood of success. The concession for these loans is typically a payment reduction through a rate reduction of 100 to 200 bps for a specific term, usually six to twelve months. Interest-only payments may also be approved during the modification period. Principal forgiveness is not an available option for restructured loans. As of September 30, 2016, the outstanding balance of TDR’s was \$261,531,000 as compared to \$302,713,000 as of September 30, 2015. As of September 30, 2016, 96.2% of the restructured loans were performing. Single-family residential loans comprised 87.2% of TDR loans as of September 30, 2016. The Company reserves for restructured loans within its allowance for loan loss methodology by taking into account the following performance indicators: 1) time since modification, 2) current payment status and 3) geographic area.

The following table provides information related to loans that were modified in a TDR during the periods presented.

| | Twelve Months Ended September 30, 2016 | | | Twelve Months Ended September 30, 2015 | | |
|---------------------------------|--|---|--|--|---|---|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Pre-Modification Outstanding Recorded Investment |
| Troubled Debt Restructurings: | | (In thousands) | | | (In thousands) | |
| Single-family residential . . . | 120 | \$23,541 | \$23,541 | 62 | \$13,378 | \$13,378 |
| Construction | — | — | — | 2 | 701 | 701 |
| Land - consumer lot loans . . | 10 | 970 | 970 | 9 | 1,546 | 1,546 |
| Commercial real estate | 7 | 2,523 | 2,523 | 3 | 3,175 | 3,175 |
| HELOC | 1 | 126 | 126 | 1 | 50 | 50 |
| Consumer | 1 | 24 | 24 | 1 | 80 | 80 |
| | 139 | \$ 27,184 | \$27,184 | 78 | \$18,930 | \$18,930 |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following table provides information on payment defaults occurring during the periods presented where the loan had been modified in a TDR within 12 months of the payment default.

| | Twelve Months Ended September 30, 2016 | | Twelve Months Ended September 30, 2015 | |
|-----------------------------------|---|------------------------|---|------------------------|
| | Number of Contracts | Recorded Investment | Number of Contracts | Recorded Investment |
| TDRs That Subsequently Defaulted: | (In thousands) | | (In thousands) | |
| Single-family residential | 17 | \$4,875 | 18 | \$2,917 |
| Construction | 1 | 279 | — | — |
| Land - consumer lot loans | 5 | 606 | 2 | 301 |
| Commercial real estate | 2 | 326 | — | — |
| | <u>25</u> | <u>\$6,086</u> | <u>20</u> | <u>\$3,218</u> |

The excess of cash flows expected to be collected over the initial fair value of acquired impaired loans is referred to as the accretable yield and this amount is accreted into interest income over the estimated life of the acquired loans using the effective yield method. Other adjustments to the accretable yield include changes in the estimated remaining life of the acquired loans, changes in expected cash flows and changes in the indices for acquired loans with variable interest rates.

The following table shows the changes in accretable yield for acquired impaired loans and acquired non-impaired loans including covered loans for the years ended September 30, 2016 and 2015.

| | Twelve Months Ended September 30, 2016 | | | | Twelve Months Ended September 30, 2015 | | | |
|--|--|--------------------------------|-----------------------|--------------------------------|--|--------------------------------|-----------------------|--------------------------------|
| | Acquired Impaired | | Acquired Non-impaired | | Acquired Impaired | | Acquired Non-impaired | |
| | Accretable Yield | Carrying Amount of Loans | Accretable Yield | Carrying Amount of Loans | Accretable Yield | Carrying Amount of Loans | Accretable Yield | Carrying Amount of Loans |
| | (In thousands) | | | | (In thousands) | | | |
| Beginning balance | \$ 72,705 | \$111,300 | \$ 7,204 | \$187,080 | \$ 97,125 | \$135,826 | \$14,513 | \$275,862 |
| Net reclassification from non-accretable | 4,867 | — | — | — | 6,307 | — | 346 | — |
| Accretion | (18,730) | 18,730 | (2,982) | 2,982 | (30,727) | 30,727 | (7,655) | 7,655 |
| Transfers to REO | — | (175) | — | — | — | (2,975) | — | (150) |
| Payments received, net | — | (38,094) | — | (58,930) | — | (52,278) | — | (96,287) |
| Ending Balance | <u>\$ 58,842</u> | <u>\$ 91,761</u> | <u>\$ 4,222</u> | <u>\$ 131,132</u> | <u>\$ 72,705</u> | <u>\$111,300</u> | <u>\$ 7,204</u> | <u>\$187,080</u> |

At September 30, 2016 and September 30, 2015, none of the acquired impaired or non-impaired loans were classified as non-performing assets. Therefore, interest income, through accretion of the difference between the carrying amount of the loans and the expected cash flows, was recognized on all acquired loans.

The FDIC loss share coverage for the acquired commercial loans from the former Horizon Bank expired after March 31, 2015. These loans were transferred to loans receivable. The FDIC loss share coverage for the acquired commercial loans from the former Home Valley Bank expired after of September 30, 2015 with final reporting as of October 31, 2015. Recoveries to the extent that claims were made will continue to be shared for three years. The FDIC loss share coverage for single family residential loans will continue for another four years.

The outstanding principal balance of covered loans was \$28,974,000 as of September 30, 2016, as compared to \$75,909,000 as of September 30, 2015. The discount balance related to the covered loans was \$2,738,000 as of September 30, 2016.

The following table shows the year to date activity for the FDIC indemnification asset.

| | Twelve Months Ended September 30, 2016 | Twelve Months Ended September 30, 2015 |
|--|---|---|
| (In thousands) | | |
| Balance at beginning of year | \$16,275 | \$ 36,860 |
| Additions and impairment | — | (1,795) |
| Payments received | (1,730) | (720) |
| Amortization | (2,012) | (18,588) |
| Accretion | 236 | 518 |
| Balance at end of year | <u>\$12,769</u> | <u>\$ 16,275</u> |

NOTE E

ALLOWANCE FOR LOSSES ON LOANS

The following tables summarize the activity in the allowance for loan losses.

| Twelve Months Ended September 30, 2016 | Beginning Allowance | Charge-offs | Recoveries | Provision & Transfers | Ending Allowance |
|--|------------------------|-------------------|-----------------|--------------------------|---------------------|
| (In thousands) | | | | | |
| Single-family residential | \$ 47,347 | \$ (3,106) | \$ 3,251 | \$ (9,696) | \$ 37,796 |
| Construction | 6,680 | — | 745 | 12,413 | 19,838 |
| Construction - custom | 990 | (60) | 60 | 90 | 1,080 |
| Land - acquisition & development | 5,781 | (42) | 8,220 | (7,936) | 6,023 |
| Land - consumer lot loans | 2,946 | (732) | 5 | 316 | 2,535 |
| Multi-family | 5,304 | — | — | 1,621 | 6,925 |
| Commercial real estate | 8,960 | (103) | 1,812 | (2,081) | 8,588 |
| Commercial & industrial | 24,980 | (941) | 2,933 | 1,036 | 28,008 |
| HELOC | 902 | (54) | 21 | (56) | 813 |
| Consumer | 2,939 | (962) | 2,018 | (2,107) | 1,888 |
| | <u>\$106,829</u> | <u>\$ (6,000)</u> | <u>\$19,065</u> | <u>\$ (6,400)</u> | <u>\$113,494</u> |

| Twelve Months Ended September 30, 2015 | Beginning Allowance | Charge-offs | Recoveries | Provision & Transfers | Ending Allowance |
|--|------------------------|-------------------|-----------------|--------------------------|---------------------|
| (In thousands) | | | | | |
| Single-family residential | \$ 62,763 | \$ (5,524) | \$13,403 | \$(23,295) | \$ 47,347 |
| Construction | 6,742 | (388) | 120 | 206 | 6,680 |
| Construction - custom | 1,695 | — | — | (705) | 990 |
| Land - acquisition & development | 5,592 | (38) | 207 | 20 | 5,781 |
| Land - consumer lot loans | 3,077 | (459) | 221 | 107 | 2,946 |
| Multi-family | 4,248 | — | 220 | 836 | 5,304 |
| Commercial real estate | 7,548 | (1,711) | 735 | 2,388 | 8,960 |
| Commercial & industrial | 16,527 | (3,354) | 1,374 | 10,433 | 24,980 |
| HELOC | 928 | (66) | 2 | 38 | 902 |
| Consumer | 3,227 | (3,060) | 3,688 | (916) | 2,939 |
| Covered loans | 2,244 | — | — | (2,244) | — |
| | <u>\$ 114,591</u> | <u>\$(14,600)</u> | <u>\$19,970</u> | <u>\$(13,132)</u> | <u>\$106,829</u> |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Company recorded a release of allowance for loan losses of \$6,400,000 during the year ended September 30, 2016, as compared to a release of \$11,162,000 for the year ended September 30, 2015. The credit quality of the portfolio has been improving significantly and economic conditions are more stable.

The Company had recoveries, net of charge-offs, of \$13,065,000 for the year ended September 30, 2016, compared with net recoveries of \$5,370,000 for the year ended September 30, 2015. A loan is charged-off when the loss is estimable and it is confirmed that the borrower is not expected to be able to meet its contractual obligations.

Non-accrual loans decreased to \$42,414,000 as of September 30, 2016 from \$67,810,000 as of September 30, 2015. Non-performing assets ("NPAs") totaled \$71,441,000, or 0.48% of total assets, at September 30, 2016, compared to \$128,908,000, or 0.88% of total assets, as of September 30, 2015. Acquired loans, including covered loans, are not classified as non-performing loans because they are recorded at fair value at acquisition and reflect lifetime estimated losses at that time. As of September 30, 2016, \$20,175,000 in acquired loans were subject to the general allowance as the discount related to these balances was not sufficient to absorb potential losses.

There is no allowance for covered loans as of September 30, 2016 or September 30, 2015.

At September 30, 2016, \$113,128,000 of the allowance was calculated under the formulas contained in our general allowance methodology and the remaining \$366,000 represents specific reserves on loans that were deemed to be impaired.

The following tables show a summary of loans collectively and individually evaluated for impairment and the related allocation of general and specific reserves.

| September 30, 2016 | Loans Collectively Evaluated for Impairment | | | Loans Individually Evaluated for Impairment | | |
|--|---|--|-------------|---|---|-------------|
| | General Reserve Allocation | Gross Loans Subject to General Reserve (1) | Ratio | Specific Reserve Allocation | Gross Loans Subject to Specific Reserve (1) | Ratio |
| | (In thousands) | | | (In thousands) | | |
| Single-family residential | \$ 37,536 | \$ 5,585,912 | 0.7% | 260 | \$ 19,629 | 1.3% |
| Construction | 19,838 | 498,450 | 4.0 | — | — | — |
| Construction - custom | 1,080 | 229,298 | 0.5 | — | 330 | — |
| Land - acquisition & development | 6,022 | 90,850 | 6.6 | 2 | 850 | 0.2 |
| Land - consumer lot loans | 2,535 | 92,828 | 2.7 | — | 558 | — |
| Multi-family | 6,911 | 1,091,974 | 0.6 | 13 | 1,505 | 0.9 |
| Commercial real estate | 8,497 | 957,380 | 0.9 | 91 | 11,157 | 0.8 |
| Commercial & industrial | 28,008 | 966,930 | 2.9 | — | — | — |
| HELOC | 813 | 133,203 | 0.6 | — | 239 | — |
| Consumer | 1,888 | 137,315 | 1.4 | — | 3 | — |
| | <u>\$ 113,128</u> | <u>\$ 9,784,140</u> | <u>1.2%</u> | <u>366</u> | <u>\$ 34,271</u> | <u>1.1%</u> |

(1) Excludes acquired loans with discounts sufficient to absorb potential losses and covered loans.

| September 30, 2015 | Loans Collectively Evaluated for Impairment | | | Loans Individually Evaluated for Impairment | | |
|--|---|--|-------|---|---|-------|
| | General Reserve Allocation | Gross Loans Subject to General Reserve (1) | Ratio | Specific Reserve Allocation | Gross Loans Subject to Specific Reserve (1) | Ratio |
| | (In thousands) | | | (In thousands) | | |
| Single-family residential | \$ 47,073 | \$ 5,595,752 | 0.8% | \$ 275 | \$ 51,718 | 0.5% |
| Construction | 6,680 | 124,679 | 5.4 | — | 5,441 | — |
| Construction - custom | 990 | 205,692 | 0.5 | — | — | — |
| Land - acquisition & development | 5,781 | 72,602 | 8.0 | — | 2,198 | — |
| Land - consumer lot loans | 2,946 | 93,103 | 3.2 | — | 10,824 | — |
| Multi-family | 5,304 | 1,062,194 | 0.5 | — | 5,348 | — |
| Commercial real estate | 8,960 | 844,691 | 1.1 | — | 8,826 | — |
| Commercial & industrial | 24,980 | 643,577 | 3.9 | — | — | — |
| HELOC | 902 | 126,594 | 0.7 | — | 1,072 | — |
| Consumer | 2,938 | 194,569 | 1.5 | — | 86 | — |
| | <u>\$ 106,554</u> | <u>\$ 8,963,453</u> | 1.2% | <u>\$ 275</u> | <u>\$ 85,513</u> | 0.3% |

(1) Excludes acquired loans with discounts sufficient to absorb potential losses and covered loans.

The Company has an asset quality review function that analyzes the loan portfolio and reports the results of the review to the Board of Directors on a quarterly basis. The single-family residential, HELOC and consumer portfolios are evaluated based on their performance as a pool of loans, since no single loan is individually significant or judged by its risk rating, size or potential risk of loss. The construction, land, multi-family, commercial real estate and commercial and industrial loans are risk rated on a loan by loan basis to determine the relative risk inherent in specific borrowers or loans. Based on that risk rating, the loans are assigned a grade and classified as follows:

- Pass - the credit does not meet one of the definitions defined below.
- Special mention - A special mention credit is considered to be currently protected from loss but is potentially weak. No loss of principal or interest is foreseen; however, proper supervision and Management attention is required to deter further deterioration in the credit. Assets in this category constitute some undue and unwarranted credit risk but not to the point of justifying a risk rating of substandard. The credit risk may be relatively minor yet constitutes an unwarranted risk in light of the circumstances surrounding a specific asset.
- Substandard - A substandard credit is an unacceptable credit. Additionally, repayment in the normal course is in jeopardy due to the existence of one or more well defined weaknesses. In these situations, loss of principal is likely if the weakness is not corrected. A substandard asset is inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral pledged, if any. Assets so classified will have a well defined weakness or weaknesses that jeopardize the liquidation of the debt. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets risk rated substandard.
- Doubtful - A credit classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weakness makes collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The probability of loss is high, but because of certain important and reasonably specific pending factors that may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral, and refinancing plans.
- Loss - Credits classified loss are considered uncollectible and of such little value that their continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this asset even though partial recovery may be affected in the future. Losses should be taken in the period in which they are identified as uncollectible. Partial charge-off versus full charge-off may be taken if the collateral offers some identifiable protection.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following tables provide information on loans based on credit quality indicators (defined above).

| September 30, 2016 | Internally Assigned Grade | | | | | Total Gross Loans |
|---|---------------------------|--------------------|-------------|----------|------|----------------------|
| | Pass | Special mention | Substandard | Doubtful | Loss | |
| | (In thousands) | | | | | |
| Non-acquired loans | | | | | | |
| Single-family residential | \$ 5,570,634 | \$ — | \$ 50,432 | \$ — | \$ — | \$ 5,621,066 |
| Construction | 1,098,549 | 8,595 | 3,267 | — | — | 1,110,411 |
| Construction - custom | 473,069 | — | — | — | — | 473,069 |
| Land - acquisition & development | 110,125 | — | 6,031 | — | — | 116,156 |
| Land - consumer lot loans | 100,862 | — | 991 | — | — | 101,853 |
| Multi-family | 1,112,342 | 3,237 | 3,222 | — | — | 1,118,801 |
| Commercial real estate | 928,032 | 13,446 | 14,686 | — | — | 956,164 |
| Commercial & industrial | 900,571 | 7,160 | 38,917 | — | — | 946,648 |
| HELOC | 134,298 | — | 487 | — | — | 134,785 |
| Consumer | 137,367 | — | 83 | — | — | 137,450 |
| Total non-acquired loans | 10,565,849 | 32,438 | 118,116 | — | — | 10,716,403 |
| Acquired loans | 108,616 | 47 | 6,731 | — | — | 115,394 |
| Credit impaired acquired loans | 60,985 | — | 28,852 | — | — | 89,837 |
| Covered loans | 28,647 | — | 327 | — | — | 28,974 |
| Total gross loans | \$ 10,764,097 | \$ 32,485 | \$ 154,026 | \$ — | \$ — | \$ 10,950,608 |
| Total grade as a % of total gross loans | 98.3% | 0.3% | 1.4% | —% | —% | |

| September 30, 2015 | Internally Assigned Grade | | | | | Total Gross Loans |
|---|---------------------------|--------------------|-------------|----------|------|----------------------|
| | Pass | Special mention | Substandard | Doubtful | Loss | |
| | (In thousands) | | | | | |
| Non-acquired loans | | | | | | |
| Single-family residential | \$ 5,558,700 | \$ — | \$ 93,145 | \$ — | \$ — | \$ 5,651,845 |
| Construction | 197,935 | — | 2,574 | — | — | 200,509 |
| Construction - custom | 396,307 | — | — | — | — | 396,307 |
| Land - acquisition & development | 89,656 | — | 4,552 | — | — | 94,208 |
| Land - consumer lot loans | 103,569 | — | 420 | — | — | 103,989 |
| Multi-family | 1,118,673 | 865 | 6,184 | — | — | 1,125,722 |
| Commercial real estate | 971,510 | 4,360 | 10,400 | — | — | 986,270 |
| Commercial & industrial | 575,034 | 1,496 | 36,306 | — | — | 612,836 |
| HELOC | 127,398 | — | 248 | — | — | 127,646 |
| Consumer | 194,451 | — | 204 | — | — | 194,655 |
| Total non-acquired loans | 9,333,233 | 6,721 | 154,033 | — | — | 9,493,987 |
| Acquired loans | 149,891 | — | 16,402 | — | — | 166,293 |
| Credit impaired acquired loans | 61,019 | — | 26,062 | — | — | 87,081 |
| Covered loans | 61,776 | — | 14,133 | — | — | 75,909 |
| Total gross loans | \$ 9,605,919 | \$ 6,721 | \$ 210,630 | \$ — | \$ — | \$ 9,823,270 |
| Total grade as a % of total gross loans | 97.8% | 0.1% | 2.1% | —% | —% | |

The following tables provide information on loans based on payment activity.

| September 30, 2016 | Performing Loans | | Non-Performing Loans | |
|--|----------------------|-------------|----------------------|-------------|
| | Amount | % of Total | Amount | % of Total |
| | | Gross Loans | | Gross Loans |
| | (In thousands) | | (In thousands) | |
| Single-family residential | \$ 5,587,919 | 99.4% | \$ 33,148 | 0.6% |
| Construction | 1,110,411 | 100.0 | — | — |
| Construction - custom | 473,069 | 100.0 | — | — |
| Land - acquisition & development | 116,097 | 99.9 | 58 | 0.1 |
| Land - consumer lot loans | 101,343 | 99.5 | 510 | 0.5 |
| Multi-family | 1,118,025 | 99.9 | 776 | 0.1 |
| Commercial real estate | 949,064 | 99.3 | 7,100 | 0.7 |
| Commercial & industrial | 946,065 | 99.9 | 583 | 0.1 |
| HELOC | 134,546 | 99.8 | 239 | 0.2 |
| Consumer | 137,450 | 100.0 | — | — |
| | <u>\$ 10,673,989</u> | 99.6% | <u>\$ 42,414</u> | 0.4% |

| September 30, 2015 | Performing Loans | | Non-Performing Loans | |
|--|---------------------|-------------|----------------------|-------------|
| | Amount | % of Total | Amount | % of Total |
| | | Gross Loans | | Gross Loans |
| | (In thousands) | | (In thousands) | |
| Single-family residential | \$ 5,592,771 | 99.0% | \$ 59,074 | 1.0% |
| Construction | 199,755 | 99.6 | 754 | 0.4 |
| Construction - custom | 395,575 | 99.8 | 732 | 0.2 |
| Land - acquisition & development | 94,208 | 100.0 | — | — |
| Land - consumer lot loans | 102,716 | 98.8 | 1,273 | 1.2 |
| Multi-family | 1,123,165 | 99.8 | 2,558 | 0.2 |
| Commercial real estate | 984,093 | 99.8 | 2,176 | 0.2 |
| Commercial & industrial | 612,836 | 100.0 | — | — |
| HELOC | 127,083 | 99.6 | 563 | 0.4 |
| Consumer | 193,975 | 99.7 | 680 | 0.3 |
| | <u>\$ 9,426,177</u> | 99.3% | <u>\$ 67,810</u> | 0.7% |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following tables provide information on impaired loans by loan category.

| September 30, 2016 | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment |
|---|------------------------|--------------------------------|----------------------|-----------------------------------|
| (In thousands) | | | | |
| <u>Impaired loans with no related allowance recorded:</u> | | | | |
| Single-family residential | \$ 9,627 | \$ 11,366 | \$ — | \$ 6,511 |
| Construction | — | — | — | — |
| Construction - custom | — | — | — | — |
| Land - acquisition & development | 138 | 9,001 | — | 614 |
| Land - consumer lot loans | 499 | 609 | — | 317 |
| Multi-family | 394 | 3,972 | — | 638 |
| Commercial real estate | 11,741 | 21,301 | — | 6,260 |
| Commercial & industrial | 1,030 | 3,082 | — | 863 |
| HELOC | 209 | 315 | — | 165 |
| Consumer | 74 | 550 | — | 111 |
| | 23,712 | 50,196 | — | 15,479 |
| <u>Impaired loans with an allowance recorded:</u> | | | | |
| Single-family residential | 228,186 | 232,595 | 3,809 | 216,632 |
| Construction | — | — | — | — |
| Construction - custom | — | — | — | — |
| Land - acquisition & development | 1,154 | 2,094 | 1 | 1,766 |
| Land - consumer lot loans | 9,630 | 10,678 | 1 | 9,548 |
| Multi-family | 1,505 | 1,505 | 13 | 1,522 |
| Commercial real estate | 19,434 | 22,848 | 91 | 19,311 |
| Commercial & industrial | — | — | — | — |
| HELOC | 1,506 | 1,521 | — | 1,413 |
| Consumer | 116 | 306 | — | 100 |
| | 261,531 | 271,547 | 3,915(1) | 250,292 |
| <u>Total:</u> | | | | |
| Single-family residential | 237,813 | 243,961 | 3,809 | 223,143 |
| Construction | — | — | — | — |
| Construction - custom | — | — | — | — |
| Land - acquisition & development | 1,292 | 11,095 | 1 | 2,380 |
| Land - consumer lot loans | 10,129 | 11,287 | 1 | 9,865 |
| Multi-family | 1,899 | 5,477 | 13 | 2,160 |
| Commercial real estate | 31,175 | 44,149 | 91 | 25,571 |
| Commercial & industrial | 1,030 | 3,082 | — | 863 |
| HELOC | 1,715 | 1,836 | — | 1,578 |
| Consumer | 190 | 856 | — | 211 |
| | \$ 285,243 | \$ 321,743 | \$ 3,915 (1) | \$ 265,771 |

(1) Includes \$366,000 of specific reserves and \$3,549,000 included in the general reserves.

| September 30, 2015 | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment |
|---|------------------------|--------------------------------|----------------------|-----------------------------------|
| (In thousands) | | | | |
| <u>Impaired loans with no related allowance recorded:</u> | | | | |
| Single-family residential | \$ 17,250 | \$ 19,644 | \$ — | \$ 14,069 |
| Construction | 453 | 2,151 | — | 471 |
| Construction - custom | 554 | 554 | — | 182 |
| Land - acquisition & development | 2,570 | 9,426 | — | 926 |
| Land - consumer lot loans | 727 | 814 | — | 544 |
| Multi-family | 3,770 | 7,054 | — | 1,545 |
| Commercial real estate | 9,427 | 15,620 | — | 8,130 |
| Commercial & industrial | 2,955 | 13,066 | — | 2,681 |
| HELOC | 683 | 1,532 | — | 536 |
| Consumer | 477 | 703 | — | 390 |
| | 38,866 | 70,564 | — | 29,474 |
| <u>Impaired loans with an allowance recorded:</u> | | | | |
| Single-family residential | 259,461 | 263,268 | 6,678 | 260,028 |
| Construction | 4,988 | 5,778 | — | 5,432 |
| Construction - custom | — | — | — | — |
| Land - acquisition & development | 2,486 | 3,426 | — | 3,478 |
| Land - consumer lot loans | 11,289 | 11,554 | — | 11,324 |
| Multi-family | 3,823 | 3,823 | — | 3,732 |
| Commercial real estate | 19,124 | 21,078 | — | 18,886 |
| Commercial & industrial | — | — | — | — |
| HELOC | 1,443 | 1,443 | — | 1,359 |
| Consumer | 99 | 289 | — | 102 |
| | 302,713 | 310,659 | 6,678(1) | 304,341 |
| <u>Total:</u> | | | | |
| Single-family residential | 276,711 | 282,912 | 6,678 | 274,097 |
| Construction | 5,441 | 7,929 | — | 5,903 |
| Construction - custom | 554 | 554 | — | 182 |
| Land - acquisition & development | 5,056 | 12,852 | — | 4,404 |
| Land - consumer lot loans | 12,016 | 12,368 | — | 11,868 |
| Multi-family | 7,593 | 10,877 | — | 5,277 |
| Commercial real estate | 28,551 | 36,698 | — | 27,016 |
| Commercial & industrial | 2,955 | 13,066 | — | 2,681 |
| HELOC | 2,126 | 2,975 | — | 1,895 |
| Consumer | 576 | 992 | — | 492 |
| | \$ 341,579 | \$ 381,223 | \$ 6,678(1) | \$ 333,815 |

(1) Includes \$275,000 of specific reserves and \$6,403,000 included in the general reserves.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE F

FAIR VALUE MEASUREMENTS

ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active exchange markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

We have established and documented the Company's process for determining the fair values of the Company's assets and liabilities, where applicable. Fair value is based on quoted market prices, when available, for identical or similar assets or liabilities. In the absence of quoted market prices, fair value is determined using valuation models or third-party appraisals. The following is a description of the valuation methodologies used to measure and report the fair value of financial assets and liabilities on a recurring or nonrecurring basis.

Measured on a Recurring Basis

Available-for-sale investment securities and derivative contracts

Securities available for sale are recorded at fair value on a recurring basis. The fair value of debt securities are priced using model pricing based on the securities' relationship to other benchmark quoted prices as provided by an independent third party, and under GAAP are considered a Level 2 input method. Securities that are traded on active exchanges, including the Company's equity securities, are measured using the closing price in an active market and are considered a Level 1 input method.

The Company offers interest rate swaps to its variable rate borrowers who want to manage their interest rate risk. At the same time, the Company enters into the opposite trade with a counter party to offset its interest rate risk. The Company has also entered into a commercial loan hedge as well as long term borrowing hedges using interest rate swaps. The fair value of these interest rate swaps are estimated by a third party pricing service using a discounted cash flow technique. These are considered a Level 2 input method.

The following table presents the balance and ASC 825 level of assets measured at fair value on a recurring basis.

| | September 30, 2016 | | | |
|--|--------------------|---------------------|-------------|---------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| | (In thousands) | | | |
| Available-for-sale securities | | | | |
| Equity securities | \$ 101,824 | \$ — | \$ — | \$ 101,824 |
| U.S. government and agency securities | — | 259,351 | — | 259,351 |
| Municipal bonds | — | 27,670 | — | 27,670 |
| Corporate debt securities | — | 461,138 | — | 461,138 |
| Mortgage-backed securities | | | | |
| Agency pass-through certificates | — | 993,041 | — | 993,041 |
| Commercial MBS | — | 79,870 | — | 79,870 |
| Other debt securities | — | — | — | — |
| Total Available-for-sale securities | 101,824 | 1,821,070 | — | 1,922,894 |
| Interest rate contracts | — | 20,895 | — | 20,895 |
| Total Financial Assets | \$ 101,824 | \$ 1,841,965 | \$ — | \$ 1,943,789 |
| Financial Liabilities | | | | |
| Interest rate contracts | \$ — | \$ 20,895 | \$ — | \$ 20,895 |
| Commercial loan hedges | — | 3,312 | — | 3,312 |
| Long term borrowing hedges | — | 31,347 | — | 31,347 |
| Total Financial Liabilities | \$ — | \$ 55,554 | \$ — | \$ 55,554 |

There were no transfers between, into and/or out of Levels 1, 2 or 3 during the year ended September 30, 2016.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

| | September 30, 2015 | | | |
|--|--------------------|---------------------|-------------|---------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| | (In thousands) | | | |
| Available-for-sale securities | | | | |
| Equity securities | \$ 101,952 | \$ — | \$ — | \$ 101,952 |
| U.S. government and agency securities | — | 482,464 | — | 482,464 |
| Municipal bonds | — | 27,123 | — | 27,123 |
| Corporate debt securities | — | 505,800 | — | 505,800 |
| Mortgage-backed securities | | | | |
| Agency pass-through certificates | | | | — |
| Commercial MBS | — | 1,160,518 | — | 1,160,518 |
| Other debt securities | — | 102,706 | — | 102,706 |
| Total Available-for-sale securities | 101,952 | 2,278,611 | — | 2,380,563 |
| Interest rate contracts | — | 11,879 | — | 11,879 |
| Total Financial Assets | \$ 101,952 | \$ 2,290,490 | \$ — | \$ 2,392,442 |
| Financial Liabilities | | | | |
| Interest rate contracts | \$ — | \$ 11,879 | \$ — | \$ 11,879 |
| Commercial loan hedges | — | 966 | — | 966 |
| Long term borrowing hedges | — | 14,555 | — | 14,555 |
| Total Financial Liabilities | \$ — | \$ 27,400 | \$ — | \$ 27,400 |

There were no transfers between, into and/or out of Level 1, 2 or 3 during the year ended September 30, 2015.

Measured on a Nonrecurring Basis

Impaired Loans & Real Estate Owned

Real estate owned (“REO”) consists principally of properties acquired through foreclosure. From time to time, and on a nonrecurring basis, adjustments using fair value measurements are recorded to reflect increases or decreases based on the current appraisal or estimated value of the collateral, but only up to the fair value of the real estate owned as of the initial transfer date less selling costs.

When management determines that the fair value of the collateral or the real estate owned requires additional adjustments, either as a result of an updated appraised value or when there is no observable market price, the Company classifies the impaired loan or real estate owned as Level 3. Level 3 assets recorded at fair value on a nonrecurring basis represent impaired loans for which a specific reserve is recorded or a partial charge-off was recorded based on the fair value of collateral, as well as real estate owned where the fair value of the property was less than the cost basis.

The following table presents the recorded balance of assets that were measured at estimated fair value on a nonrecurring basis for the periods presented, and the total gains (losses) resulting from those fair value adjustments for the periods presented. These estimated fair values are shown gross of estimated selling costs:

| | September 30, 2016 | | | | Three Months Ended September 30, 2016 | Twelve Months Ended September 30, 2016 |
|------------------------------------|--------------------|---------|-----------|-----------|---------------------------------------|--|
| | Level 1 | Level 2 | Level 3 | Total | Total Gains (Losses) | |
| | (In thousands) | | | | | |
| Impaired loans (1) | \$ — | \$ — | \$ 17,476 | \$ 17,476 | \$ (474) | \$ (4,236) |
| Real estate owned (2) | — | — | 25,190 | 25,190 | (1,003) | (3,947) |
| Balance at end of period | \$ — | \$ — | \$ 42,666 | \$ 42,666 | \$ (1,477) | \$ (8,183) |

(1) The gains (losses) represent remeasurements of collateral-dependent impaired loans.

(2) The gains (losses) represent aggregate writedowns and charge-offs on real estate owned.

| | September 30, 2015 | | | | Three Months Ended September 30, 2015 | Twelve Months Ended September 30, 2015 |
|------------------------------------|--------------------|---------|-----------|-----------|---------------------------------------|--|
| | Level 1 | Level 2 | Level 3 | Total | Total Gains (Losses) | |
| | (In thousands) | | | | | |
| Impaired loans (1) | \$ — | \$ — | \$ 6,735 | \$ 6,735 | \$ (40) | \$ (4,241) |
| Real estate owned (2) | — | — | 81,448 | 81,448 | (654) | 7,749 |
| Balance at end of period | \$ — | \$ — | \$ 88,183 | \$ 88,183 | \$ (694) | \$ 3,508 |

(1) The gains (losses) represent remeasurements of collateral-dependent impaired loans.

(2) The gains (losses) represent aggregate writedowns and charge-offs on real estate owned.

The following describes the process used to value Level 3 assets measured on a nonrecurring basis:

Impaired loans - The Company adjusts the carrying amount of impaired loans when there is evidence of probable loss and the expected fair value of the loan is less than its contractual amount. The amount of the impairment may be determined based on the estimated present value of future cash flows or the fair value of the underlying collateral. Impaired loans with a specific reserve allowance based on cash flow analysis or the value of the underlying collateral are classified as Level 3 assets.

The evaluations for impairment are prepared by the Problem Loan Review Committee, which is chaired by the Chief Credit Officer and includes the Loan Review manager and Special Credits manager, as well as senior credit officers, division managers and group executives, as applicable. These evaluations are performed in conjunction with the quarterly allowance for loan loss process.

Applicable loans that were included in the previous quarter's review are reevaluated and if their values are materially different from the prior quarter evaluation, the underlying information (loan balance and collateral value) are compared. Material differences are evaluated for reasonableness and discussions are held between the relationship manager and their division manager to understand the difference and determine if any adjustment is necessary.

The inputs are developed and substantiated on a quarterly basis, based on current borrower developments, market conditions and collateral values. The following methods are used to value impaired loans:

- The fair value of the collateral, which may take the form of real estate or personal property, is based on internal estimates, field observations, assessments provided by third-party appraisers and other valuation models. The Company performs or reaffirms valuations of collateral-dependent impaired loans at least annually. Adjustments are made if management believes that more recent information is available and relevant with respect to the fair value of the collateral.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

- The present value of the expected future cash flows of the loans is used for measurement of non collateral-dependent loans to test for impairment. The Company estimates the future cash flows and then discounts those using the contractual interest rate.

Real estate owned - When a loan is reclassified from loan status to real estate owned due to the Company taking possession of the collateral, a Special Credits officer, along with the Special Credits manager, obtains a valuation, which may include appraisals or third-party price options, which is used to establish the fair value of the underlying collateral. The determined fair value, less selling costs, becomes the carrying value of the REO asset.

Fair Values of Financial Instruments

U. S. GAAP requires disclosure of fair value information about financial instruments, whether or not recognized on the statement of financial condition, for which it is practicable to estimate those values. Certain financial instruments and all non-financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value estimates presented do not reflect the underlying fair value of the Company. Although management is not aware of any factors that would materially affect the estimated fair value amounts presented below, such amounts have not been comprehensively revalued for purposes of these financial statements since the dates shown, and therefore, estimates of fair value subsequent to those dates may differ significantly from the amounts presented below.

| | Level | September 30, 2016 | | September 30, 2015 | |
|--|-------|--------------------|----------------------|--------------------|----------------------|
| | | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| (In thousands) | | | | | |
| Financial assets | | | | | |
| Cash and cash equivalents | 1 | \$ 450,368 | \$ 450,368 | \$ 284,049 | \$ 284,049 |
| Available-for-sale securities: | | | | | |
| Equity securities | 1 | 101,824 | 101,824 | 101,952 | 101,952 |
| U.S. government and agency securities . . . | 2 | 259,351 | 259,351 | 482,464 | 482,464 |
| Municipal bonds | 2 | 27,670 | 27,670 | 27,123 | 27,123 |
| Corporate debt securities | 2 | 461,138 | 461,138 | 505,800 | 505,800 |
| Mortgage-backed securities | | | | | |
| Agency pass-through certificates | 2 | 993,041 | 993,041 | 1,160,518 | 1,160,518 |
| Commercial MBS | 2 | 79,870 | 79,870 | 102,706 | 102,706 |
| Total available-for-sale securities | | 1,922,894 | 1,922,894 | 2,380,563 | 2,380,563 |
| Held-to-maturity securities: | | | | | |
| Mortgage-backed securities | | | | | |
| Agency pass-through certificates | 2 | 1,417,599 | 1,441,556 | 1,643,216 | 1,637,420 |
| Total held-to-maturity securities | | 1,417,599 | 1,441,556 | 1,643,216 | 1,637,420 |
| Loans receivable | 3 | 9,910,920 | 10,414,794 | 9,170,634 | 9,667,750 |
| FDIC indemnification asset | 3 | 12,769 | 12,095 | 16,275 | 15,522 |
| FHLB and FRB stock | 2 | 117,205 | 117,205 | 107,198 | 107,198 |
| Other assets - interest rate contracts | 2 | 20,895 | 20,895 | 11,879 | 11,879 |
| Financial liabilities | | | | | |
| Customer accounts | 2 | 10,600,852 | 10,184,321 | 10,631,703 | 10,004,290 |
| FHLB advances and other borrowings | 2 | 2,080,000 | 2,184,671 | 1,830,000 | 1,938,384 |
| Other liabilities - interest rate contracts | 2 | 20,895 | 20,895 | 11,879 | 11,879 |
| Other liabilities - commercial loan hedges . . | 2 | 3,312 | 3,312 | 966 | 966 |
| Other liabilities - long term borrowing hedges | 2 | 31,347 | 31,347 | 14,555 | 14,555 |

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

Cash and cash equivalents – The carrying amount of these items is a reasonable estimate of their fair value.

Available-for-sale securities and held-to-maturity securities – Securities at fair value are primarily priced using model pricing based on the securities' relationship to other benchmark quoted prices as provided by an independent third party, and are considered a Level 2 input method. Equity securities which are exchange traded are considered a Level 1 input method.

Loans receivable – For certain homogeneous categories of loans, such as fixed- and variable-rate residential mortgages, fair value is estimated for securities backed by similar loans, adjusted for differences in loan characteristics, using the same methodology described above for AFS and HTM securities. The fair value of other loan types is estimated by discounting the future cash flows and estimated prepayments using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining term. Some loan types were valued at carrying value because of their floating rate or expected maturity characteristics. Net deferred loan fees are not included in the fair value calculation but are included in the carrying amount.

FDIC indemnification asset – The fair value of the indemnification asset is estimated by discounting the expected future cash flows using the current rates.

FHLB and FRB stock – The fair value is based upon the par value of the stock which equates to its carrying value.

Customer accounts – The fair value of demand deposits, savings accounts, and money market accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated by discounting the estimated future cash flows using the rates currently offered for deposits with similar remaining maturities.

FHLB advances – The fair value of FHLB advances and other borrowings is estimated by discounting the estimated future cash flows using rates currently available to the Company for debt with similar remaining maturities.

Interest Rate Contracts – The Bank offers interest rate swaps to its variable rate borrowers who want to manage their interest rate risk. At the same time, the Bank enters into the opposite trade with a counterparty to offset its interest rate risk. The fair value of these interest rate swaps are estimated by a third party pricing service using a discounted cash flow technique.

Commercial Loan Hedges – The fair value of the interest rate swaps are estimated by a third party pricing service using a discounted cash flow technique.

Long Term Borrowing Hedges – The fair value of the interest rate swaps are estimated by a third party pricing service using a discounted cash flow technique.

NOTE G

DERIVATIVES AND HEDGING ACTIVITIES

The Company periodically enters into certain interest rate swap agreements in order to provide commercial loan customers the ability to convert from variable to fixed interest rate payments, while the Company retains a variable rate loan. Under these agreements, the Company enters into a variable rate loan agreement and a swap agreement with the client. The swap agreement effectively converts the client's variable rate loan into a fixed rate. The Company enters into a corresponding swap agreement with a third party in order to offset its exposure on the variable and fixed components of the client's swap agreement. The Company had \$840,935,000 and \$439,416,000 notional in interest rate swaps to hedge this exposure as of September 30, 2016 and September 30, 2015, respectively. As of September 30, 2016, \$34,432,000 of the outstanding notional balance related to a related party loan. The interest rate swaps are derivatives under FASB ASC 815, Derivatives and Hedging, with changes in fair value recorded in earnings. There was no net impact to the statement of operations for the year ended September 30, 2016 as the changes in value for the asset and liability side of the swaps offset each other.

The Company has also entered into interest rate swaps, some of which are forward-starting, to convert certain existing and future short-term borrowings to fixed rate payments. The primary purpose of these hedges is to mitigate the risk of rising interest rates, specifically LIBOR rates, which are a benchmark for the short term borrowings. The hedging program qualifies as a cash flow hedge under ASC 815, which provides for offsetting of the recognition of gains and losses of the interest rate swaps and the hedged items. The hedged item is the LIBOR portion of the series of existing or future short-term fixed rate borrowings over the term of the interest rate swap. The change in the fair value of the interest rate swaps is recorded in other comprehensive income. The Company had \$700,000,000 and \$400,000,000 notional in interest rate swaps to hedge existing and anticipated future borrowings as of September 30, 2016 and September 30, 2015, respectively. The unrealized loss, gross of the related tax benefit, on these interest rate swaps as of September 30, 2016 was \$31,347,000.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Company has also entered into an interest rate swap to hedge the interest rate risk of an individual fixed rate commercial loan and this relationship qualifies as a fair value hedge under ASC 815, which provides for offsetting of the recognition of gains and losses of the interest rate swap and the hedged item. The Company hedges this loan using an interest rate swap with a notional amount of \$54,155,000 and \$54,815,000 as of September 30, 2016 and September 30, 2015, respectively.

The following table presents the fair value and balance sheet classification of derivatives outstanding.

| (In thousands) | Asset Derivatives | | | | Liability Derivatives | | | |
|--------------------------------------|--------------------|------------------|--------------------|------------------|-----------------------|------------------|--------------------|------------------|
| | September 30, 2016 | | September 30, 2015 | | September 30, 2016 | | September 30, 2015 | |
| | Balance Sheet | Fair Value | Balance Sheet | Fair Value | Balance Sheet | Fair Value | Balance Sheet | Fair Value |
| Interest rate contracts . . . | Other assets | \$ 20,895 | Other assets | \$ 11,879 | Other liabilities | \$ 20,895 | Other liabilities | \$ 11,879 |
| Commercial loan hedges | Other assets | — | Other assets | — | Other liabilities | 3,312 | Other liabilities | 966 |
| Long term borrowing hedges | Other assets | — | Other assets | — | Other liabilities | 31,347 | Other liabilities | 14,555 |
| | | <u>\$ 20,895</u> | | <u>\$ 11,879</u> | | <u>\$ 55,554</u> | | <u>\$ 27,400</u> |

NOTE H

INTEREST RECEIVABLE

The following table provides a summary of interest receivable by interest earning asset type.

| | September 30, 2016 | | September 30, 2015 | |
|--------------------------------------|--------------------|---------------|--------------------|---------------|
| | (In thousands) | | | |
| Loans receivable | \$ | 29,858 | \$ | 30,930 |
| Mortgage-backed securities | | 5,670 | | 6,695 |
| Investment securities | | 2,141 | | 2,804 |
| | \$ | <u>37,669</u> | \$ | <u>40,429</u> |

Interest receivable was \$37,669,000 at September 30, 2016 as compared to \$40,429,000 as of September 30, 2015. The decrease is primarily due to lower rates as the average period rate for earning assets was 3.58% as of September 30, 2016 compared to 3.63% as of September 30, 2015.

NOTE I

PREMISES AND EQUIPMENT

The following table provides a summary of premises and equipment by asset type.

| | | September 30, 2016 | | September 30, 2015 | |
|--|-----------------------|--------------------|------------------|--------------------|-----------------|
| | | (In thousands) | | | |
| | Estimated Useful Life | | | | |
| Land | — | \$ | 109,414 | \$ | 113,347 |
| Buildings | 25 - 40 | | 143,841 | | 147,757 |
| Leasehold improvements | 7 - 15 | | 18,365 | | 10,193 |
| Furniture, software and equipment | 2 - 10 | | 115,199 | | 89,919 |
| | | | <u>386,819</u> | | <u>361,216</u> |
| Less accumulated depreciation and amortization | | | <u>(104,868)</u> | | <u>(84,969)</u> |
| | | \$ | <u>281,951</u> | \$ | <u>276,247</u> |

The Company has non-cancelable operating leases for certain branch offices. Future minimum net rental commitments for all non-cancelable leases, including maintenance and associated costs, are as follows: \$4,902,000 for 2017, \$3,942,000 for 2018, \$3,422,000 for 2019, \$3,228,000 for 2020, \$2,538,000 for 2021 and \$13,159,000 thereafter.

Rental expense, including amounts paid under month-to-month cancelable leases, amounted to \$5,300,000, \$6,600,000 and \$6,600,000 in 2016, 2015, and 2014, respectively.

NOTE J

CUSTOMER ACCOUNTS

The following table provides the composition of the Company's customer accounts, including interest rate buckets and maturity buckets for time deposits.

| | September 30, 2016 | September 30, 2015 |
|---|-----------------------|-----------------------|
| | (In thousands) | |
| Checking accounts, .15% and under | \$ 2,721,721 | \$ 2,555,766 |
| Passbook and statement accounts, .10% and under | 820,980 | 700,794 |
| Insured money market accounts, .01% to .15% | 2,462,891 | 2,564,318 |
| Time deposit accounts | | |
| Less than 1.00% | 3,268,272 | 3,126,119 |
| 1.00% to 1.99% | 1,292,612 | 1,177,356 |
| 2.00% to 2.99% | 34,376 | 501,409 |
| 3.00% to 3.99% | — | 5,156 |
| 4.00% and higher | — | 785 |
| Total time deposits | <u>4,595,260</u> | <u>4,810,825</u> |
| | <u>\$ 10,600,852</u> | <u>\$ 10,631,703</u> |

Time deposit maturities are as follows:

| | September 30, 2016 | September 30, 2015 |
|---------------|-----------------------|-----------------------|
| | (In thousands) | |
| Within 1 year | \$ 2,894,900 | \$ 2,862,313 |
| 1 to 2 years | 798,309 | 1,068,792 |
| 2 to 3 years | 293,058 | 321,118 |
| Over 3 years | 608,993 | 558,602 |
| | <u>\$ 4,595,260</u> | <u>\$ 4,810,825</u> |

Customer accounts over \$250,000 totaled \$2,250,622,000 as of September 30, 2016 and \$2,096,690,000 as of September 30, 2015.

Interest expense on customer accounts consisted of the following:

| Year ended September 30, | 2016 | 2015 | 2014 |
|--|------------------|------------------|------------------|
| | (In thousands) | | |
| Checking accounts | \$ 1,491 | \$ 1,036 | \$ 1,259 |
| Passbook and statement accounts | 734 | 660 | 607 |
| Insured money market accounts | 3,285 | 3,631 | 4,574 |
| Time deposit accounts | <u>47,425</u> | <u>46,273</u> | <u>52,636</u> |
| | 52,935 | 51,600 | 59,076 |
| Less early withdrawal penalties | (450) | (546) | (552) |
| | <u>\$ 52,485</u> | <u>\$ 51,054</u> | <u>\$ 58,524</u> |
| Weighted average interest rate at end of year | 0.50% | 0.48% | 0.51% |
| Weighted daily average interest rate during the year | 0.50% | 0.48% | 0.57% |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE K

FHLB ADVANCES AND OTHER BORROWINGS

The table below shows the maturity dates of outstanding FHLB advances.

| | September 30, 2016 | September 30, 2015 |
|-----------------------------|-----------------------|-----------------------|
| | (In thousands) | |
| FHLB advances | | |
| Within 1 year | \$ 200,000 | \$ 250,000 |
| 1 to 3 years | 880,000 | 750,000 |
| 4 to 5 years | 700,000 | 430,000 |
| More than 5 years | 300,000 | 400,000 |
| | <u>\$ 2,080,000</u> | <u>\$ 1,830,000</u> |

There were no advances included in the above table which are callable by the FHLB.

Financial data pertaining to the weighted-average cost and the amount of FHLB advances were as follows.

| | 2016 | 2015 | 2014 |
|--|----------------|--------------|--------------|
| | (In thousands) | | |
| Weighted average interest rate at end of year | 3.15% | 3.35% | 3.52% |
| Weighted daily average interest rate during the year | 3.22% | 3.57% | 3.56% |
| Daily average of FHLB advances during the year | \$ 1,992,434 | \$ 1,848,904 | \$ 1,955,205 |
| Maximum amount of FHLB advances at any month end | \$ 2,080,000 | \$ 1,930,000 | \$ 2,205,000 |
| Interest expense during the year (excludes interest rate swap expense) | \$ 64,058 | \$ 64,331 | \$ 68,307 |

On June 1, 2015, the FHLB of Seattle merged into the FHLB of Des Moines to create a larger, financially stronger, member-owned cooperative. The Bank has a credit line with the Federal Home Loan Bank of Des Moines ("FHLB") equal to 49.0% of total assets. The FHLB of Des Moines has assumed the Bank's advances with the FHLB of Seattle as of the merger date.

The Bank has entered into borrowing agreements with the FHLB to borrow funds under a short-term floating rate cash management advance program and a fixed-rate term loan agreements. All borrowings are secured by stock of the FHLB, deposits with the FHLB, and a blanket pledge of qualifying loans receivable as provided in the agreements with the FHLB.

As of September 30, 2016, 2015 and 2014, respectively, there were no reverse repurchase agreements or other borrowings. The Bank has historically entered into sales of reverse repurchase agreements which are an additional source of liquidity. Fixed-coupon reverse repurchase agreements have been treated as financings, and the obligations to repurchase securities sold have been reflected as a liability in the consolidated statements of financial condition in prior years.

NOTE L

INCOME TAXES

The table below provides a summary of the Company's tax assets and liabilities, including deferred tax assets and deferred tax liabilities by major source. Deferred tax balances represent temporary differences between the tax basis and the financial statement carrying amounts of assets and liabilities.

| | September 30, 2016 | September 30, 2015 |
|--|-----------------------|-----------------------|
| | (In thousands) | |
| Deferred tax assets | | |
| Loan loss reserves | \$ 45,531 | \$ 43,749 |
| REO reserves | 4,018 | 11,213 |
| Valuation adjustment on available-for-sale securities and cash flow hedges . . . | 6,482 | — |
| Asset purchase tax basis difference (net) | — | 5,973 |
| Delinquent accrued interest | 2,812 | 3,069 |
| FDIC loss share guarantee receivable | 9,598 | 7,803 |
| Other, net | 3,210 | 3,891 |
| Total deferred tax assets | <u>71,651</u> | <u>75,698</u> |
| Deferred tax liabilities | | |
| Federal Home Loan Bank stock dividends | 24,135 | 24,135 |
| Valuation adjustment on available-for-sale securities and cash flow hedges . . . | — | 205 |
| Asset purchase tax basis difference (net) | 2,830 | |
| Loan origination costs | 14,826 | 13,875 |
| Depreciation | <u>34,936</u> | <u>25,934</u> |
| Total deferred tax liabilities | <u>76,727</u> | <u>64,149</u> |
| Net deferred tax asset (liability) | <u>(5,076)</u> | <u>11,549</u> |
| Current tax asset | 21,123 | 2,964 |
| Net tax asset | <u>\$ 16,047</u> | <u>\$ 14,513</u> |

The table below presents a reconciliation of the statutory federal income tax rate to the Company's effective income tax rate.

| Year ended September 30, | 2016 | 2015 | 2014 |
|-------------------------------------|------------|------------|------------|
| Statutory income tax rate | 35% | 35% | 35% |
| State income tax | 1 | 2 | 2 |
| Other differences | <u>(2)</u> | <u>(1)</u> | <u>(1)</u> |
| Effective income tax rate | <u>34%</u> | <u>36%</u> | <u>36%</u> |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following table summarizes the Company's income tax expense (benefit) for the respective periods.

| Year ended September 30, | 2016 | 2015 | 2014 |
|--------------------------|----------------|-----------|-----------|
| | (In thousands) | | |
| Federal: | | | |
| Current | \$ 57,173 | \$ 79,841 | \$ 70,797 |
| Deferred | 21,961 | 3,244 | 10,591 |
| | 79,134 | 83,085 | 81,388 |
| State: | | | |
| Current | \$ 3,600 | 6,636 | \$ 4,987 |
| Deferred | 1,351 | (518) | 1,189 |
| | 4,951 | 6,118 | 6,176 |
| Total | | | |
| Current | 60,773 | 86,477 | 75,784 |
| Deferred | 23,312 | 2,726 | 11,780 |
| | \$ 84,085 | \$ 89,203 | \$ 87,564 |

Based on current information the Company does not expect that changes in the amount of unrecognized tax benefits over the next twelve months will have a significant impact on its results of operations or financial position. The Company's liability for uncertain tax positions was \$105,000 as of September 30, 2016 and \$110,000 as of September 30, 2015. These amounts, if recognized, would affect the Company's effective tax rate. The Company records interest and penalties related to uncertain tax positions in income tax expense.

The Company's federal income tax returns are open for the tax years 2013 forward. The Company has been examined by the Internal Revenue Service through the year ended September 30, 2012.

State income tax returns are generally subject to examination for a period of three to five years after filing of the respective return. The state impact of any federal changes remains subject to examination by various states for a period of up to two years after formal notification to the states. The Company's unrecognized tax benefits are related to state tax returns open from 2013 through 2016.

NOTE M

401(K) AND EMPLOYEE STOCK OWNERSHIP PLAN

The Company maintains a 401(k) and Employee Stock Ownership Plan (the "Plan") for the benefit of its employees. Company contributions are made annually as approved by the Board of Directors. Such amounts are not in excess of amounts permitted by the Employee Retirement Income Security Act of 1974.

Plan participants may make voluntary after-tax contributions of their considered earnings as defined by the Plan. In addition, participants may make pre-tax contributions up to the statutory limits through the 401(k) provisions of the Plan. The annual addition from contributions to an individual participant's account in this Plan cannot exceed the lesser of 100% of base salary or \$53,000.

Effective January 1, 2016, new employees become eligible to participate in the Plan upon completion of one year of service. Such eligible employees become a participant in the Plan on the first day of the calendar quarter (January 1, April 1, July 1 or October 1) coincident with or following the completion of the one year of service requirement. The Plan defines "year of service" as a 12-month period in which the eligible employee works at least 1,000 hours of service and the first eligibility service period starts on the first day of employment. After the first 12-month eligibility service period, if the Plan needs to measure another eligibility service period (e.g., if the employee does not complete 1,000 hours of service in the first 12-month period), the Plan will measure the eligibility service period on a Plan Year basis.

Effective January 1, 2014, the Company added a guaranteed safe harbor matching contribution component to the plan equal to 100% of the first 4% of compensation that employee's contribute to their account. In addition to the new match being guaranteed, all safe harbor matching contributions are immediately vested. The new match is not subject to the 6 year vesting schedule of the current profit sharing contribution. This provides plan participants more investment flexibility. The Company anticipates that all eligible employees, regardless of personal plan participation, will continue to receive an annual discretionary profit sharing contribution from the Company, now capped at 7% of eligible compensation with this change.

Company contributions to the Plan amounted to \$7,600,000, \$8,700,000 and \$7,314,000 for the years ended 2016, 2015 and 2014, respectively.

NOTE N

STOCK AWARD PLANS

The Company's stock based compensation plan ('2011 Incentive Plan') provides for grants of stock options and restricted stock. Stockholders authorized 5,000,000 shares of common stock to be reserved pursuant to the 2011 Incentive Plan and 3,348,400 shares remain available for issuance as of September 30, 2016.

When applicable, stock options are granted with an exercise price equal to the market price of the Company's stock at the date of grant; those option awards generally vest based on 5 years of continuous service and have 10-year contractual terms. The Company's policy is to issue new shares upon option exercises. The fair value of stock options granted is estimated on the date of grant using the Black-Scholes option-pricing model. This model requires input of highly subjective assumptions, changes to which can materially affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options granted but are not considered by the model. Expected volatility is based on the historical volatility of the Company's stock. The risk-free interest rate is based on the U.S. Treasury yield curve that is in effect at the time of grant with a remaining term equal to the options' expected life. The expected term represents the period of time that options granted are expected to be outstanding.

Stock Option Awards:

There were no stock options granted under the 2011 Incentive Plan during 2016, 2015 and 2014.

A summary of stock option activity and changes during the year are as follows.

| Options | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value (In thousands) |
|-----------------------------------|----------------|--|---|---|
| Outstanding at September 30, 2015 | 1,027,374 | \$ 21.64 | 3 | \$ 1,867 |
| Granted | — | — | | |
| Exercised | (438,456) | 21.51 | | |
| Forfeited | (129,475) | 22.32 | | |
| Outstanding at September 30, 2016 | <u>459,443</u> | <u>\$ 21.47</u> | <u>2</u> | <u>\$ 2,392</u> |
| Exercisable at September 30, 2016 | <u>459,443</u> | <u>\$ 21.47</u> | <u>2</u> | <u>\$ 2,392</u> |

The table below presents other information regarding stock options.

| Year ended September 30, | 2016 | 2015 | 2014 |
|---|--|--------|--------|
| | (In thousands, except fair value of options granted) | | |
| Compensation cost for stock options | \$ 89 | \$ 232 | \$ 324 |
| Weighted average grant date fair value per stock option | 2.73 | 2.96 | 2.95 |
| Total intrinsic value of options exercised | 1,651 | 831 | 1,136 |
| Grant date FV of options exercised | 1,422 | 368 | 1,962 |
| Cash received from option exercises | 9,283 | 2,069 | 10,142 |
| Tax benefit realized for option exercises | — | — | 159 |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following is a summary of activity related to non-vested stock options.

| Year ended September 30, | 2016 | | 2015 | | 2014 | |
|------------------------------------|---------------------|--|---------------------|--|---------------------|--|
| | Options Outstanding | Weighted Average Grant Date Fair Value | Options Outstanding | Weighted Average Grant Date Fair Value | Options Outstanding | Weighted Average Grant Date Fair Value |
| Non-vested Stock Options | | | | | | |
| Outstanding at beginning of period | 69,287 | \$ 3.85 | 145,795 | \$ 3.87 | 287,750 | \$ 3.44 |
| Granted | — | — | — | — | — | — |
| Vested | (62,227) | 3.91 | (61,018) | 3.88 | (119,520) | 2.88 |
| Forfeited | (7,060) | 3.89 | (15,490) | 3.90 | (22,435) | 3.63 |
| Outstanding at end of period | — | \$ — | 69,287 | \$ 3.85 | 145,795 | \$ 3.87 |

As of September 30, 2016, there was no remaining unrecognized compensation cost for stock options.

Restricted Stock Awards:

The Company grants shares of restricted stock pursuant to the 2011 Incentive Plan. The restricted stock grants are subject to a service condition and vest over a period of one to seven years.

Certain grants of restricted stock to executive officers are also subject to additional performance conditions based upon meeting certain total shareholder return targets pre-established by the Board. The Company had a total of 490,363 shares of restricted stock outstanding as of September 30, 2016, with a fair market value at the date of grant of \$7,845,808.

The following table summarizes information about nonvested restricted stock activity.

| Year ended September 30, | 2016 | | 2015 | | 2014 | |
|------------------------------------|-------------|-----------------------------|-------------|-----------------------------|-------------|-----------------------------|
| | Outstanding | Weighted Average Fair Value | Outstanding | Weighted Average Fair Value | Outstanding | Weighted Average Fair Value |
| Non-vested Restricted Stock | | | | | | |
| Outstanding at beginning of period | 521,302 | \$ 15.03 | 515,845 | \$ 14.10 | 480,904 | \$ 11.52 |
| Granted | 229,450 | 17.20 | 301,750 | 14.26 | 300,500 | 15.43 |
| Vested | (165,965) | 15.96 | (223,043) | 13.24 | (202,014) | 11.68 |
| Forfeited | (94,424) | 13.64 | (73,250) | 10.72 | (63,545) | 8.50 |
| Outstanding at end of period | 490,363 | \$ 16.00 | 521,302 | \$ 15.03 | 515,845 | \$ 14.10 |

Compensation expense related to restricted stock awards was \$3,357,108, \$3,271,564, and \$3,085,081 for the years ended 2016, 2015 and 2014, respectively.

NOTE O

STOCKHOLDERS' EQUITY

The Company and the Bank are subject to various regulatory capital requirements. Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of Common Equity Tier 1, Tier 1 and Total capital to risk weighted assets (as defined in the regulations) and Tier 1 capital to average assets (as defined in the regulations). Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary action by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. The Company and the Bank are also subject to certain restrictions on the amount of dividends that they may declare without prior regulatory approval.

As of September 30, 2016 and 2015, the Company and the Bank met all capital adequacy requirements to which they are subject, and the OCC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum Common Equity Tier 1, Tier 1 risk-based, Total risk-based and Tier 1 leverage ratios as set forth in the following table. The Bank's actual capital amounts and ratios as of these dates are also presented. There are no conditions or events since that management believes have changed the Bank's categorization.

| | Actual | | Capital Adequacy Guidelines | Categorized as Well Capitalized Under Prompt Corrective Action Provisions |
|--|--------------|--------|-----------------------------|---|
| | Capital | Ratio | Ratio | Ratio |
| September 30, 2016 (In thousands) | | | | |
| Common Equity Tier 1 risk-based capital ratio: | | | | |
| The Company | \$ 1,690,380 | 17.54% | 4.50% | NA |
| The Bank | 1,668,828 | 17.32 | 4.50 | 6.50% |
| Tier 1 risk-based capital ratio: | | | | |
| The Company | 1,690,380 | 17.54 | 6.00 | NA |
| The Bank | 1,668,828 | 17.32 | 6.00 | 8.00 |
| Total risk-based capital ratio: | | | | |
| The Company | 1,807,740 | 18.76 | 8.00 | NA |
| The Bank | 1,786,188 | 18.54 | 8.00 | 10.00 |
| Tier 1 leverage ratio: | | | | |
| The Company | 1,690,380 | 11.60 | 4.00 | NA |
| The Bank | 1,668,828 | 11.45 | 4.00 | 5.00 |
| September 30, 2015 | | | | |
| Common Equity Tier 1 risk-based capital ratio: | | | | |
| The Company | \$ 1,658,985 | 18.81% | 4.50% | NA |
| The Bank | 1,652,569 | 18.73 | 4.50 | 6.50% |
| Tier 1 risk-based capital ratio: | | | | |
| The Company | 1,658,985 | 18.81 | 6.00 | NA |
| The Bank | 1,652,569 | 18.73 | 6.00 | 8.00 |
| Total risk-based capital ratio: | | | | |
| The Company | 1,769,587 | 20.07 | 8.00 | NA |
| The Bank | 1,763,171 | 19.98 | 8.00 | 10.00 |
| Tier 1 leverage ratio: | | | | |
| The Company | 1,658,985 | 11.71 | 4.00 | N/A |
| The Bank | 1,652,569 | 11.66 | 4.00 | 5.00 |

At periodic intervals, the Federal Reserve, the OCC and the FDIC routinely examine the Company's and the Bank's financial statements as part of their oversight. Based on their examinations, these regulators can direct that the Company's or Bank's financial statements be adjusted in accordance with their findings.

The federal banking agencies released new regulatory capital rules which became effective on January 1, 2015. These new rules raised the minimum capital ratios and established new criteria for regulatory capital. Minimum capital ratios for four measures are now established for capital adequacy purposes as indicated in the table above. The Common Equity Tier 1 capital ratio is new; it recognizes common equity as the highest form of capital. The denominator for all except the leverage ratio is risk weighted assets. The new rules also set forth a "capital conversation buffer" of up to 2.5%. In the event that a bank's capital levels fall below the minimum ratios plus these buffers, restrictions can be placed on the bank by its regulators. These restrictions include reducing dividend payments, share-backs and staff bonus payments. The purpose of these buffers is to require banks to build up capital outside of periods of stress that can be drawn down during periods of stress. As a result, even during periods where

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

losses are incurred, the minimum capital ratios can still be met. The new capital rules detail a phase-in period for the new minimum ratios and the capital buffers before the full minimum ratios take effect in 2019. The Company has calculated its capital ratios using the new rules since March 31, 2015 and the change did not have a material impact on its consolidated financial statements. There are also new standards for Adequate and Well Capitalized criteria that are used for “Prompt Corrective Action” purposes. To remain categorized as well capitalized, the Bank must maintain minimum Common Equity Tier 1 risk-based, Tier 1 risk-based, Total risk-based and Tier 1 leverage ratios as set forth in the above table. These rules are further described in the 10-K report under “Washington Federal, National Association (Bank) - Regulatory Capital Requirements”. Both the Company and the Bank have sufficient capital to meet these new rules.

The Company and the Bank are subject to regulatory restrictions on paying dividends.

The Company has an ongoing stock repurchase program and 3,867,563 shares were repurchased during 2016 at a weighted average price of \$22.72. In 2015, 5,841,204 shares were repurchased at a weighted average price of \$21.70. As of September 30, 2016, Management had authorization from the Board of Directors to repurchase up to 5,039,310 additional shares.

In connection with the 2008 Troubled Asset Relief Program (“TARP”), the Company issued 1,707,456 warrants to purchase common stock at an exercise price of \$17.57. In September 2016, the Company repurchased 892,240 of these warrants with a value of \$7,718,158. Warrants remaining outstanding were 808,616 as of September 30, 2016 and 1,700,856 as of September 30, 2015, and they have an expiration date of November 14, 2018. The outstanding warrants are considered in the calculation of diluted shares outstanding using the treasury stock method.

The following table sets forth information regarding earnings per share calculations.

| Year ended September 30, | 2016 | 2015 | 2014 |
|---|------------|------------|-------------|
| Weighted average shares outstanding | 91,399,038 | 95,644,639 | 101,154,030 |
| Weighted average dilutive warrants | 440,366 | 340,016 | 352,171 |
| Weighted average dilutive options | 73,514 | 69,304 | 84,150 |
| Weighted average diluted shares | 91,912,918 | 96,053,959 | 101,590,351 |
| Net income (In thousands) | \$ 164,049 | \$ 160,316 | \$ 157,364 |
| Basic EPS | \$ 1.79 | \$ 1.68 | \$ 1.56 |
| Diluted EPS | 1.78 | 1.67 | 1.55 |

NOTE P

FINANCIAL INFORMATION – WASHINGTON FEDERAL, INC.

The following Washington Federal, Inc. (parent company only) financial information should be read in conjunction with the other notes to the Consolidated Financial Statements.

Condensed Statements of Financial Condition

| | September 30, 2016 | September 30, 2015 |
|--|-----------------------|-----------------------|
| | (In thousands) | |
| Assets | | |
| Cash | \$ 24,300 | \$ 7,628 |
| Other assets | 15 | — |
| Investment in subsidiary | 1,954,179 | 1,949,262 |
| Total assets | <u>\$ 1,978,494</u> | <u>\$ 1,956,890</u> |
| Liabilities | | |
| Other liabilities | \$ 2,763 | \$ 1,211 |
| Total liabilities | <u>2,763</u> | <u>1,211</u> |
| Stockholders' equity | | |
| Total stockholders' equity | <u>1,975,731</u> | <u>1,955,679</u> |
| Total liabilities and stockholders' equity | <u>\$ 1,978,494</u> | <u>\$ 1,956,890</u> |

Condensed Statements of Operations

| Twelve Months Ended September 30, | 2016 | 2015 | 2014 |
|---|-------------------|-------------------|-------------------|
| | (In thousands) | | |
| Income | | | |
| Dividends from subsidiary | \$ 148,000 | \$ 175,000 | \$ 70,000 |
| Total Income | 148,000 | 175,000 | 70,000 |
| Expense | | | |
| Miscellaneous | 435 | 439 | 485 |
| Total expense | 435 | 439 | 485 |
| Net income (loss) before equity in undistributed net income (loss) | | | |
| of subsidiary | 147,565 | 174,561 | 69,515 |
| Equity in undistributed net income of subsidiary | 16,336 | (14,402) | 87,675 |
| Income before income taxes | <u>163,901</u> | <u>160,159</u> | <u>157,190</u> |
| Income tax benefit (expense) | 148 | 157 | 174 |
| Net income | <u>\$ 164,049</u> | <u>\$ 160,316</u> | <u>\$ 157,364</u> |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Condensed Statements of Cash Flows

| Twelve Months Ended September 30, | 2016 | 2015 | 2014 |
|---|----------------|------------|------------|
| | (In thousands) | | |
| Cash Flows From Operating Activities | | | |
| Net income | \$ 164,049 | \$ 160,316 | \$ 157,364 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Equity in undistributed net income of subsidiaries | (12,677) | 32,375 | (87,943) |
| Decrease (increase) in other assets | (15) | — | 1 |
| Increase in other liabilities | 1,552 | (13,189) | 4,152 |
| Net cash provided by (used in) operating activities | 152,909 | 179,502 | 73,574 |
| Cash Flows From Financing Activities | | | |
| Proceeds from exercise of common stock options and related tax benefit | 9,283 | 2,070 | 10,252 |
| Warrants purchased | (7,744) | — | — |
| Treasury stock purchased | (87,850) | (126,728) | (104,291) |
| Dividends paid on common stock | (49,926) | (51,111) | (42,065) |
| Net cash provided by (used in) financing activities | (136,237) | (175,769) | (136,104) |
| Increase (decrease) in cash | 16,672 | 3,733 | (62,530) |
| Cash at beginning of year | 7,628 | 3,895 | 66,425 |
| Cash at end of year | \$ 24,300 | \$ 7,628 | \$ 3,895 |

NOTE Q

SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following is a summary of the unaudited interim results of operations by quarter for the years presented.

| Twelve Months Ended September 30, 2016 | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---------------------------------------|----------------|---------------|----------------|
| | (In thousands, except per share data) | | | |
| Interest income | \$ 135,124 | \$ 135,063 | \$ 133,735 | \$ 132,872 |
| Interest expense | 28,255 | 28,738 | 29,495 | 30,056 |
| Net interest income | 106,869 | 106,325 | 104,240 | 102,816 |
| Provision (release) for loan losses | — | (1,500) | (1,650) | (3,100) |
| Other operating income (including REO gain (loss), net) | 12,055 | 14,623 | 15,573 | 14,830 |
| Other operating expense | 64,509 | 59,226 | 56,305 | 55,407 |
| Income before income taxes | 54,415 | 63,222 | 65,158 | 65,339 |
| Income tax expense | 19,317 | 21,499 | 22,154 | 21,115 |
| Net income | \$ 35,098 | \$ 41,723 | \$ 43,004 | \$ 44,224 |
| Basic earnings per share | \$ 0.38 | \$ 0.45 | \$ 0.47 | \$ 0.49 |
| Diluted earnings per share | 0.38 | 0.45 | 0.47 | 0.49 |
| Cash dividends paid per share | 0.13 | 0.14 | 0.14 | 0.14 |

| Twelve Months Ended September 30, 2015 | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|--|---------------------------------------|-------------------|------------------|-------------------|
| | (In thousands, except per share data) | | | |
| Interest income | \$ 132,741 | \$ 132,630 | \$ 129,300 | \$ 135,339 |
| Interest expense | 30,558 | 28,750 | 28,735 | 28,486 |
| Net interest income | 102,183 | 103,880 | 100,565 | 106,853 |
| Provision (release) for loan losses | (5,500) | (3,949) | (1,932) | 219 |
| Other operating income (REO expense) | 5,695 | 12,314 | 14,999 | 16,719 |
| Other operating expense | 53,600 | 57,324 | 56,719 | 57,208 |
| Income before income taxes | 59,778 | 62,819 | 60,777 | 66,145 |
| Income tax expense | 21,371 | 22,458 | 21,727 | 23,647 |
| Net income | \$ 38,407 | \$ 40,361 | \$ 39,050 | \$ 42,498 |
| Basic earnings per share | \$ 0.39 | \$ 0.42 | \$ 0.41 | \$ 0.46 |
| Diluted earnings per share | 0.39 | 0.42 | 0.41 | 0.45 |
| Cash dividends paid per share | 0.15 | 0.13 | 0.13 | 0.13 |

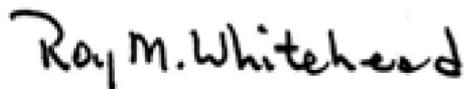
MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Washington Federal, Inc. (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control system was designed to provide reasonable assurance to the Company's management and Board of Directors regarding the preparation and fair presentation of published financial statements.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of September 30, 2016. In making this assessment, the Company's management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in the 2013 version of its Internal Control-Integrated Framework. Based on its assessment, the Company's management believes that as of September 30, 2016, the Company's internal control over financial reporting was effective based on those criteria.

The Company's independent auditors, Deloitte & Touche LLP, an independent registered public accounting firm, have issued an audit report on the Company's internal control over financial reporting and their report follows.

November 21, 2016



Roy M. Whitehead
Chairman of the Board and
Chief Executive Officer



Vincent L. Beatty
Senior Vice President and
Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Washington Federal, Inc.
Seattle, Washington

We have audited the accompanying consolidated statements of financial condition of Washington Federal, Inc. and subsidiaries (the "Company") as of September 30, 2016 and 2015, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended September 30, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of Washington Federal, Inc. and subsidiaries as of September 30, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2016, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of September 30, 2016, based on the criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated November 21, 2016 expressed an unqualified opinion on the Company's internal control over financial reporting.



Seattle, Washington
November 21, 2016

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Washington Federal, Inc.
Seattle, Washington

We have audited the internal control over financial reporting of Washington Federal, Inc. and subsidiaries (the “Company”) as of September 30, 2016, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Because management’s assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), management’s assertion and our audit of the Company’s internal control over financial reporting included controls over the preparation of the schedules equivalent to the basic financial statements in accordance with the instructions for the Office of the Comptroller of the Currency Instructions for Call Reports for Balance Sheet on schedule RC, Income Statement on schedule RI, and Changes in Bank Equity Capital on schedule RI-A. The Company’s management is responsible 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 Report’s on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed by, or under the supervision of, the company’s principal executive and principal financial officers, or persons performing similar functions, and effected by the company’s board of directors, management, and other personnel 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 the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

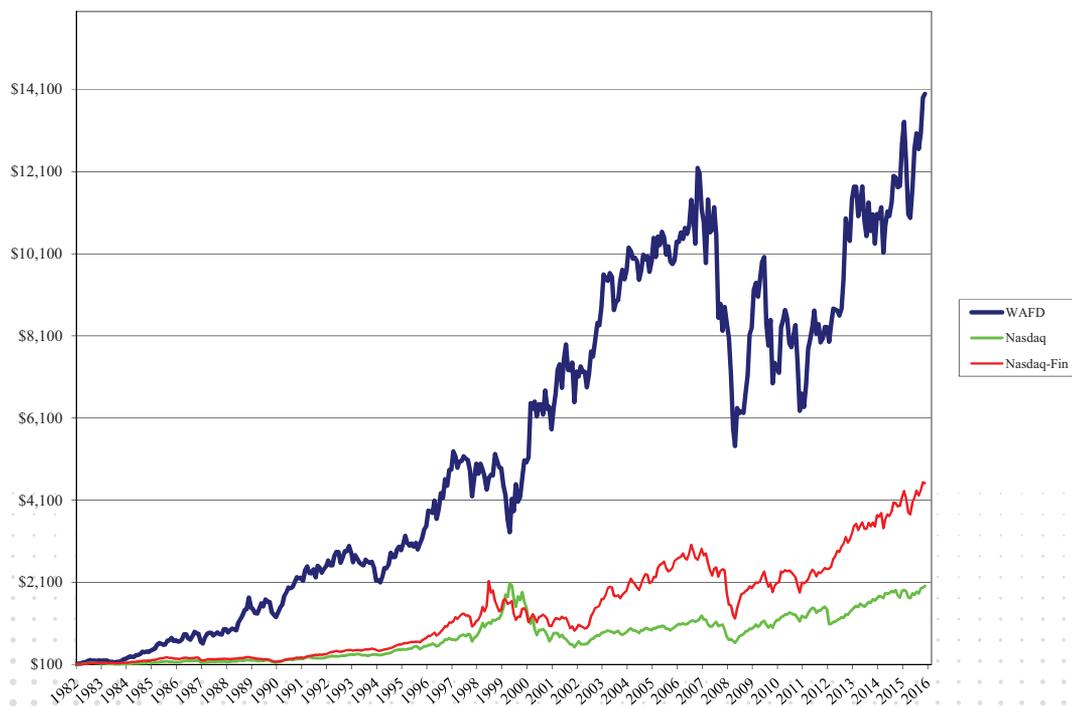
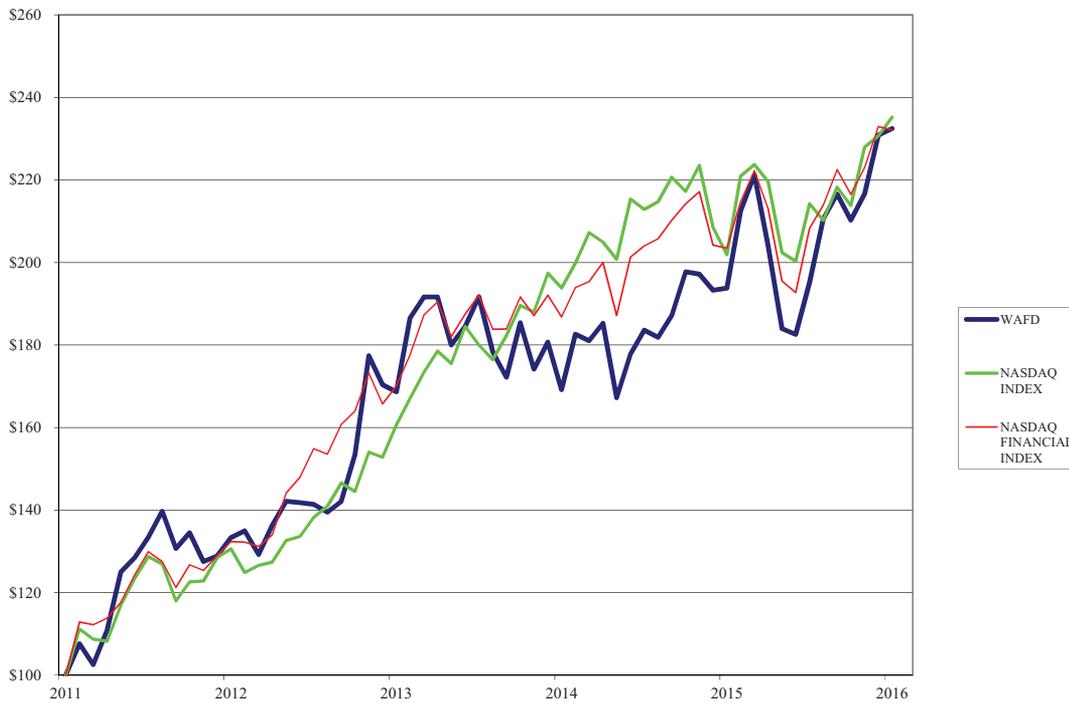
In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2016, based on the criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended September 30, 2016, of the Company and our report dated November 21, 2016, expressed an unqualified opinion on those consolidated financial statements.

Deloitte & Touche LLP
Seattle, Washington
November 21, 2016

PERFORMANCE GRAPHS

The following graphs compare the cumulative total return to Washington Federal stockholders (stock price appreciation plus reinvested dividends) to the cumulative total return of the Nasdaq Stock Market Index (U.S. Companies) and the Nasdaq Financial Stocks Index for the five year period ended September 30, 2016 and since Washington Federal first became a publicly traded company on November 9, 1982, respectively. The graphs assume that \$100 was invested on September 30, 2011 and November 9, 1982, respectively, in Washington Federal Common Stock, the Nasdaq Stock Market Index and the Nasdaq Financial Stocks Index, and that all dividends were reinvested. Management of Washington Federal cautions that the stock price performance shown in the graphs below should not be considered indicative of potential future stock price performance.



GENERAL CORPORATE AND STOCKHOLDERS' INFORMATION

| | |
|--|---|
| Corporate Headquarters | 425 Pike Street Seattle, Washington 98101 (206) 624-7930 |
| Independent Auditors | Deloitte & Touche LLP Seattle, Washington |
| Transfer Agent, Registrar and Dividend | Stockholder inquiries regarding transfer requirements, cash or stock dividends, lost certificates, consolidating records, correcting a name or changing an address should be directed to the transfer agent: |
| Disbursing Agent | American Stock Transfer & Trust Company 59 Maiden Lane Plaza Level New York, NY 10038 Telephone: 1-888-888-0315 www.amstock.com |
| Annual Meeting | The annual meeting of stockholders will be held at the Sheraton Hotel in downtown Seattle on January 18, 2017, at 2 p.m., Pacific Time. |
| Form 10-K | To find out more about the Company, please visit our website. The Company uses its website to distribute financial and other material information about the Company. This report and all SEC filings of the Company are available through the Company's website: www.washingtonfederal.com |
| Stock Information | Washington Federal, Inc. is traded on the NASDAQ Global Select Market. The common stock symbol is WAFD. At September 30, 2016, there were approximately 1,400 stockholders of record. |

| Quarter Ended | Stock Prices | | Dividends |
|--------------------|--------------|----------|-----------|
| | High | Low | |
| December 31, 2014 | \$ 22.49 | \$ 19.67 | \$ 0.15 |
| March 31, 2015 | 22.14 | 19.86 | 0.13 |
| June 30, 2015 | 24.16 | 21.46 | 0.13 |
| September 30, 2015 | 23.93 | 21.39 | 0.13 |
| December 31, 2015 | 26.05 | 22.61 | 0.13 |
| March 31, 2016 | 23.23 | 19.87 | 0.14 |
| June 30, 2016 | 25.22 | 21.79 | 0.14 |
| September 30, 2016 | 26.98 | 23.73 | 0.14 |

Our Board of Directors' dividend policy is to review our financial performance, capital adequacy, regulatory compliance and cash resources on a quarterly basis, and, if such review is favorable, to declare and pay a cash dividend to shareholders.

DIRECTORS AND EXECUTIVE OFFICERS

BOARD OF DIRECTORS

ROY M. WHITEHEAD
Chairman of the Board and
Chief Executive Officer

DAVID K. GRANT
Managing Partner of Catalyst
Storage Partners. Former Chief
Executive Officer of Shurgard
Storage Centers, Inc.

ANNA C. JOHNSON
Senior Partner
Scan East West Travel

THOMAS J. KELLEY
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Arthur Andersen LLP

ERIN N. LANTZ
Vice President and General
Manager, Zillow Group

BARBARA L. SMITH, PhD.
Owner, B. Smith Consulting Group

MARK N. TABBUTT
Chairman of Saltchuk Resources

RANDALL H. TALBOT
Managing Director of Talbot
Financial, LLC. Former President,
Chief Executive Officer and
Director of Symetra Financial
Corporation, Inc.

DIRECTOR EMERITUS

W. ALDEN HARRIS

EXECUTIVE MANAGEMENT COMMITTEE

ROY M. WHITEHEAD
Chairman of the Board and
Chief Executive Officer

BRENT J. BEARDALL
President and Chief Banking Officer

VINCENT L. BEATTY
Senior Vice President
Chief Financial Officer

CATHY E. COOPER
Executive Vice President
Retail Banking Group Manager

MARK A. SCHOONOVER
Executive Vice President
Chief Credit Officer

WASHINGTON FEDERAL LOCATIONS



Go to www.washingtonfederal.com to find a full list of all the locations to serve you.



Washington Federal, Inc.
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www.washingtonfederal.com