Capitol Federal Financial Inc
Form 10-Q
February 09, 2017

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

Form 10-Q

(Mark One)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2016
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number: 001-34814
Capitol Federal Financial, Inc.
(Exact name of registrant as specified in its charter)

Maryland	27-2631712
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
700 South Kansas Avenue, Topeka, Kansas	66603
(Address of principal executive offices)	(Zip Code)

(785) 235-1341
Registrant's telephone number, including area code

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer ¨	Non-accelerated filer ¨	Smaller Reporting Company ¨

(Do not check if a smaller reporting company)
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ

As of February 3, 2017, there were 137,975,531 shares of Capitol Federal Financial, Inc. common stock outstanding.

PART I -- FINANCIAL INFORMATION
Item 1. Financial Statements

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share amounts)

	(Unaudited) December 31, 2016	September 30, 2016
ASSETS:		
Cash and cash equivalents (includes interest-earning deposits of $128,460 and $267,829)	$150,560	$281,764
Securities:		
Available-for-sale ("AFS"), at estimated fair value (amortized cost of $492,395 and $517,791)	499,792	527,301
Held-to-maturity ("HTM"), at amortized cost (estimated fair value of $1,027,292 and $1,122,867)	1,022,215	1,100,874
Loans receivable, net (allowance for credit losses ("ACL") of $8,521 and $8,540)	7,071,410	6,958,024
Federal Home Loan Bank Topeka ("FHLB") stock, at cost	105,364	109,970
Premises and equipment, net	83,838	83,221
Other assets	206,331	206,093
TOTAL ASSETS	$9,139,510	$9,267,247
LIABILITIES:		
Deposits	$5,192,674	$5,164,018
FHLB borrowings	2,272,754	2,372,389
Repurchase agreements	200,000	200,000
Advance payments by borrowers for taxes and insurance	25,403	62,643
Income taxes payable, net	9,369	310
Deferred income tax liabilities, net	24,594	25,374
Accounts payable and accrued expenses	46,541	49,549
Total liabilities	7,771,335	7,874,283
STOCKHOLDERS' EQUITY:		
Preferred stock, $.01 par value; 100,000,000 shares authorized, no shares issued or outstanding	—	—
Common stock, $.01 par value; 1,400,000,000 shares authorized, 137,915,672 and 137,486,172		
shares issued and outstanding as of December 31, 2016 and September 30, 2016, respectively	1,379	1,375
Additional paid-in capital	1,162,584	1,156,855
Unearned compensation, Employee Stock Ownership Plan ("ESOP")	(39,235)	(39,647)
Retained earnings	238,846	268,466
Accumulated other comprehensive income ("AOCI"), net of tax	4,601	5,915
Total stockholders' equity	1,368,175	1,392,964
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$9,139,510	$9,267,247

See accompanying notes to consolidated financial statements.

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CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)
(Dollars in thousands, except per share amounts)

	For the Three Months Ended December 31,	
	2016	2015
INTEREST AND DIVIDEND INCOME:		
Loans receivable	$61,945	$ 60,223
Mortgage-backed securities ("MBS")	6,362	7,831
Cash and cash equivalents	2,969	1,620
FHLB stock	2,939	3,152
Investment securities	1,107	1,533
Total interest and dividend income	75,322	74,359
INTEREST EXPENSE:		
FHLB borrowings	16,117	16,074
Deposits	10,396	8,799
Repurchase agreements	1,503	1,504
Total interest expense	28,016	26,377
NET INTEREST INCOME	47,306	47,982
PROVISION FOR CREDIT LOSSES	—	—
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	47,306	47,982
NON-INTEREST INCOME:		
Retail fees and charges	3,709	3,814
Income from bank-owned life insurance ("BOLI")	523	703
Other non-interest income	1,036	1,049
Total non-interest income	5,268	5,566
NON-INTEREST EXPENSE:		
Salaries and employee benefits	10,634	10,487
Information technology and communications	2,834	2,558
Occupancy, net	2,675	2,672
Deposit and loan transaction costs	1,386	1,274
Regulatory and outside services	1,346	1,486
Federal insurance premium	894	1,382
Advertising and promotional	690	1,154
Office supplies and related expense	437	887
Low income housing partnerships	—	773
Other non-interest expense	701	917
Total non-interest expense	21,597	23,590
INCOME BEFORE INCOME TAX EXPENSE	30,977	29,958
INCOME TAX EXPENSE	10,399	9,240
NET INCOME	$20,578	$ 20,718
Basic earnings per share ("EPS")	$0.15	$ 0.16
Diluted EPS	$0.15	$ 0.16
Dividends declared per share	$0.38	$ 0.34
Basic weighted average common shares	133,696,574	132,822,283
Diluted weighted average common shares	133,949,796	132,911,156

See accompanying notes to consolidated financial statements.

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)
(Dollars in thousands)

	For the Three Months Ended December 31,	
	2016	2015
Net income	$20,578	$20,718
Other comprehensive income (loss), net of tax:		
Changes in unrealized holding gains (losses) on AFS securities, net of taxes of $799 and $1,700	(1,314)	(2,798)
Comprehensive income	$19,264	$17,920

See accompanying notes to consolidated financial statements.

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CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (Unaudited)
(Dollars in thousands, except per share amounts)

	Common Stock	Additional Paid-In Capital	Unearned Compensation ESOP	Retained Earnings	AOCI	Total Stockholders' Equity
Balance at October 1, 2016	$ 1,375	$1,156,855	$ (39,647)	$268,466	$5,915	$ 1,392,964
Net income				20,578		20,578
Other comprehensive income (loss), net of tax					(1,314)	(1,314)
ESOP activity, net		222	412			634
Restricted stock activity, net		14				14
Stock-based compensation		157				157
Stock options exercised	4	5,336				5,340
Cash dividends to stockholders ($0.38 per share)				(50,198)		(50,198)
Balance at December 31, 2016	$ 1,379	$1,162,584	$ (39,235)	$238,846	$4,601	$ 1,368,175

See accompanying notes to consolidated financial statements.

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(Dollars in thousands)

	For the Three Months Ended December 31,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$20,578	$ 20,718
Adjustments to reconcile net income to net cash provided by operating activities:		
FHLB stock dividends	(2,939)	(3,152)
Amortization and accretion of premiums and discounts on securities	1,362	1,289
Depreciation and amortization of premises and equipment	1,891	1,706
Amortization of deferred amounts related to FHLB advances, net	365	751
Common stock committed to be released for allocation - ESOP	634	525
Stock-based compensation	157	533
Changes in:		
Other assets, net	(437)	83
Income taxes payable/receivable	8,899	9,226
Accounts payable and accrued expenses	(3,556)	(5,514)
Net cash provided by operating activities	26,954	26,165
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of AFS securities	(35,890)	—
Purchase of HTM securities	—	(1,432)
Proceeds from calls, maturities and principal reductions of AFS securities	61,274	116,678
Proceeds from calls, maturities and principal reductions of HTM securities	77,309	71,312
Proceeds from the redemption of FHLB stock	98,950	94,500
Purchase of FHLB stock	(91,405)	(59,832)
Net increase in loans receivable	(114,245)	(41,994)
Purchase of premises and equipment	(1,981)	(4,555)
Proceeds from sale of other real estate owned ("OREO")	1,272	815
Net cash (used in) provided by investing activities	(4,716)	175,492

(Continued)

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(Dollars in thousands)

	For the Three Months Ended December 31, 2016	2015
CASH FLOWS FROM FINANCING ACTIVITIES:		
Dividends paid	(50,198)	(44,551)
Net change in deposits	28,656	139,960
Proceeds from borrowings	2,100,000	1,500,000
Repayments on borrowings	(2,200,000)	(2,300,000)
Change in advance payments by borrowers for taxes and insurance	(37,240)	(37,502)
Stock options exercised	5,147	158
Excess tax benefits from stock options	193	—
Net cash used in financing activities	(153,442)	(741,935)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(131,204)	(540,278)
CASH AND CASH EQUIVALENTS:		
Beginning of period	281,764	772,632
End of period	$ 150,560	$ 232,354
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Income tax payments	$ 5	$ 13
Interest payments	$ 29,016	$ 25,686

See accompanying notes to consolidated financial statements. (Concluded)

Notes to Consolidated Financial Statements (Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
Basis of Presentation - The consolidated financial statements include the accounts of Capitol Federal® Financial, Inc. (the "Company") and its wholly-owned subsidiary, Capitol Federal Savings Bank (the "Bank"). The Bank has a wholly-owned subsidiary, Capitol Funds, Inc. Capitol Funds, Inc. has a wholly-owned subsidiary, Capitol Federal Mortgage Reinsurance Company. All intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2016, filed with the Securities and Exchange Commission ("SEC"). Interim results are not necessarily indicative of results for a full year.

Net Presentation of Cash Flows Related to Borrowings - Beginning in fiscal year 2014, the Bank implemented a leverage strategy ("leverage strategy") to increase earnings. This leverage strategy involves borrowing up to $2.10 billion either on the Bank's FHLB line of credit or by entering into short-term FHLB advances, depending on the rates offered by the FHLB at the time of the borrowings, with some or all of the balance being repaid prior to the end of each quarter for regulatory purposes. Proceeds from the borrowings, net of required FHLB stock holdings, are deposited at the Federal Reserve Bank of Kansas City. The contractual maturities of the FHLB advances utilized in conjunction with the leverage strategy beginning in the current quarter are seven days or less; therefore, cash flows related to these advances are reported on a net basis within the consolidated statements of cash flows.

Low Income Housing Partnerships - As part of the Bank's community reinvestment initiatives, the Bank invests in affordable housing limited partnerships ("low income housing partnerships") that make equity investments in affordable housing properties. The Bank is a limited partner in each partnership in which it invests. A separate, unrelated third party is the general partner. The Bank receives affordable housing tax credits and other tax benefits for these investments. Prior to October 1, 2016, the Bank accounted for its low income housing partnership investments using the equity method of accounting, as two of the Bank’s officers were involved in the operational management of the low income housing partnership investment group. On October 1, 2016, due to both officers' resignation from operational management, the Bank began using the proportional method of accounting for its low income housing partnership investments.

Recent Accounting Pronouncements - In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers. The ASU, as amended, clarifies principles for recognizing revenue and provides a common revenue standard for GAAP and International Financial Reporting Standards. Additionally, the ASU provides implementation guidance on several topics and requires entities to disclose both quantitative and qualitative information regarding contracts with customers. ASU 2014-09 is effective for fiscal years beginning after December 15, 2017, including interim reporting periods within that reporting period, which is October 1, 2018 for the Company. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016. The Company expects that the majority of its revenue will not be within the scope of ASU 2014-09.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments, Recognition and Measurement of Financial Assets and Liabilities. The ASU supersedes certain accounting guidance related to equity securities with readily determinable fair values and the related impairment assessment. An entity's equity investments that are accounted for under the equity method of accounting or result in consolidation of an investee are not included within the scope of this ASU. The ASU requires public business entities to utilize the exit price notation in determining fair value for financial instruments measured at amortized cost on the balance sheet. The ASU requires additional reporting in other comprehensive income for financial liabilities measured at fair value in accordance with the fair value option. The ASU also requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balances or in the notes to the financial statements. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, including interim periods with those fiscal years, which is October 1, 2018 for the Company. Early adoption is not permitted except in certain circumstances. The Company has not yet completed its evaluation of ASU 2016-01.

In February 2016, the FASB issued ASU 2016-02, Leases. The ASU amends lease accounting guidance by requiring that lessees recognize the assets and liabilities arising from leases on the balance sheet. Additionally, the ASU requires entities to disclose both quantitative and qualitative information regarding their leasing activities. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, which is October 1, 2019 for the Company. Early adoption is permitted. The Company has not yet completed its evaluation of ASU 2016-02.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting. The ASU simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, along with simplifying the classification in the statement of cash flows. The ASU is effective for annual reporting periods beginning after December 15, 2016, including interim periods within those annual reporting periods, which is October 1, 2017 for the Company. The Company has not yet completed its evaluation of ASU 2016-09.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments. The ASU replaces the incurred loss impairment methodology in current GAAP, which requires credit losses to be recognized when it is probable that a loss has incurred, with a new impairment methodology. The new impairment methodology requires an entity to measure, at each reporting date, the expected credit losses of financial assets not measured at fair value, such as loans, HTM debt securities, and loan commitments, over their contractual lives. Under the new impairment methodology, expected credit losses will be measured at each reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Additionally, the ASU amends the current credit loss measurements for AFS debt securities. Credit losses related to AFS debt securities will be recorded through the ACL rather than as a direct write-down as per current GAAP. The ASU also requires enhanced disclosures related to credit quality and significant estimates and judgments used by management when estimating credit losses. The ASU is effective for annual reporting periods beginning after December 15, 2019, including interim periods within those annual reporting periods, which is October 1, 2020 for the Company. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the ASU and the impact it may have to our formula analysis model.

2. EARNINGS PER SHARE

Shares acquired by the ESOP are not considered in the basic average shares outstanding until the shares are committed for allocation or vested to an employee's individual account. Unvested shares awarded pursuant to the Company's restricted stock benefit plans are treated as participating securities in the computation of EPS pursuant to the two-class method as they contain nonforfeitable rights to dividends. The two-class method is an earnings allocation that determines EPS for each class of common stock and participating security.

	For the Three Months Ended December 31,	
	2016	2015
	(Dollars in thousands, except per share amounts)	
Net income	$20,578	$ 20,718
Income allocated to participating securities	(13)	(27)
Net income available to common stockholders	$20,565	$ 20,691
Average common shares outstanding	133,696,125	132,821,834
Average committed ESOP shares outstanding	449	449
Total basic average common shares outstanding	133,696,574	132,822,283
Effect of dilutive stock options	253,222	88,873
Total diluted average common shares outstanding	133,949,796	132,911,156
Net EPS:		

Basic	$0.15	$ 0.16
Diluted	$0.15	$ 0.16
Antidilutive stock options, excluded from the diluted average common shares outstanding calculation	236,400	872,039

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3. SECURITIES

The following tables reflect the amortized cost, estimated fair value, and gross unrealized gains and losses of AFS and HTM securities at the dates presented. The majority of the MBS and investment securities portfolios are composed of securities issued by United States Government-Sponsored Enterprises ("GSEs").

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(Dollars in thousands)			
AFS:				
GSE debentures	$321,246	$ 156	$ 798	$320,604
MBS	169,037	8,284	7	177,314
Trust preferred securities	2,112	—	238	1,874
	$492,395	$ 8,440	$ 1,043	$499,792
HTM:				
MBS	$989,012	$ 13,084	$ 7,858	$994,238
Municipal bonds	33,203	68	217	33,054
	$1,022,215	$ 13,152	$ 8,075	$1,027,292

	September 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(Dollars in thousands)			
AFS:				
GSE debentures	$346,226	$ 815	$ 3	$347,038
MBS	169,442	9,069	4	178,507
Trust preferred securities	2,123	—	367	1,756
	$517,791	$ 9,884	$ 374	$527,301
HTM:				
MBS	$1,067,571	$ 22,862	$ 1,219	$1,089,214
Municipal bonds	33,303	357	7	33,653
	$1,100,874	$ 23,219	$ 1,226	$1,122,867

The following tables summarize the estimated fair value and gross unrealized losses of those securities on which an unrealized loss at the dates presented was reported and the continuous unrealized loss position for less than 12 months and equal to or greater than 12 months as of the dates presented.

	December 31, 2016			
	Less Than 12 Months		Equal to or Greater Than 12 Months	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)			
AFS:				
GSE debentures	$199,151	$ 798	$—	$ —
MBS	10,936	2	641	5
Trust preferred securities	—	—	1,874	238
	$210,087	$ 800	$2,515	$ 243
HTM:				
MBS	$505,924	$ 6,170	$61,781	$ 1,688
Municipal bonds	22,649	212	836	5
	$528,573	$ 6,382	$62,617	$ 1,693

	September 30, 2016			
	Less Than 12 Months		Equal to or Greater Than 12 Months	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)			
AFS:				
GSE debentures	$24,997	$ 3	$—	$ —
MBS	—	—	654	4
Trust preferred securities	—	—	1,756	367
	$24,997	$ 3	$2,410	$ 371
HTM:				
MBS	$147,930	$ 538	$66,646	$ 681
Municipal bonds	4,771	6	391	1
	$152,701	$ 544	$67,037	$ 682

The unrealized losses at December 31, 2016 and September 30, 2016 were primarily a result of an increase in market yields from the time the securities were purchased. In general, as market yields rise, the fair value of securities will decrease; as market yields fall, the fair value of securities will increase. Management generally views changes in fair value caused by changes in interest rates as temporary; therefore, these securities have not been classified as other-than-temporarily impaired. The impairment is also considered temporary because scheduled coupon payments have been made, it is anticipated that the entire principal balance will be collected as scheduled, and management neither intends to sell the securities, nor is it more likely than not that the Company will be required to sell the securities before the recovery of the remaining amortized cost amount, which could be at maturity. As a result of the analysis, management has concluded that no other-than-temporary impairments existed at December 31, 2016 or

September 30, 2016.

The amortized cost and estimated fair value of debt securities as of December 31, 2016, by contractual maturity, are shown below. Actual principal repayments may differ from contractual maturities due to prepayment or early call privileges by the issuer. In the case of MBS, borrowers on the underlying loans generally have the right to prepay their loans without prepayment penalty. For this reason, MBS are not included in the maturity categories.

	AFS		HTM	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	(Dollars in thousands)			
One year or less	$25,030	$25,032	$7,576	$7,610
One year through five years	296,216	295,572	20,699	20,565
Five years through ten years	—	—	4,928	4,879
Ten years and thereafter	2,112	1,874	—	—
	323,358	322,478	33,203	33,054
MBS	169,037	177,314	989,012	994,238
	$492,395	$499,792	$1,022,215	$1,027,292

The following table presents the taxable and non-taxable components of interest income on investment securities for the periods presented.

	For the Three Months Ended December 31,	
	2016	2015
	(Dollars in thousands)	
Taxable	$964	$1,354
Non-taxable	143	179
	$1,107	$1,533

The following table summarizes the carrying value of securities pledged as collateral for the obligations indicated below as of the dates presented.

	December 31, 2016	September 30, 2016
	(Dollars in thousands)	
Public unit deposits	$427,077	$419,282
Repurchase agreements	217,193	217,374
Federal Reserve Bank	14,765	15,938
	$659,035	$652,594

4. LOANS RECEIVABLE AND ALLOWANCE FOR CREDIT LOSSES

Loans receivable, net at the dates presented is summarized as follows:

	December 31, 2016	September 30, 2016
	(Dollars in thousands)	
Real estate loans:		
One- to four-family:		
Originated	$4,027,991	$4,005,615
Correspondent purchased	2,288,368	2,206,072
Bulk purchased	400,506	416,653
Construction	37,524	39,430
Total	6,754,389	6,667,770
Commercial:		
Permanent	104,323	110,768
Construction	76,254	43,375
Total	180,577	154,143
Total real estate loans	6,934,966	6,821,913
Consumer loans:		
Home equity	122,378	123,345
Other	4,213	4,264
Total consumer loans	126,591	127,609
Total loans receivable	7,061,557	6,949,522
Less:		
ACL	8,521	8,540
Discounts/unearned loan fees	25,028	24,933
Premiums/deferred costs	(43,402)	(41,975)
	$7,071,410	$6,958,024

Lending Practices and Underwriting Standards - Originating and purchasing one- to four-family loans is the Bank's primary lending business, resulting in a loan concentration in residential first mortgage loans. The Bank purchases one- to four-family loans, on a loan-by-loan basis, from a select group of correspondent lenders. The Bank also originates consumer loans primarily secured by one- to four-family residential properties and commercial real estate loans and also participates in commercial real estate loans. As a result of our one- to four-family lending activities, the Bank has a concentration of loans secured by real property located in Kansas and Missouri.

One- to four-family loans - Full documentation to support an applicant's credit and income, and sufficient funds to cover all applicable fees and reserves at closing, are required on all loans. Generally, loans are underwritten according to the "ability to repay" and "qualified mortgage" standards, as issued by the Consumer Financial Protection Bureau ("CFPB"). Properties securing one- to four-family loans are appraised by either staff appraisers or fee appraisers, both of which are independent of the loan origination function and approved by our Board of Directors.

The underwriting standards for loans purchased from correspondent and nationwide lenders are generally similar to the Bank's internal underwriting standards. The underwriting of loans purchased from correspondent lenders on a loan-by-loan basis is performed by the Bank's underwriters.

The Bank also originates construction-to-permanent loans secured by one- to four-family residential real estate. Construction loans are obtained by homeowners who will occupy the property when construction is complete.

Construction loans to builders for speculative purposes are not permitted by the Bank's lending policies. Construction draw requests and the supporting documentation are reviewed and approved by designated personnel. The Bank also performs regular documented inspections of the construction project to ensure the funds are being used for the intended purpose and the project is being completed according to the plans and specifications provided.

Commercial real estate loans - The Bank's commercial real estate loans are originated by the Bank or are in participation with a lead bank. When underwriting a commercial real estate loan, several factors are considered, such as the income producing potential of the property, cash equity provided by the borrower, the financial strength of the borrower, managerial expertise of the borrower or tenant, feasibility studies, lending experience with the borrower and the marketability of the property. For commercial real estate participation loans, the Bank performs the same underwriting procedures as if the loan was being originated by the Bank.
At the time of origination, loan-to-value ("LTV") ratios on commercial real estate loans generally do not exceed 80% of the appraised value of the property securing the loans and the minimum debt service coverage ratio is generally 1.25. Appraisals on properties securing these loans are performed by independent state certified fee appraisers.

Consumer loans - The Bank offers a variety of secured consumer loans, including home equity loans and lines of credit, home improvement loans, auto loans, and loans secured by savings deposits. The Bank also originates a very limited amount of unsecured loans. The Bank does not originate any consumer loans on an indirect basis, such as contracts purchased from retailers of goods or services which have extended credit to their customers. The majority of the consumer loan portfolio is comprised of home equity lines of credit for which the Bank also has the first mortgage or the home equity line of credit is in the first lien position.

The underwriting standards for consumer loans include a determination of an applicant's payment history on other debts and an assessment of an applicant's ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of an applicant is a primary consideration, the underwriting process also includes a comparison of the value of the security in relation to the proposed loan amount.

Credit Quality Indicators - Based on the Bank's lending emphasis and underwriting standards, management has segmented the loan portfolio into three segments: (1) one- to four-family; (2) consumer; and (3) commercial real estate. The one- to four-family and consumer loan portfolios are further segmented into classes for purposes of providing disaggregated information about the credit quality of the loan portfolio. The classes are: one- to four-family - originated, one- to four-family - correspondent purchased, one- to four-family - bulk purchased, consumer - home equity, and consumer - other. The one- to four-family - correspondent purchased class was segregated from the one- to four-family originated class in the current quarter due to the size of the portfolio along with the loan product composition, geographic locations and inherent credit risks within the portfolio. The prior period information presented within this note has been conformed to the new loan class presentation.

The Bank's primary credit quality indicators for the one- to four-family and consumer - home equity loan portfolios are delinquency status, asset classifications, LTV ratios, and borrower credit scores. The Bank's primary credit quality indicators for the commercial real estate and consumer - other loan portfolios are delinquency status and asset classifications.

The following tables present the recorded investment, by class, in loans 30 to 89 days delinquent, loans 90 or more days delinquent or in foreclosure, total delinquent loans, current loans, and total recorded investment at the dates presented. The recorded investment in loans is defined as the unpaid principal balance of a loan, less charge-offs and inclusive of unearned loan fees and deferred costs. At December 31, 2016 and September 30, 2016, all loans 90 or more days delinquent were on nonaccrual status.

	December 31, 2016				
	30 to 89 Days Delinquent	90 or More Days Delinquent or in Foreclosure	Total Delinquent Loans	Current Loans	Total Recorded Investment
	(Dollars in thousands)				
One- to four-family - originated	$11,199	$ 6,625	$ 17,824	$4,032,155	$4,049,979
One- to four-family - correspondent	7,928	555	8,483	2,312,776	2,321,259
One- to four-family - bulk purchased	4,895	8,053	12,948	389,661	402,609
Commercial real estate	—	—	—	179,493	179,493
Consumer - home equity	665	456	1,121	121,257	122,378
Consumer - other	17	18	35	4,178	4,213
	$24,704	$ 15,707	$ 40,411	$7,039,520	$7,079,931

	September 30, 2016				
	30 to 89 Days Delinquent	90 or More Days Delinquent or in Foreclosure	Total Delinquent Loans	Current Loans	Total Recorded Investment
	(Dollars in thousands)				
One- to four-family - originated	$13,545	$ 8,153	$ 21,698	$4,007,012	$4,028,710
One- to four-family - correspondent	3,389	992	4,381	2,233,941	2,238,322
One- to four-family - bulk purchased	5,082	7,380	12,462	406,379	418,841
Commercial real estate	—	—	—	153,082	153,082
Consumer - home equity	635	520	1,155	122,190	123,345
Consumer - other	62	9	71	4,193	4,264
	$22,713	$ 17,054	$ 39,767	$6,926,797	$6,966,564

The recorded investment of mortgage loans secured by residential real estate properties for which formal foreclosure proceedings were in process as of December 31, 2016 and September 30, 2016 was $7.2 million and $5.7 million, respectively, which is included in loans 90 or more days delinquent or in foreclosure in the table above. The carrying value of residential OREO held as a result of obtaining physical possession upon completion of a foreclosure or through completion of a deed in lieu of foreclosure was $2.1 million at December 31, 2016 and $2.5 million at September 30, 2016.

The following table presents the recorded investment, by class, in loans classified as nonaccrual at the dates presented.

	December 31, 2016	September 30, 2016
	(Dollars in thousands)	
One- to four-family - originated	$17,985	$ 17,086

One- to four-family - correspondent	1,794	3,788
One- to four-family - bulk purchased	8,200	7,411
Commercial real estate	—	—
Consumer - home equity	827	848
Consumer - other	18	10
	$28,824	$ 29,143

In accordance with the Bank's asset classification policy, management regularly reviews the problem loans in the Bank's portfolio to determine whether any loans require classification. Loan classifications are defined as follows:

- Special mention - These loans are performing loans on which known information about the collateral pledged or the possible credit problems of the borrower(s) have caused management to have doubts as to the ability of the borrower(s) to comply with present loan repayment terms and which may result in the future inclusion of such loans in the non-performing loan categories.
- Substandard - A loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard loans include those characterized by the distinct possibility the Bank will sustain some loss if the deficiencies are not corrected.
- Doubtful - Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses present make collection or liquidation in full on the basis of currently existing facts and conditions and values highly questionable and improbable.
- Loss - Loans classified as loss are considered uncollectible and of such little value that their continuance as assets on the books is not warranted.

The following table sets forth the recorded investment in loans classified as special mention or substandard, by class, at the dates presented. Special mention and substandard loans are included in the ACL formula analysis model if the loans are not individually evaluated for loss. Loans classified as doubtful or loss are individually evaluated for loss. At the dates presented, there were no loans classified as doubtful, and all loans classified as loss were fully charged-off.

	December 31, 2016		September 30, 2016	
	Special Mention	Substandard	Special Mention	Substandard
	(Dollars in thousands)			
One- to four-family - originated	$8,764	$ 28,564	$10,242	$ 27,818
One- to four-family - correspondent	6,838	4,850	2,496	5,168
One- to four-family - bulk purchased	880	11,616	1,156	11,480
Commercial real estate	—	—	—	—
Consumer - home equity	58	1,469	54	1,431
Consumer - other	—	30	8	16
	$16,540	$ 46,529	$13,956	$ 45,913

The following table shows the weighted average credit score and weighted average LTV for originated and purchased one- to four-family loans and originated consumer home equity loans at the dates presented. Borrower credit scores are intended to provide an indication as to the likelihood that a borrower will repay their debts. Credit scores are updated at least semiannually, with the last update in September 2016, from a nationally recognized consumer rating agency. The LTV ratios provide an estimate of the extent to which the Bank may incur a loss on any given loan that may go into foreclosure. The consumer - home equity LTV does not take into account the first lien position, if applicable. The LTV ratios were based on the current loan balance and either the lesser of the purchase price or original appraisal, or the most recent Bank appraisal, if available. In most cases, the most recent appraisal was obtained at the time of origination.

	December 31, 2016		September 30, 2016	
	Credit Score	LTV	Credit Score	LTV
One- to four-family - originated	766	63%	766	63%
One- to four-family - correspondent	764	68	764	68
One- to four-family - bulk purchased	753	64	753	64
Consumer - home equity	755	20	755	20
	764	64	764	64

Troubled Debt Restructurings ("TDRs") - The following tables present the recorded investment prior to restructuring and immediately after restructuring in all loans restructured during the periods presented. These tables do not reflect the recorded investment at the end of the periods indicated. Any increase in the recorded investment at the time of the restructuring was generally due to the capitalization of delinquent interest and/or escrow balances.

	For the Three Months Ended December 31, 2016		
	Number of Contracts	Pre-Restructured Outstanding	Post-Restructured Outstanding
	(Dollars in thousands)		
One- to four-family - originated	38	$ 3,928	$ 4,185
One- to four-family - correspondent	—	—	—
One- to four-family - purchased	—	—	—
Commercial real estate	—	—	—
Consumer - home equity	8	206	212
Consumer - other	—	—	—
	46	$ 4,134	$ 4,397

	For the Three Months Ended December 31, 2015		
	Number of Contracts	Pre-Restructured Outstanding	Post-Restructured Outstanding
	(Dollars in thousands)		
One- to four-family - originated	30	$ 3,106	$ 3,165
One- to four-family - correspondent	—	—	—
One- to four-family - bulk purchased	1	123	122
Commercial real estate	—	—	—
Consumer - home equity	4	61	61
Consumer - other	—	—	—
	35	$ 3,290	$ 3,348

The following table provides information on TDRs that became delinquent during the periods presented within 12 months after being restructured.

	For the Three Months Ended			
	December 31, 2016		December 31, 2015	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Dollars in thousands)			
One- to four-family - originated	11	$ 978	11	$ 800
One- to four-family - correspondent	—	—	—	—
One- to four-family - bulk purchased	—	—	—	—
Commercial real estate	—	—	—	—
Consumer - home equity	4	115	2	78
Consumer - other	—	—	—	—
	15	$ 1,093	13	$ 878

Impaired loans - The following information pertains to impaired loans, by class, as of the dates presented. A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement.

	December 31, 2016			September 30, 2016		
	Recorded Investment	Unpaid Principal Balance	Related ACL	Recorded Investment	Unpaid Principal Balance	Related ACL
	(Dollars in thousands)					
With no related allowance recorded						
One- to four-family - originated	$24,077	$24,759	$ —	$22,982	$23,640	$ —
One- to four-family - correspondent	4,244	4,233	—	2,963	2,950	—
One- to four-family - bulk purchased	11,175	12,870	—	10,985	12,684	—
Commercial real estate	—	—	—	—	—	—
Consumer - home equity	1,070	1,269	—	1,014	1,230	—
Consumer - other	16	39	—	10	42	—
	40,582	43,170	—	37,954	40,546	—
With an allowance recorded						
One- to four-family - originated	11,723	11,760	89	13,430	13,476	125
One- to four-family - correspondent	1,056	1,059	2	2,662	2,664	4
One- to four-family - bulk purchased	1,320	1,313	15	1,650	1,627	49
Commercial real estate	—	—	—	—	—	—
Consumer - home equity	499	499	31	548	548	38
Consumer - other	14	14	1	6	6	1
	14,612	14,645	138	18,296	18,321	217
Total						
One- to four-family - originated	35,800	36,519	89	36,412	37,116	125
One- to four-family - correspondent	5,300	5,292	2	5,625	5,614	4
One- to four-family - bulk purchased	12,495	14,183	15	12,635	14,311	49
Commercial real estate	—	—	—	—	—	—
Consumer - home equity	1,569	1,768	31	1,562	1,778	38
Consumer - other	30	53	1	16	48	1
	$55,194	$57,815	$ 138	$56,250	$58,867	$ 217

The following information pertains to impaired loans, by class, for the periods presented.

	For the Three Months Ended			
	December 31, 2016		December 31, 2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
With no related allowance recorded				
One- to four-family - originated	$22,687	$ 205	$10,843	$ 110
One- to four-family - correspondent	3,138	24	129	3
One- to four-family - bulk purchased	10,898	46	11,090	51
Commercial real estate	—	—	—	—
Consumer - home equity	991	30	574	8
Consumer - other	11	—	9	—
	37,725	305	22,645	172
With an allowance recorded				
One- to four-family - originated	13,289	125	26,779	252
One- to four-family - correspondent	2,254	20	1,335	13
One- to four-family - bulk purchased	1,428	6	3,246	7
Commercial real estate	—	—	—	—
Consumer - home equity	587	15	954	11
Consumer - other	13	—	13	—
	17,571	166	32,327	283
Total				
One- to four-family - originated	35,976	330	37,622	362
One- to four-family - correspondent	5,392	44	1,464	16
One- to four-family - bulk purchased	12,326	52	14,336	58
Commercial real estate	—	—	—	—
Consumer - home equity	1,578	45	1,528	19
Consumer - other	24	—	22	—
	$55,296	$ 471	$54,972	$ 455

Allowance for Credit Losses - The following is a summary of ACL activity, by loan portfolio segment, for the periods presented, and the ending balance of ACL based on the Company's impairment methodology.

	For the Three Months Ended December 31, 2016						
	One- to Four-Family						
	Originated	Correspondent Purchased	Bulk Purchased	Total	Commercial Real Estate	Consumer	Total
	(Dollars in thousands)						
Beginning balance	$3,928	$ 2,102	$ 1,065	$7,095	$ 1,208	$ 237	$8,540
Charge-offs	(24)	—	—	(24)	—	(8)	(32)
Recoveries	—	—	—	—	—	13	13
Provision for credit losses	(161)	(38)	(53)	(252)	287	(35)	—
Ending balance	$3,743	$ 2,064	$ 1,012	$6,819	$ 1,495	$ 207	$8,521

	For the Three Months Ended December 31, 2015						
	One- to Four-Family						
	Originated	Correspondent Purchased	Bulk Purchased	Total	Commercial Real Estate	Consumer	Total
	(Dollars in thousands)						
Beginning balance	$4,865	$ 2,115	$ 1,434	$8,414	$ 742	$ 287	$9,443
Charge-offs	(57)	—	(175)	(232)	—	(18)	(250)
Recoveries	3	—	—	3	—	5	8
Provision for credit losses	1	(95)	31	(63)	59	4	—
Ending balance	$4,812	$ 2,020	$ 1,290	$8,122	$ 801	$ 278	$9,201

The following is a summary of the loan portfolio and related ACL balances, at the dates presented, by loan portfolio segment disaggregated by the Company's impairment method. There was no ACL for loans individually evaluated for impairment at either date as all losses were charged-off.

	December 31, 2016						
	One- to Four-Family						
	Originated	Correspondent Purchased	Bulk Purchased	Total	Commercial Real Estate	Consumer	Total
	(Dollars in thousands)						
Recorded investment in loans collectively evaluated for impairment	$4,024,073	$ 2,311,667	$391,175	$6,726,915	$ 179,493	$125,358	$7,031,766
Recorded investment in loans individually evaluated for impairment	25,906	9,592	11,434	46,932	—	1,233	48,165
	$4,049,979	$ 2,321,259	$402,609	$6,773,847	$ 179,493	$126,591	$7,079,931
ACL for loans collectively evaluated for impairment	$3,743	$ 2,064	$1,012	$6,819	$ 1,495	$207	$8,521

	September 30, 2016						
	One- to Four-Family						
	Originated	Correspondent Purchased	Bulk Purchased	Total	Commercial Real Estate	Consumer	Total
	(Dollars in thousands)						
Recorded investment in loans collectively evaluated for impairment	$4,003,750	$ 2,233,347	$407,833	$6,644,930	$ 153,082	$126,504	$6,924,516
Recorded investment in loans individually evaluated for impairment	24,960	4,975	11,008	40,943	—	1,105	42,048
	$4,028,710	$ 2,238,322	$418,841	$6,685,873	$ 153,082	$127,609	$6,966,564
ACL for loans collectively evaluated for impairment	$3,928	$ 2,102	$1,065	$7,095	$ 1,208	$237	$8,540

5. LOW INCOME HOUSING PARTNERSHIPS

The Bank's investment in low income housing partnerships, which is included in other assets in the consolidated balance sheets, was $56.9 million and $58.0 million at December 31, 2016 and September 30, 2016, respectively. The Bank's obligations related to unfunded commitments, which are included in accounts payable and accrued expenses in the consolidated balance sheets, were $26.3 million and $27.2 million at December 31, 2016 and September 30, 2016, respectively. The majority of the commitments are projected to be funded through the end of calendar year 2019.

For the three months ended December 31, 2016, the net income tax benefit associated with these investments, which consists of proportional amortization expense and affordable housing tax credits and other related tax benefits, was reported in income tax expense in the consolidated statements of income. The amount of proportional amortization expense during the three months ended December 31, 2016 was $1.1 million and the amount of affordable housing tax credits and other related tax benefits was $1.7 million, resulting in a net income tax benefit of $577 thousand. For the three months ended December 31, 2015, low income housing partnership expenses were reported in low income housing partnerships in the consolidated statements of income, other tax benefits were $292 thousand, and affordable housing tax credits were $1.2 million. There were no impairment losses during the three months ended December 31, 2016 and 2015 resulting from the forfeiture or ineligibility of tax credits or other circumstances.

6. REPURCHASE AGREEMENTS

At both December 31, 2016 and September 30, 2016, the Company had repurchase agreements outstanding in the amount of $200.0 million with a weighted average contractual rate of 2.94%. All of the Company's repurchase agreements at December 31, 2016 and September 30, 2016 were fixed-rate. See Note 3 for information regarding the amount of securities pledged as collateral in conjunction with repurchase agreements. Securities are delivered to the party with whom each transaction is executed and the party agrees to resell the same securities to the Bank at the maturity of the agreement. The Bank retains the right to substitute similar or like securities throughout the terms of the agreements. The repurchase agreements and collateral are subject to valuation at current market levels and the Bank may ask for the return of excess collateral or be required to post additional collateral due to changes in the market values of these items. The Bank may also be required to post additional collateral as a result of principal payments received on the securities pledged.

The following table presents the scheduled maturity of repurchase agreements by fiscal year as of December 31, 2016:

	Amount (Dollars in thousands)
2017	$ —
2018	100,000
2019	—
2020	100,000
2021	—
Thereafter	—
	$ 200,000

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair Value Measurements - The Company uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures in accordance with Accounting Standards Codification ("ASC") 820 and ASC 825. The Company did not have any liabilities that were measured at fair value at December 31, 2016 or September 30, 2016. The Company's AFS securities are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets or liabilities on a non-recurring basis, such as OREO and loans individually evaluated for impairment. These non-recurring fair value adjustments involve the application of lower of cost or fair value accounting or write-downs of individual assets.

The Company groups its assets at fair value in three levels based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1 - Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2 - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 - Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company's own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models, and similar techniques. The results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability.

The Company bases its fair values on the price that would be received from the sale of an asset in an orderly transaction between market participants at the measurement date under current market conditions. The Company maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

The following is a description of valuation methodologies used for assets measured at fair value on a recurring basis.

AFS Securities - The Company's AFS securities portfolio is carried at estimated fair value, with any unrealized gains and losses, net of taxes, reported as AOCI in stockholders' equity. The majority of the securities within the AFS portfolio were issued by GSEs. The Company primarily uses prices obtained from third party pricing services to determine the fair value of its securities. On a quarterly basis, management corroborates a sample of prices obtained from the third party pricing service for Level 2 securities by comparing them to an independent source. If the price provided by the independent source varies by more than a predetermined percentage from the price received from the third party pricing service, then the variance is researched by management. The Company did not have to adjust prices obtained from the third party pricing service when determining the fair value of its securities during the three month months ended December 31, 2016 or during fiscal year 2016. The Company's major security types, based on the nature and risks of the securities, are:

- GSE Debentures - Estimated fair values are based on a discounted cash flow method. Cash flows are determined by taking any embedded options into consideration and are discounted using current market yields for similar securities. (Level 2)
- MBS - Estimated fair values are based on a discounted cash flow method. Cash flows are determined based on prepayment projections of the underlying mortgages and are discounted using current market yields for benchmark securities. (Level 2)
- Municipal Bonds - Estimated fair values are based on a discounted cash flow method. Cash flows are determined by taking any embedded options into consideration and are discounted using current market yields for securities with similar credit profiles. (Level 2)
- Trust Preferred Securities - Estimated fair values are based on a discounted cash flow method. Cash flows are determined by taking prepayment and underlying credit considerations into account. The discount rates are derived

from secondary trades and bid/offer prices. (Level 3)

The following tables provide the level of valuation assumption used to determine the carrying value of the Company's assets measured at fair value on a recurring basis at the dates presented.

	December 31, 2016			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(Dollars in thousands)			
AFS Securities:				
GSE debentures	$320,604	$ —	$ 320,604	$ —
MBS	177,314	—	177,314	—
Municipal bonds	—	—	—	—
Trust preferred securities	1,874	—	—	1,874
	$499,792	$ —	$ 497,918	$ 1,874

	September 30, 2016			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(Dollars in thousands)			
AFS Securities:				
GSE debentures	$347,038	$ —	$ 347,038	$ —
MBS	178,507	—	178,507	—
Municipal bonds	—	—	—	—
Trust preferred securities	1,756	—	—	1,756
	$527,301	$ —	$ 525,545	$ 1,756

The Company's Level 3 AFS securities had no activity during the three months ended December 31, 2016, except for principal repayments of $19 thousand and decreases in net unrealized losses included in other comprehensive income of $80 thousand. The Company's Level 3 AFS securities had no activity during the three months ended December 31, 2015, except for principal repayments of $5 thousand, and increases in net unrealized losses included in other comprehensive income of $39 thousand.

The following is a description of valuation methodologies used for significant assets measured at fair value on a non-recurring basis.

Loans Receivable - The balance of loans individually evaluated for impairment at December 31, 2016 and September 30, 2016 was $48.1 million and $42.0 million, respectively. Substantially all of these loans were secured by residential real estate and were individually evaluated to determine if the carrying value of the loan was in excess of the fair value of the collateral, less estimated selling costs of 10%. When no impairment is indicated, the carrying amount is considered to approximate fair value. Fair values were estimated through current appraisals or current

Federal Housing Finance Agency ("FHFA") housing price indices, which is a broad based measure of the movement of single-family house prices and is a weighted, repeat-sales index. Management does not adjust or apply a discount to the appraised value or FHFA housing price indices, except for the estimated sales costs noted above. The primary significant unobservable input for loans individually evaluated for impairment using appraisals to determine the estimated fair value was the appraisal. Fair values of loans individually evaluated for impairment cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the loan, and, as such are classified as Level 3. Based on this evaluation, the Bank charged-off all loss amounts as of December 31, 2016 and September 30, 2016; therefore, there was no ACL related to these loans.

OREO - OREO primarily represents real estate acquired as a result of foreclosure or by deed in lieu of foreclosure and is carried at lower of cost or fair value. Fair value is estimated through current appraisals or listing prices, less estimated selling costs of 10%. Management does not adjust or apply a discount to the appraised value or listing price, except for the estimated sales costs noted above. The primary significant unobservable input for OREO was the appraisal or listing price. Fair values of foreclosed property cannot be determined with precision and may not be realized in an actual sale of the property and, as such, are classified as Level 3. The fair value of OREO at December 31, 2016 and September 30, 2016 was $3.4 million and $3.7 million, respectively.

The following tables provide the level of valuation assumptions used to determine the carrying value of the Company's assets measured at fair value on a non-recurring basis at the dates presented.

	December 31, 2016			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(Dollars in thousands)			
Loans individually evaluated for impairment	$48,065	$ —	$ —	$ 48,065
OREO	3,362	—	—	3,362
	$51,427	$ —	$ —	$ 51,427

	September 30, 2016			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(Dollars in thousands)			
Loans individually evaluated for impairment	$41,995	$ —	$ —	$ 41,995
OREO	3,734	—	—	3,734
	$45,729	$ —	$ —	$ 45,729

Fair Value Disclosures - The Company determined estimated fair value amounts using available market information and a variety of valuation methodologies as of the dates presented. Considerable judgment is required to interpret market data to develop the estimates of fair value. The estimates presented are not necessarily indicative of amounts the Company would realize from a current market exchange at subsequent dates.

The carrying amounts and estimated fair values of the Company's financial instruments, at the dates presented, were as follows:

	December 31, 2016		September 30, 2016	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(Dollars in thousands)			
Assets:				
Cash and cash equivalents	$150,560	$150,560	$281,764	$281,764
AFS securities	499,792	499,792	527,301	527,301
HTM securities	1,022,215	1,027,292	1,100,874	1,122,867

Loans receivable	7,071,410	7,188,403	6,958,024	7,292,971
FHLB stock	105,364	105,364	109,970	109,970
Liabilities:				
Deposits	5,192,674	5,207,640	5,164,018	5,204,251
FHLB borrowings	2,272,754	2,293,591	2,372,389	2,434,151
Repurchase agreements	200,000	203,861	200,000	207,303

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

Cash and Cash Equivalents - The carrying amounts of cash and cash equivalents are considered to approximate their fair value due to the nature of the financial assets. (Level 1)

HTM Securities - Estimated fair values of securities are based on one of three methods: (1) quoted market prices where available; (2) quoted market prices for similar instruments if quoted market prices are not available; (3) unobservable data that represents the Bank's assumptions about items that market participants would consider in determining fair value where no market data is available. HTM securities are carried at amortized cost. (Level 2)

Loans Receivable - The fair value of one- to four-family loans and home equity loans are generally estimated using the present value of expected future cash flows, assuming future prepayments and using discount factors determined by prices obtained from securitization markets, less a discount for the cost of servicing and lack of liquidity. The estimated fair value of the Bank's commercial and consumer loans are based on the expected future cash flows assuming future prepayments and discount factors based on current offering rates. (Level 3)

FHLB stock - The carrying value and estimated fair value of FHLB stock equals cost, which is based on redemption at par value. (Level 1)

Deposits - The estimated fair value of demand deposits, savings, and money market accounts is the amount payable on demand at the reporting date. The estimated fair value of these deposits at December 31, 2016 and September 30, 2016 was $2.41 billion and $2.34 billion, respectively. (Level 1) The fair value of certificates of deposit is estimated by discounting future cash flows using current London Interbank Offered Rates ("LIBOR"). The estimated fair value of certificates of deposit at December 31, 2016 and September 30, 2016 was $2.80 billion and $2.87 billion, respectively. (Level 2)

FHLB borrowings and Repurchase Agreements - The fair value of fixed-maturity borrowed funds is estimated by discounting estimated future cash flows using current offer rates. (Level 2)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
The Company and the Bank may from time to time make written or oral "forward-looking statements," including statements contained in documents filed or furnished by the Company with the SEC. These forward-looking statements may be included in this Quarterly Report on Form 10-Q and the exhibits attached to it, in the Company's reports to stockholders, in the Company's press releases, and in other communications by the Company, which are made in good faith by us pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements include statements about our beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions, which are subject to significant risks and uncertainties, and are subject to change based on various factors, some of which are beyond our control. The words "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan" and similar expressions are intended to identify forward-looking statements. The following factors, among others, could cause our future results to differ materially from the beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions expressed in the forward-looking statements:

- our ability to maintain overhead costs at reasonable levels;
- our ability to originate and purchase a sufficient volume of one- to four-family loans in order to maintain the balance of that portfolio at a level desired by management;
- our ability to invest funds in wholesale or secondary markets at favorable yields compared to the related funding source;
- our ability to access cost-effective funding;
- fluctuations in deposit flows;
- the future earnings and capital levels of the Bank and the continued non-objection by our primary federal banking regulators, to the extent required, to distribute capital from the Bank to the Company, which could affect the ability of the Company to pay dividends in accordance with its dividend policy;
- the strength of the U.S. economy in general and the strength of the local economies in which we conduct operations, including areas where we have purchased large amounts of correspondent loans;
- changes in real estate values, unemployment levels, and the level and direction of loan delinquencies and charge-offs may require changes in the estimates of the adequacy of the ACL, which may adversely affect our business;
- increases in non-performing assets, which may require the Bank to increase the ACL, charge-off loans and incur elevated collection and carrying costs related to such non-performing assets;
- results of examinations of the Bank and the Company by their respective primary federal banking regulators, including the possibility that the regulators may, among other things, require us to increase our ACL;
- changes in accounting principles, policies, or guidelines;
- the effects of, and changes in, monetary and interest rate policies of the Board of Governors of the Federal Reserve System ("FRB");
- the effects of, and changes in, trade and fiscal policies and laws of the United States government;
- the effects of, and changes in, foreign and military policies of the United States government;
- inflation, interest rate, market, monetary, and currency fluctuations;
- the timely development and acceptance of our new products and services and the perceived overall value of these products and services by users, including the features, pricing, and quality compared to competitors' products and services;
- the willingness of users to substitute competitors' products and services for our products and services;
- our success in gaining regulatory approval of our products and services and branching locations, when required;
- the impact of changes in financial services laws and regulations, including laws concerning taxes, banking, securities, consumer protection and insurance and the impact of other governmental initiatives affecting the financial services industry;
- implementing business initiatives may be more difficult or expensive than anticipated;
- significant litigation;

- technological changes;
- acquisitions and dispositions;
- changes in consumer spending, borrowing and saving habits; and
- our success at managing the risks involved in our business.

This list of important factors is not all inclusive. We do not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company or the Bank.

As used in this Form 10-Q, unless we specify otherwise, "the Company," "we," "us," and "our" refer to Capitol Federal Financial, Inc. a Maryland corporation. "Capitol Federal Savings," and "the Bank," refer to Capitol Federal Savings Bank, a federal savings bank and the wholly-owned subsidiary of Capitol Federal Financial, Inc.

The following discussion and analysis is intended to assist in understanding the financial condition, results of operations, liquidity, and capital resources of the Company. The Bank comprises almost all of the consolidated assets and liabilities of the Company and the Company is dependent primarily upon the performance of the Bank for the results of its operations. Because of this relationship, references to management actions, strategies and results of actions apply to both the Bank and the Company. This discussion and analysis should be read in conjunction with Management's Discussion and Analysis included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2016, filed with the SEC.

Executive Summary
The following summary should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations section in its entirety.

We have been, and intend to continue to be, a community-oriented financial institution offering a variety of financial services to meet the needs of the communities we serve. We attract retail deposits from the general public and invest those funds primarily in permanent loans secured by first mortgages on owner-occupied, one- to four-family residences. We also originate consumer loans primarily secured by mortgages on one- to four-family residences and originate and participate in commercial real estate loans. We also invest in certain investment securities and MBS using funding from deposits, FHLB borrowings, and repurchase agreements.

The Company's results of operations are primarily dependent on net interest income, which is the difference between the interest earned on loans, MBS, investment securities, and cash, and the interest paid on deposits and borrowings. On a weekly basis, management reviews deposit flows, loan demand, cash levels, and changes in several market rates to assess all pricing strategies. The Bank's pricing strategy for first mortgage loan products includes setting interest rates based on secondary market prices and competitor pricing for our local lending markets, and secondary market prices and national competitor pricing for our correspondent lending markets. Generally, deposit pricing is based upon a survey of competitors in the Bank's market areas, and the need to attract funding and retain maturing deposits. The majority of our loans are fixed-rate products with maturities up to 30 years, while the majority of our retail deposits have stated maturities or repricing dates of less than two years.

The Company is significantly affected by prevailing economic conditions, including federal monetary and fiscal policies and federal regulation of financial institutions. Retail deposit balances are influenced by a number of factors, including interest rates paid on competing investment products, the level of personal income, and the personal rate of savings within our market areas. Lending activities are influenced by the demand for housing and other loans, our loan underwriting guidelines compared to those of our competitors, as well as interest rate pricing competition from other lending institutions.

Local economic conditions have a significant impact on the ability of borrowers to repay loans and the value of the collateral securing these loans. The industries in the Bank's local market areas, where the property securing approximately 70% of the Bank's one- to four-family loans is located, are diversified, especially in the Kansas City metropolitan statistical area, which comprises the largest segment of our loan portfolio and deposit base. As of December 2016, the unemployment rate was 4.2% for Kansas and 4.4% for Missouri, compared to the national average of 4.7%, based on information from the Bureau of Labor Statistics. The Kansas City market area has an average household income of approximately $74 thousand per annum, based on 2016 estimates from Nielsen. The average household income in our combined market areas is approximately $70 thousand per annum, with 90% of the population at or above the poverty level, also based on the 2016 estimates from Nielsen. The FHFA price index for Kansas and Missouri has not experienced any significant fluctuations over the past several years, which indicates relative stability in property values in our local market areas.

For the quarter ended December 31, 2016, the Company recognized net income of $20.6 million, or $0.15 per share, compared to net income of $20.7 million, or $0.16 per share, for the quarter ended December 31, 2015. The Bank continued to utilize a leverage strategy to increase earnings during the current quarter. The leverage strategy during the current quarter involved borrowing up to $2.10 billion either on the Bank's FHLB line of credit or by entering into short-term FHLB advances, depending on the rates offered by FHLB. The borrowings were repaid prior to quarter end for regulatory purposes. The proceeds from the borrowings, net of the required FHLB stock holdings, were deposited at the Federal Reserve Bank of Kansas City. Net income attributable to the leverage strategy was $642 thousand during the current quarter, compared to $583 thousand for the prior year quarter.

The net interest margin decreased two basis points, from 1.75% for the prior year quarter to 1.73% for the current year quarter. Excluding the effects of the leverage strategy, the net interest margin would have decreased four basis points, from 2.11% for the prior year quarter to 2.07% for the current year quarter. The decrease in the net interest margin was due mainly to an increase in interest expense on deposits and a decrease in the yield on the MBS portfolio, partially offset by a decrease in interest expense on borrowings not related to the leverage strategy. The positive impact on the net interest margin resulting from the shift in the mix of interest-earning assets from relatively lower yielding securities to higher yielding loans was offset by a decrease in the loan portfolio yield.

Total assets were $9.14 billion at December 31, 2016 compared to $9.27 billion at September 30, 2016. The $127.7 million decrease was due primarily to a $131.2 million decrease in cash and cash equivalents and a $106.2 million decrease in the securities portfolio. These cash flows were used to fund loan growth and pay off a maturing $100.0 million FHLB advance during the current quarter.

The loans receivable portfolio, net, increased $113.4 million, to $7.07 billion at December 31, 2016, from $6.96 billion at September 30, 2016. During the current quarter, the Bank originated and refinanced $223.1 million of loans with a weighted average rate of 3.32% and purchased $180.6 million of one- to four-family loans from correspondent lenders with a weighted average rate of 3.33%. The Bank also entered into participations of $32.3 million of commercial real estate loans with a weighted average rate of 3.96%, of which $24.5 million had not yet been funded as of December 31, 2016.

Total liabilities were $7.77 billion at December 31, 2016 compared to $7.87 billion at September 30, 2016. The $102.9 million decrease was due primarily to a $99.6 million decrease in FHLB borrowings as a result of the maturity of a $100.0 million FHLB advance during the current quarter which was not replaced.

Stockholders' equity was $1.37 billion at December 31, 2016 compared to $1.39 billion at September 30, 2016. The $24.8 million decrease was due primarily to the payment of $50.2 million in cash dividends, partially offset by net income of $20.6 million.

Available Information

Financial and other Company information, including press releases, Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports can be obtained free of charge from our investor relations website, http://ir.capfed.com. SEC filings are available on our website immediately after they are electronically filed with or furnished to the SEC, and are also available on the SEC's website at www.sec.gov.

Critical Accounting Policies

Our most critical accounting policies are the methodologies used to determine the ACL and fair value measurements. These policies are important to the presentation of our financial condition and results of operations, involve a high degree of complexity, and require management to make difficult and subjective judgments that may require assumptions or estimates about highly uncertain matters. The use of different judgments, assumptions, and estimates could cause reported results to differ materially. These critical accounting policies and their application are reviewed at least annually by our audit committee. For a full discussion of our critical accounting policies, see Item 7 - "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies" in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2016.

Financial Condition

The following table presents selected balance sheet information as of the dates indicated.

	December 31, 2016	September 30, 2016	June 30, 2016	March 31, 2016	December 31, 2015
	(Dollars in thousands)				
Total assets	$9,139,510	$9,267,247	$9,241,775	$9,316,684	$9,133,422
Cash and cash equivalents	150,560	281,764	152,831	203,811	232,354
AFS securities	499,792	527,301	666,313	677,416	636,970
HTM securities	1,022,215	1,100,874	1,188,913	1,270,849	1,199,978
Loans receivable, net	7,071,410	6,958,024	6,839,123	6,769,194	6,665,128
FHLB stock, at cost	105,364	109,970	114,425	114,381	119,027
Deposits	5,192,674	5,164,018	5,085,129	5,119,829	4,972,480
FHLB borrowings	2,272,754	2,372,389	2,472,026	2,471,656	2,471,272
Repurchase agreements	200,000	200,000	200,000	200,000	200,000
Stockholders' equity	1,368,175	1,392,964	1,380,815	1,403,408	1,390,833
Equity to total assets at end of period	15.0 %	15.0 %	14.9 %	15.1 %	15.2 %

Assets. Total assets were $9.14 billion at December 31, 2016 compared to $9.27 billion at September 30, 2016. The $127.7 million decrease was due primarily to a $131.2 million decrease in cash and cash equivalents and a $106.2 million decrease in the securities portfolio. These cash flows were used to fund loan growth and pay off a maturing $100.0 million FHLB advance during the current quarter.

Loans Receivable. Loans receivable, net, increased $113.4 million to $7.07 billion at December 31, 2016 from $6.96 billion at September 30, 2016. The annualized loan portfolio growth during the current quarter was 6.5%. The growth in the loan portfolio during the current quarter was primarily in the correspondent one- to four-family purchased loan portfolio, which increased $82.3 million.

The following table presents the balance and weighted average rate of our loan portfolio as of the dates indicated. Within the one- to four-family loan portfolio at December 31, 2016, 59% of the loans had a balance at origination of less than $417 thousand.

	December 31, 2016		September 30, 2016	
	Amount	Rate	Amount	Rate
	(Dollars in thousands)			
Real estate loans:				
One- to four-family:				
Originated	$4,027,991	3.70%	$4,005,615	3.74%
Correspondent purchased	2,288,368	3.48	2,206,072	3.50
Bulk purchased	400,506	2.24	416,653	2.23
Construction	37,524	3.44	39,430	3.45
Total	6,754,389	3.54	6,667,770	3.56
Commercial:				
Permanent	104,323	4.15	110,768	4.16
Construction	76,254	4.10	43,375	4.13
Total	180,577	4.13	154,143	4.15
Total real estate loans	6,934,966	3.55	6,821,913	3.58
Consumer loans:				
Home equity	122,378	4.99	123,345	5.01
Other	4,213	4.19	4,264	4.21
Total consumer loans	126,591	4.96	127,609	4.99
Total loans receivable	7,061,557	3.58	6,949,522	3.60
Less:				
ACL	8,521		8,540	
Discounts/unearned loan fees	25,028		24,933	
Premiums/deferred costs	(43,402)		(41,975)	
Total loans receivable, net	$7,071,410		$6,958,024	

Loan Activity - The following table summarizes activity in the loan portfolio, along with weighted average rates where applicable, for the periods indicated, excluding changes in ACL, discounts/unearned loan fees, and premiums/deferred costs. Loans that were paid-off as a result of refinances are included in repayments. Loan endorsements are not included in the activity in the following table because a new loan is not generated at the time of the endorsement. The endorsed balance and rate are included in the ending loan portfolio balance and rate. During the three months ended December 31, 2016 and 2015, the Bank endorsed $33.8 million and $23.6 million of one- to four-family loans, respectively, reducing the average rate on those loans by 89 and 90 basis points, respectively.

	For the Three Months Ended							
	December 31, 2016		September 30, 2016		June 30, 2016		March 31, 2016	
	Amount	Rate	Amount	Rate	Amount	Rate	Amount	Rate
	(Dollars in thousands)							
Beginning balance	$6,949,522	3.60%	$6,832,770	3.63%	$6,763,980	3.64%	$6,661,648	3.65%
Originated and refinanced:								
Fixed	176,554	3.26	176,534	3.31	155,179	3.52	117,205	3.65
Adjustable	46,566	3.54	48,608	3.53	44,319	3.61	35,495	3.77
Purchased and participations:								
Fixed	187,674	3.52	190,830	3.50	178,762	3.71	249,017	3.68
Adjustable	25,262	2.73	65,748	3.79	24,715	2.90	27,355	2.93
Change in undisbursed loan funds	3,696		(26,760)		(23,431)		(90,800)	
Repayments	(326,839)		(337,779)		(310,041)		(235,202)	
Principal (charge-offs) recoveries, net	(19)		(22)		119		(8)	
Other	(859)		(407)		(832)		(730)	
Ending balance	$7,061,557	3.58	$6,949,522	3.60	$6,832,770	3.63	$6,763,980	3.64

The following tables present loan origination, refinance, and purchase activity for the periods indicated, excluding endorsement activity, along with associated weighted average rates and percent of total. Loan originations, purchases, and refinances are reported together. The fixed-rate one- to four-family loans less than or equal to 15 years have an original maturity at origination of less than or equal to 15 years, while fixed-rate one- to four-family loans greater than 15 years have an original maturity at origination of greater than 15 years. The adjustable-rate one- to four-family loans less than or equal to 36 months have a term to first reset of less than or equal to 36 months at origination and adjustable-rate one- to four-family loans greater than 36 months have a term to first reset of greater than 36 months at origination.

	For the Three Months Ended					
	December 31, 2016			December 31, 2015		
	Amount	Rate	% of Total	Amount	Rate	% of Total
	(Dollars in thousands)					
Fixed-rate:						
One- to four-family:						
<= 15 years	$84,347	2.78%	19.3 %	$60,427	3.01%	18.7 %
> 15 years	246,730	3.52	56.6	166,383	3.79	51.5
Commercial real estate	32,291	3.96	7.4	31,164	4.25	9.6
Home equity	733	6.09	0.2	893	5.65	0.3
Other	127	9.90	—	224	8.41	0.1
Total fixed-rate	364,228	3.39	83.5	259,091	3.68	80.2
Adjustable-rate:						
One- to four-family:						
<= 36 months	1,427	2.42	0.3	904	2.66	0.3
> 36 months	52,031	2.76	12.0	41,097	3.02	12.7
Commercial real estate	—	—	—	3,376	4.25	1.0
Home equity	17,933	4.77	4.1	18,059	4.52	5.6
Other	437	3.30	0.1	542	3.44	0.2
Total adjustable-rate	71,828	3.25	16.5	63,978	3.51	19.8
Total originated, refinanced and purchased	$436,056	3.37	100.0%	$323,069	3.64	100.0%
Purchased and participation loans included above:						
Fixed-rate:						
Correspondent - one- to four-family	$155,383	3.43		$96,111	3.66	
Participations - commercial real estate	32,291	3.96		5,533	4.25	
Total fixed-rate purchased/participations	187,674	3.52		101,644	3.69	
Adjustable-rate:						
Correspondent - one- to four-family	25,262	2.73		22,485	3.01	
Participations - commercial real estate	—	—		3,376	4.25	
Total adjustable-rate purchased/participations	25,262	2.73		25,861	3.17	
Total purchased/participation loans	$212,936	3.43		$127,505	3.59	

One- to Four-Family Loans - The following table presents, for our portfolio of one- to four-family loans, the amount, percent of total, weighted average credit score, weighted average LTV ratio, and the average balance per loan as of the dates presented. Credit scores are updated at least semiannually, with the latest update in September 2016, from a nationally recognized consumer rating agency. The LTV ratios were based on the current loan balance and either the lesser of the purchase price or original appraisal, or the most recent Bank appraisal, if available. In most cases, the most recent appraisal was obtained at the time of origination.

	December 31, 2016					September 30, 2016				
	Amount	% of Total	Credit Score	LTV	Average Balance	Amount	% of Total	Credit Score	LTV	Average Balance
	(Dollars in thousands)									
Originated	$4,027,991	60.0 %	766	63%	$ 133	$4,005,615	60.4 %	766	63%	$ 132
Correspondent purchased	2,288,368	34.0	764	68	366	2,206,072	33.3	764	68	360
Bulk purchased	400,506	6.0	753	64	307	416,653	6.3	753	64	308
	$6,716,865	100.0%	765	65	178	$6,628,340	100.0%	765	65	175

The following table presents originated, refinanced, and correspondent purchased activity in our one- to four-family loan portfolio, excluding endorsement activity, along with associated weighted average LTVs and weighted average credit scores for the periods indicated. Of the loans originated and refinanced during the current quarter, 68% had loan values of $417 thousand or less. Of the correspondent loans purchased during the current quarter, 10% had loan values of $417 thousand or less.

	For the Three Months Ended					
	December 31, 2016			December 31, 2015		
	Amount	LTV	Credit Score	Amount	LTV	Credit Score
	(Dollars in thousands)					
Originated	$144,737	76%	771	$113,655	76%	766
Refinanced by Bank customers	59,153	66	768	36,560	68	769
Correspondent purchased	180,645	72	767	118,596	74	763
	$384,535	73				