

Home Financial Bancorp

Auditor's Report and Consolidated Financial Statements

June 30, 2013 and 2012

Home Financial Bancorp

June 30, 2013 and 2012

Contents

Independent Auditor's Report.....	1
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Consolidated Financial Statements

Balance Sheets.....	3
Statements of Income	4
Statements of Comprehensive Income	5
Statements of Stockholders' Equity	6
Statements of Cash Flows	7
Notes to Financial Statements	8

Independent Auditor's Report

Audit Committee, Board of Directors and Stockholders
Home Financial Bancorp
Spencer, Indiana

We have audited the accompanying consolidated financial statements of Home Financial Bancorp and its subsidiaries, which comprise the consolidated balance sheets as of June 30, 2013 and 2012, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Home Financial Bancorp and its subsidiaries as of June 30, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

BKD, LLP

Indianapolis, Indiana
September 17, 2013

Home Financial Bancorp
Consolidated Balance Sheets
June 30, 2013 and 2012

Assets

	<u>2013</u>	<u>2012</u>
Cash	\$ 717,025	\$ 668,325
Short-term interest-bearing deposits	<u>3,246,755</u>	<u>6,095,739</u>
Total cash and cash equivalents	3,963,780	6,764,064
Interest-bearing deposits	3,349,000	1,255,128
Investment securities - available for sale	7,800,018	7,476,566
Loans, net of allowance for loan losses of \$661,810 and \$662,505	51,950,429	55,048,157
Real estate acquired for development	70,860	95,860
Premises and equipment	1,949,762	1,920,331
Federal Home Loan Bank of Indianapolis stock	1,032,500	1,032,500
Interest receivable	325,297	344,896
Other assets	<u>2,378,747</u>	<u>2,076,877</u>
Total assets	<u>\$ 72,820,393</u>	<u>\$ 76,014,379</u>

Liabilities

Deposits		
Noninterest-bearing deposits	\$ 6,706,883	\$ 4,618,573
Interest-bearing deposits	<u>44,868,584</u>	<u>48,727,203</u>
Total deposits	51,575,467	53,345,776
Borrowings	12,000,000	13,000,000
Other liabilities	<u>986,881</u>	<u>870,525</u>
Total liabilities	<u>64,562,348</u>	<u>67,216,301</u>

Commitments and Contingencies

Stockholders' Equity

Preferred stock, without par value		
Authorized and unissued - 2,000,000 shares	—	—
Common stock, without par value		
Authorized - 5,000,000 shares		
Issued and outstanding - 2013 - 1,186,518 shares and 2012 - 1,337,368 shares	2,654,657	3,031,782
Additional paid-in capital	255,430	223,166
Retained earnings	5,534,539	5,457,434
Accumulated other comprehensive income (loss)	<u>(186,581)</u>	<u>85,696</u>
Total stockholders' equity	<u>8,258,045</u>	<u>8,798,078</u>
Total liabilities and stockholders' equity	<u>\$ 72,820,393</u>	<u>\$ 76,014,379</u>

Home Financial Bancorp

Consolidated Statements of Income

Years Ended June 30, 2013 and 2012

	2013	2012
Interest Income		
Loans	\$ 3,721,270	\$ 4,013,097
Deposits with financial institutions	25,840	47,443
Investment securities	161,207	190,348
Federal Home Loan Bank stock	<u>35,979</u>	<u>29,792</u>
Total interest and dividend income	<u>3,944,296</u>	<u>4,280,680</u>
Interest Expense		
Deposits	370,676	562,659
Federal Home Loan Bank advances	<u>350,811</u>	<u>455,510</u>
Total interest expense	<u>721,487</u>	<u>1,018,169</u>
Net Interest Income	3,222,809	3,262,511
Provision for loan losses	<u>270,000</u>	<u>342,000</u>
Net Interest Income After Provision for Loan Losses	<u>2,952,809</u>	<u>2,920,511</u>
Other Income		
Service charges on deposit accounts	307,859	340,379
Loss on sale of real estate acquired for development	(5,752)	(25,126)
Net gain on sale of available-for-sale securities	137,985	47,185
ATM service fees	178,117	177,403
Other income	<u>81,942</u>	<u>98,189</u>
Total other income	<u>700,151</u>	<u>638,030</u>
Other Expenses		
Salaries and employee benefits	1,370,032	1,274,000
Net occupancy expenses	134,166	146,469
Equipment expenses	55,648	45,529
Computer processing fees	311,460	357,540
ATM transaction fees	128,099	138,759
Printing and office supplies	56,373	60,672
Legal and professional fees	180,026	121,119
Director and committee fees	97,400	69,200
Advertising expense	86,250	88,787
Repossessed property expense	124,357	160,168
Equity in losses of partnership	94,519	106,488
Other expenses	<u>327,715</u>	<u>318,577</u>
Total other expenses	<u>2,966,045</u>	<u>2,887,308</u>
Income Before Income Tax	686,915	671,233
Income tax expense	<u>138,410</u>	<u>157,935</u>
Net Income	<u>\$ 548,505</u>	<u>\$ 513,298</u>
Net Income Per Share		
Basic	\$.42	\$.39
Diluted	.42	.39

Home Financial Bancorp
Consolidated Statements of Comprehensive Income
Years Ended June 30, 2013 and 2012

	2013	2012
Net Income	\$ <u>548,505</u>	\$ <u>513,298</u>
Other Comprehensive Income (Loss)		
Unrealized appreciation (depreciation) on securities available for sale	(312,879)	185,931
Less: reclassification for realized gains included in net income	137,985	47,185
Income tax benefit (expense) related to other comprehensive income	<u>178,587</u>	<u>(54,957)</u>
Total other comprehensive income (loss)	<u>(272,277)</u>	<u>83,789</u>
Comprehensive Income	\$ <u><u>276,228</u></u>	\$ <u><u>597,087</u></u>

Home Financial Bancorp
Consolidated Statements of Stockholders' Equity
Years Ended June 30, 2013 and 2012

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balances, July 1, 2011	1,345,605	\$ 3,052,374	\$ 176,473	\$ 5,110,570	\$ 1,907	\$ 8,341,324
Net income				513,298		513,298
Other comprehensive income					83,789	83,789
Cash dividends (\$.12 per share)				(160,776)		(160,776)
Recognition Retention Plan and Trust (RRP) shares earned			46,693			46,693
Purchase of stock	(8,237)	(20,592)		(5,658)		(26,250)
Balances, June 30, 2012	1,337,368	3,031,782	223,166	5,457,434	85,696	8,798,078
Net income				548,505		548,505
Other comprehensive loss					(272,277)	(272,277)
Cash dividends (\$.12 per share)				(154,109)		(154,109)
Recognition Retention Plan and Trust (RRP) shares earned			32,264			32,264
Purchase of stock	(150,850)	(377,125)		(317,291)		(694,416)
Balances, June 30, 2013	<u>1,186,518</u>	<u>\$ 2,654,657</u>	<u>\$ 255,430</u>	<u>\$ 5,534,539</u>	<u>\$ (186,581)</u>	<u>\$ 8,258,045</u>

Home Financial Bancorp

Consolidated Statements of Cash Flows

Years Ended June 30, 2013 and 2012

	2013	2012
Operating Activities		
Net income	\$ 548,505	\$ 513,298
Items not requiring (providing) cash		
Provision for loan losses	270,000	342,000
Investment securities amortization, net	32,400	26,391
RRP shares earned	32,264	46,693
Depreciation	103,087	97,887
Deferred income taxes	35,840	(132,139)
Loss on sale of real estate acquired for development	5,752	25,126
Foreclosed asset losses	56,818	63,373
Investment securities gains	(137,985)	(47,185)
Losses from partnership	94,519	106,488
Net change in interest receivable	19,599	26,534
Other adjustments	<u>(482,485)</u>	<u>299,320</u>
Net cash provided by operating activities	<u>578,314</u>	<u>1,367,786</u>
Investing Activities		
Net change in interest-bearing deposits	(2,093,872)	(46,734)
Purchase of securities available for sale	(7,951,892)	(5,631,082)
Proceeds from sales of securities available for sale	2,413,464	1,077,263
Proceeds from maturities and paydowns of securities available for sale	4,869,772	3,376,979
Net changes in loans	3,133,122	1,500,174
Proceeds from sale of foreclosed assets	485,651	416,813
Purchase of premises and equipment	(132,518)	(92,831)
Purchase of limited partnership interests	(502,739)	(526,004)
Purchase of real estate acquired for development and development cost	(752)	(2,881)
Proceeds from sale of real estate acquired for development	<u>20,000</u>	<u>14,831</u>
Net cash provided by (used in) investing activities	<u>(240,236)</u>	<u>86,528</u>
Financing Activities		
Net change in		
Noninterest-bearing deposits	2,088,310	202,749
Interest-bearing deposits	(3,858,619)	2,352,004
Proceeds from other borrowings	2,000,000	1,500,000
Repayment of other borrowings	(3,000,000)	(3,500,000)
Purchase of stock	(694,416)	(26,250)
Dividends paid	<u>(154,109)</u>	<u>(160,776)</u>
Net cash provided by (used in) financing activities	<u>(3,618,834)</u>	<u>367,727</u>
Net Change in Cash and Cash Equivalents	(2,800,284)	1,822,041
Cash and Cash Equivalents, Beginning of Year	<u>6,764,064</u>	<u>4,942,023</u>
Cash and Cash Equivalents, End of Year	<u>\$ 3,963,780</u>	<u>\$ 6,764,064</u>
Additional Cash Flows and Supplementary Information		
Interest paid	\$ 726,747	\$ 1,023,049
Income tax paid	257,442	264,955
Transfers from loans to foreclosed assets	305,394	488,204

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Note 1: Nature of Operations and Summary of Significant Accounting Policies

The accounting and reporting policies of Home Financial Bancorp (Company) and its wholly owned subsidiaries, Our Community Bank (Bank) and OCB Insurance Agency, Inc. (OCB Insurance) and the Bank's wholly owned subsidiary, BSF, Inc. (BSF), conform to accounting principles generally accepted in the United States of America and reporting practices followed by the thrift industry. The more significant of the policies are described below.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Company is a bank holding company whose principal activity is the ownership and management of the Bank. The Bank operates under a state commercial bank charter and provides full banking services to its customers. The Bank is subject to regulation by the Indiana Department of Financial Institutions and the Federal Deposit Insurance Corporation. During 2012, the Bank legally changed its name from Owen Community Bank to Our Community Bank.

The Bank generates mortgage and consumer loans and receives deposits from customers located primarily in Owen, Putnam and surrounding counties. The Bank's loans are generally secured by specific items of collateral including real property and consumer assets.

BSF engages in purchasing and developing large tracts of real estate. After land is purchased, BSF subdivides the real estate into lots, makes improvements such as streets, and sells individual lots, usually on contract for deed. OCB Insurance provides auto and hazard insurance primarily to customers of the Bank.

Consolidation - The consolidated financial statements include the accounts of the Company, Bank, BSF and OCB Insurance after elimination of all material intercompany transactions.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, valuation of deferred tax assets and fair values of financial instruments.

Cash and Cash Equivalents - The Company considers all liquid investments with original maturities of three months or less to be cash equivalents.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Interest-Bearing Deposits in Banks - Interest-bearing deposits in banks mature within one year and are carried at cost.

Investment Securities - Debt securities are classified as held to maturity when the Company has the positive intent and ability to hold the securities to maturity. Securities held to maturity are carried at amortized cost. Debt securities not classified as held to maturity are classified as available for sale. Securities available for sale are carried at fair value with unrealized gains and losses reported separately in accumulated other comprehensive income, net of tax.

When the Company does not intend to sell a debt security, and it is more likely than not, the Company will not have to sell the security before recovery of its cost basis, it recognizes the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income.

Amortization of premiums and accretion of discounts are recorded as interest income from securities. Realized gains and losses are recorded as net security gains (losses). Gains and losses on sales of securities are determined on the specific-identification method.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoffs are reported at their outstanding principal balances adjusted for unearned income, charge-offs, the allowance for loan losses, any unamortized deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

For loans amortized at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off are reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Discounts and premiums on purchased residential real estate loans are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments. Discounts and premiums on purchased consumer loans are recognized over the expected lives of the loans using methods that approximate the interest method.

Allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonclassified loans and is based on historical charge-off experience and expected loss given default derived from the Company's internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

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

Groups of loans with similar risk characteristics are collectively evaluated for impairment based on the group's historical loss experience adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment measurements, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

Real estate acquired for development is carried at the lower of cost or fair value. Costs relating to development and improvements of property are allocated to individual lots and capitalized, whereas costs relating to holding the property are expensed. Gains and losses on sales of lots are determined on the specific-identification method.

Premises and equipment are carried at cost, net of accumulated depreciation. Depreciation is computed using the accelerated and straight-line methods based principally on the estimated useful lives of the assets. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on dispositions are included in current operations.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Federal Home Loan Bank (FHLB) stock is a required investment for institutions that are members of the FHLB system. The required investment in the common stock is based on a predetermined formula.

Pension plan costs are based on actuarial computations and charged to current operations. The funding policy is to pay at least the minimum amounts required by ERISA.

Income tax - The Company accounts for income taxes in accordance with income tax accounting guidance (ASC 740, *Income Taxes*). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Uncertain tax positions are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to the management's judgment.

The Company recognizes interest and penalties on income taxes as a component of income tax expense.

Earnings per share have been computed based upon the weighted-average common shares and potential common shares outstanding during the period. RRP shares have been excluded from the computation of average common shares and potential common shares outstanding.

Current Economic Conditions - The current protracted economic decline continues to present financial institutions with difficult circumstances and challenges, which in some cases have resulted in large and unanticipated declines in the fair values of investments and other assets, constraints on liquidity and capital and significant credit quality problems, including severe volatility in the valuation of real estate and other collateral supporting loans. The consolidated financial statements have been prepared using values and information currently available to the Company.

Due to national, state and local economic conditions, values for commercial and development real estate have declined significantly, and the market for these properties is depressed.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the consolidated balance sheets could change rapidly, resulting in material future adjustments in asset values, the allowance for loan losses and capital that could negatively impact the Company's ability to meet regulatory capital requirements and maintain sufficient liquidity.

Subsequent events have been evaluated through the date of the Independent Auditor's Report, which is the date the consolidated financial statements were available to be issued.

Note 2: Restriction on Cash and Due From Banks

At June 30, 2013, the Company's interest-bearing cash accounts exceeded federally insured limits by approximately \$99,000. Additionally, the Company had approximately \$5,923,000 at the Federal Home Loan Bank, government-sponsored entity, which is not insured by the FDIC.

Note 3: Investment Securities

	2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
Federal agencies	\$ 4,021	\$ —	\$ (208)	\$ 3,813
Municipal bonds	<u>4,087</u>	<u>3</u>	<u>(103)</u>	<u>3,987</u>
Total investment securities	<u>\$ 8,108</u>	<u>\$ 3</u>	<u>\$ (311)</u>	<u>\$ 7,800</u>

	2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
Federal agencies	\$ 4,006	\$ 15	\$ (1)	\$ 4,020
Corporate bonds	120	—	—	120
Municipal bonds	3,208	132	(6)	3,334
Marketable equity securities	<u>1</u>	<u>2</u>	<u>—</u>	<u>3</u>
Total investment securities	<u>\$ 7,335</u>	<u>\$ 149</u>	<u>\$ (7)</u>	<u>\$ 7,477</u>

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Maturities of available-for-sale investments at June 30, 2013:

	Amortized Cost	Approximate Fair Value
Within one year	\$ 855	\$ 856
One to five years	1,715	1,696
Five to ten years	4,535	4,324
After ten years	<u>1,003</u>	<u>924</u>
	<u>\$ 8,108</u>	<u>\$ 7,800</u>

No securities were pledged at June 30, 2013 and 2012.

Proceeds from sales of securities available for sale during 2013 and 2012 were \$2,413,000 and \$1,077,000, respectively. Gains realized from sales of securities during 2013 and 2012 totaled \$143,000 and \$54,000, respectively. Losses realized from sales of securities during 2013 and 2012 totaled \$5,000 and \$7,000, respectively. Net gains on security transactions for 2013 and 2012 resulted in a tax expense of \$50,000 and \$19,000, respectively.

At June 30, 2013 and 2012, certain investments in agency and municipal bond securities are reported in the consolidated financial statements at an amount less than their historical cost. At June 30, 2013 and 2012, total fair value of these investments was \$6,795,000 and \$1,754,000, which is approximately 87.1 and 23.5 percent of the Company's investment portfolio, respectively. These declines primarily resulted from changes in market interest rates.

The following tables show investment totals of gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2013 and 2012.

Description of Securities	2013					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Agency bonds	\$ 3,813	\$ (208)	\$ —	\$ —	\$ 3,813	\$ (208)
Municipal bonds	<u>2,879</u>	<u>(100)</u>	<u>103</u>	<u>(3)</u>	<u>2,982</u>	<u>(103)</u>
	<u>\$ 6,692</u>	<u>\$ (308)</u>	<u>\$ 103</u>	<u>\$ (3)</u>	<u>\$ 6,795</u>	<u>\$ (311)</u>

Description of Securities	2012					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Agency bonds	\$ 1,249	\$ (1)	\$ —	\$ —	\$ 1,249	\$ (1)
Municipal bonds	<u>301</u>	<u>(4)</u>	<u>204</u>	<u>(2)</u>	<u>505</u>	<u>(6)</u>
	<u>\$ 1,550</u>	<u>\$ (5)</u>	<u>\$ 204</u>	<u>\$ (2)</u>	<u>\$ 1,754</u>	<u>\$ (7)</u>

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Note 4: Loans and Allowance

	2013	2012
Real estate mortgage loans		
Residential	\$ 40,746	\$ 43,548
Mobile home and land	4,636	5,557
Nonresidential	5,413	4,658
Mobile home loans	1,491	1,952
Commercial and industrial	179	180
Consumer loans	<u>302</u>	<u>280</u>
	<u>52,767</u>	<u>56,175</u>
Undisbursed portion of loans	(143)	(444)
Deferred loan fees	(12)	(20)
Allowance for loan losses	<u>(662)</u>	<u>(663)</u>
	<u>(817)</u>	<u>(1,127)</u>
Total loans	<u>\$ 51,950</u>	<u>\$ 55,048</u>

The risk characteristics of each loan portfolio segment are as follows:

Commercial and industrial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory, and may include a personal guarantee. Short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Nonresidential real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The characteristics of properties securing the Company's commercial real estate portfolio are diverse, but with geographic location almost entirely in the Company's market area. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. In general, the Company avoids financing single purpose projects unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate versus nonowner-occupied loans.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Residential, mobile home and land, mobile home and consumer loans consist of two segments - residential mortgage loans and personal loans. For residential mortgage loans that are secured by 1-4 family residences or mobile homes with land and are generally owner-occupied, the Company generally establishes a maximum loan-to-value ratio. Home equity loans are typically secured by a subordinate interest in 1-4 family residences, and consumer personal loans are secured by consumer personal assets, such as automobiles, mobile homes or recreational vehicles. Some consumer personal loans are unsecured, such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas, such as unemployment levels. Repayment can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

The following presents, by portfolio segment, the activity in the allowance for loan losses for the years ended June 30, 2013 and 2012:

	2013						
	Real Estate Mortgage Loans			Mobile Home Loans	Commercial	Consumer Loans	Total
	Residential	Mobile Home and Land	Nonresidential				
Beginning balance	\$ 285	\$ 65	\$ 36	\$ 90	\$ 180	\$ 7	\$ 663
Provision	180	(23)	15	80	(1)	19	270
Loans charged off	(148)	—	(25)	(107)	—	(2)	(282)
Recoveries	<u>4</u>	<u>—</u>	<u>—</u>	<u>7</u>	<u>—</u>	<u>—</u>	<u>11</u>
Ending Balance	<u>\$ 321</u>	<u>\$ 42</u>	<u>\$ 26</u>	<u>\$ 70</u>	<u>\$ 179</u>	<u>\$ 24</u>	<u>\$ 662</u>

	2012						
	Real Estate Mortgage Loans			Mobile Home Loans	Commercial	Consumer Loans	Total
	Residential	Mobile Home and Land	Nonresidential				
Beginning balance	\$ 322	\$ 114	\$ 88	\$ 122	\$ 4	\$ 13	\$ 663
Provision	165	(30)	(52)	77	176	6	342
Loans charged off	(205)	(20)	—	(111)	—	(12)	(348)
Recoveries	<u>3</u>	<u>1</u>	<u>—</u>	<u>2</u>	<u>—</u>	<u>—</u>	<u>6</u>
Ending Balance	<u>\$ 285</u>	<u>\$ 65</u>	<u>\$ 36</u>	<u>\$ 90</u>	<u>\$ 180</u>	<u>\$ 7</u>	<u>\$ 663</u>

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

The following tables present the balance in the allowance for loan losses and the recorded investment in loans based on the portfolio segment and impairment method as of June 30, 2013 and 2012:

	2013						
	Real Estate Mortgage Loans			Mobile Home Loans	Commercial	Consumer Loans	Total
	Residential	Mobile Home and Land	Nonresidential				
Allowance Balances:							
Individually evaluated for impairment	\$ 83	\$ 9	\$ 3	\$ 9	\$ 179	\$ 13	\$ 296
Collectively evaluated for impairment	<u>238</u>	<u>33</u>	<u>23</u>	<u>61</u>	<u>—</u>	<u>11</u>	<u>366</u>
Total Allowance for Loan Losses	<u>\$ 321</u>	<u>\$ 42</u>	<u>\$ 26</u>	<u>\$ 70</u>	<u>\$ 179</u>	<u>\$ 24</u>	<u>\$ 662</u>

Loan Balances:							
Individually evaluated for impairment	\$ 2,366	\$ 241	\$ 152	\$ 223	\$ 179	\$ 13	\$ 3,174
Collectively evaluated for impairment	<u>38,380</u>	<u>4,395</u>	<u>5,261</u>	<u>1,268</u>	<u>—</u>	<u>289</u>	<u>49,593</u>
Total Loan Balances	<u>\$ 40,746</u>	<u>\$ 4,636</u>	<u>\$ 5,413</u>	<u>\$ 1,491</u>	<u>\$ 179</u>	<u>\$ 302</u>	<u>\$ 52,767</u>

	2012						
	Real Estate Mortgage Loans			Mobile Home Loans	Commercial	Consumer Loans	Total
	Residential	Mobile Home and Land	Nonresidential				
Allowance Balances:							
Individually evaluated for impairment	\$ 128	\$ 5	\$ 8	\$ 27	\$ 180	\$ —	\$ 348
Collectively evaluated for impairment	<u>157</u>	<u>60</u>	<u>28</u>	<u>63</u>	<u>—</u>	<u>7</u>	<u>315</u>
Total Allowance for Loan Losses	<u>\$ 285</u>	<u>\$ 65</u>	<u>\$ 36</u>	<u>\$ 90</u>	<u>\$ 180</u>	<u>\$ 7</u>	<u>\$ 663</u>

Loan Balances:							
Individually evaluated for impairment	\$ 2,052	\$ 138	\$ 165	\$ 236	\$ 180	\$ —	\$ 2,771
Collectively evaluated for impairment	<u>41,496</u>	<u>5,419</u>	<u>4,493</u>	<u>1,716</u>	<u>—</u>	<u>280</u>	<u>53,404</u>
Total Loan Balances	<u>\$ 43,548</u>	<u>\$ 5,557</u>	<u>\$ 4,658</u>	<u>\$ 1,952</u>	<u>\$ 180</u>	<u>\$ 280</u>	<u>\$ 56,175</u>

Management's general practice is to charge down loans individually evaluated for impairment to the fair value of the underlying collateral.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Consistent with regulatory guidance, charge-offs on all loan segments are taken when specific loans, or portions thereof, are considered uncollectible. The Company's policy is to promptly charge these loans off in the period the uncollectible loss is reasonably determined.

For all loan portfolio segments except 1-4 family residential properties and consumer, the Company promptly charges off loans, or portions thereof, when available information confirms that specific loans are uncollectible based on information that includes, but is not limited to, (1) the deteriorating financial condition of the borrower, (2) declining collateral values, and/or (3) legal action, including bankruptcy, that impairs the borrower's ability to adequately meet its obligations. For impaired loans that are considered to be solely collateral dependent, a partial charge-off is recorded when a loss has been confirmed by an updated appraisal or other appropriate valuation of the collateral.

The Company charges off residential, mobile home and land, mobile home, and consumer loans, or portions thereof, when the Company reasonably determines the amount of the loss. The Company adheres to timeframes established by applicable regulatory guidance which provides for the charge-down of 1-4 family first and junior lien mortgages to the net realizable value less costs to sell when the loan is 180 days past due, charge-off of unsecured open-end loans when the loan is 180 days past due, and charge-down to the net realizable value when other secured loans are 120 days past due. Loans at these respective delinquency thresholds for which the Company can clearly document that the loan is both well-secured and in the process of collection, such that collection will occur regardless of delinquency status, need not be charged off.

The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the prior three years. Management believes the historical loss experience methodology is appropriate in the current economic environment, as it captures loss rates that are comparable to the current period being analyzed.

The following tables present the credit risk profile of the Company's loan portfolio based on rating category as of June 30, 2013 and 2012:

	2013					Total
	Pass	Special Mention	Substandard	Doubtful	Loss	
Impaired loans with no related allowance recorded:						
Real estate mortgage loans:						
Residential	\$ 39,834	\$ 211	\$ 701	\$ —	\$ —	\$ 40,746
Mobile home and land	4,471	105	60	—	—	4,636
Nonresidential	5,390	—	23	—	—	5,413
Mobile home	1,419	14	58	—	—	1,491
Commercial and industrial	—	—	179	—	—	179
Consumer loans	<u>289</u>	<u>—</u>	<u>13</u>	<u>—</u>	<u>—</u>	<u>302</u>
Total	<u>\$ 51,403</u>	<u>\$ 330</u>	<u>\$ 1,034</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 52,767</u>

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

	2012					Total
	Pass	Special Mention	Substandard	Doubtful	Loss	
Impaired loans with no related allowance recorded:						
Real estate mortgage loans:						
Residential	\$ 42,616	\$ 81	\$ 851	\$ —	\$ —	\$ 43,548
Mobile home and land	5,466	55	36	—	—	5,557
Nonresidential	4,602	—	56	—	—	4,658
Mobile home	1,738	36	178	—	—	1,952
Commercial and industrial	—	—	180	—	—	180
Consumer loans	<u>280</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>280</u>
Total	<u>\$ 54,702</u>	<u>\$ 172</u>	<u>\$ 1,301</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 56,175</u>

Internal Risk Categories

The pass grade is considered satisfactory. The grade of Special Mention, represents loans of lower quality and is considered criticized. The grades of Substandard, and Doubtful, refer to assets that are classified. The use and application of these grades by the bank will be uniform and shall conform to the bank's policy.

Pass - Loans of reasonable credit strength and repayment ability proving an average credit risk due to one or more underlying weaknesses.

Special Mention - A special mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Ordinarily, special mention credits have characteristics which corrective management action would remedy.

Substandard - Loans classified as substandard are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that 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 Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current known facts, conditions and values, highly questionable and improbable.

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

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

The following tables present the Company's loan portfolio aging analysis as of June 30, 2013 and 2012:

	2013						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Loans > 90 Days and Accruing
Real estate mortgage loans:							
Residential	\$ 1,433	\$ 530	\$ 911	\$ 2,874	\$ 37,872	\$ 40,746	\$ —
Mobile home and land	322	215	166	703	3,933	4,636	—
Nonresidential	4	—	23	27	5,386	5,413	—
Mobile home loans	113	13	72	198	1,293	1,491	—
Commercial and industrial	—	—	179	179	—	179	—
Consumer loans	—	—	—	—	302	302	—
Total	<u>\$ 1,872</u>	<u>\$ 758</u>	<u>\$ 1,351</u>	<u>\$ 3,981</u>	<u>\$ 48,786</u>	<u>\$ 52,767</u>	<u>\$ —</u>

	2012						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Loans > 90 Days and Accruing
Real estate mortgage loans:							
Residential	\$ 1,390	\$ 666	\$ 932	\$ 2,988	\$ 40,560	\$ 43,548	\$ —
Mobile home and land	334	192	91	617	4,940	5,557	—
Nonresidential	174	—	56	230	4,428	4,658	—
Mobile home loans	65	25	189	279	1,673	1,952	—
Commercial and industrial	—	—	180	180	—	180	—
Consumer loans	—	—	—	—	280	280	—
Total	<u>\$ 1,963</u>	<u>\$ 883</u>	<u>\$ 1,448</u>	<u>\$ 4,294</u>	<u>\$ 51,881</u>	<u>\$ 56,175</u>	<u>\$ —</u>

The entire balance of a loan is considered delinquent if the minimum payment contractually required to be made is not received by the specified due date.

The following table presents the Company's nonaccrual loans at June 30:

	2013	2012
Real estate mortgage loans:		
Residential	\$ 911	\$ 932
Mobile home and land	166	91
Nonresidential	23	56
Mobile home loans	72	189
Commercial and industrial	179	180
Consumer loans	—	—
Total	<u>\$ 1,351</u>	<u>\$ 1,448</u>

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

The following tables present impaired loans for the years ended June 30, 2013 and 2012:

	2013				
	Recorded Balance	Unpaid Principal Balance	Related Allowance	Average Investment in Impaired Loans	Interest Income Recognized
Impaired loans without a specific valuation allowance:					
Real estate mortgage loans:					
Residential	\$ 1,751	\$ 1,751	\$ —	\$ 1,431	\$ 122
Mobile home and land	181	181	—	160	18
Nonresidential	128	128	—	122	12
Mobile home loans	166	166	—	170	17
Commercial and industrial	—	—	—	—	—
Consumer loans	—	—	—	—	—
Total	<u>2,226</u>	<u>2,226</u>	<u>—</u>	<u>1,883</u>	<u>169</u>
Impaired loans with a specific valuation allowance:					
Real estate mortgage loans:					
Residential	615	615	83	356	40
Mobile home and land	60	60	9	44	6
Nonresidential	23	23	3	24	3
Mobile home loans	57	57	9	31	7
Commercial and industrial	179	179	179	179	14
Consumer loans	<u>13</u>	<u>13</u>	<u>13</u>	<u>14</u>	<u>—</u>
Total	<u>947</u>	<u>947</u>	<u>296</u>	<u>648</u>	<u>70</u>
Total impaired loans	<u>\$ 3,173</u>	<u>\$ 3,173</u>	<u>\$ 296</u>	<u>\$ 2,531</u>	<u>\$ 239</u>

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

	2012				
	Recorded Balance	Unpaid Principal Balance	Related Allowance	Average Investment in Impaired Loans	Interest Income Recognized
Impaired loans without a specific valuation allowance:					
Real estate mortgage loans:					
Residential	\$ 1,539	\$ 1,539	\$ —	\$ 1,641	\$ 185
Mobile home and land	138	138	—	154	32
Nonresidential	109	109	—	212	23
Mobile home loans	173	173	—	160	30
Commercial and industrial	—	—	—	—	—
Consumer loans	—	—	—	—	—
Total	<u>1,959</u>	<u>1,959</u>	<u>—</u>	<u>2,167</u>	<u>270</u>
Impaired loans with a specific valuation allowance:					
Real estate mortgage loans:					
Residential	513	513	128	261	30
Mobile home and land	—	—	5	—	—
Nonresidential	56	56	8	66	7
Mobile home loans	63	63	27	63	8
Commercial and industrial	180	180	180	180	14
Consumer loans	—	—	—	—	—
Total	<u>812</u>	<u>812</u>	<u>348</u>	<u>570</u>	<u>59</u>
Total impaired loans	<u>\$ 2,771</u>	<u>\$ 2,771</u>	<u>\$ 348</u>	<u>\$ 2,737</u>	<u>\$ 329</u>

Interest income on the impaired loans is recognized on the cash basis.

Interest income on loans individually classified as impaired is recognized on a cash basis after all past due and current principal payments have been made. Subsequent payments on nonaccrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured.

Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

The following tables present information regarding troubled debt restructurings by class for the years ended June 30, 2013 and 2012

Newly classified troubled debt restructurings:

	2013		
	Number of Loans	Pre- Modification Recorded Balance	Post- Modification Recorded Balance
Real estate mortgage loans:			
Residential	17	\$ 1,034	\$ 1,045
Mobile home and land	6	112	115
Nonresidential	1	47	47
Mobile home loans	3	43	43
Commercial and industrial	—	—	—
Consumer loans	—	—	—
	<u>27</u>	<u>\$ 1,236</u>	<u>\$ 1,250</u>
Total			

	2012		
	Number of Loans	Pre- Modification Recorded Balance	Post- Modification Recorded Balance
Real estate mortgage loans:			
Residential	16	\$ 966	\$ 966
Mobile home and land	2	62	62
Nonresidential	2	102	102
Mobile home loans	4	104	104
Commercial and industrial	—	—	—
Consumer loans	—	—	—
	<u>24</u>	<u>\$ 1,234</u>	<u>\$ 1,234</u>
Total			

All of the Company's troubled debt restructurings for the period were extensions of the terms of the customers' notes.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Troubled debt restructurings that subsequently defaulted:

	2013	
	Number of Loans	Recorded Balance
Real estate mortgage loans:		
Residential	4	\$ 193
Mobile home and land	1	36
Nonresidential	—	—
Mobile home loans	2	67
Commercial and industrial	—	—
Consumer loans	—	—
Total	7	\$ 296

	2012	
	Number of Loans	Recorded Balance
Real estate mortgage loans:		
Residential	3	\$ 270
Mobile home and land	—	—
Nonresidential	1	56
Mobile home loans	1	16
Commercial and industrial	—	—
Consumer loans	—	—
Total	5	\$ 342

Note 5: Premises and Equipment

	2013	2012
Land	\$ 390	\$ 390
Buildings	2,682	2,612
Equipment	1,361	1,298
Total cost	4,433	4,300
Accumulated depreciation	(2,483)	(2,380)
Net	\$ 1,950	\$ 1,920

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Note 6: Investment in Limited Partnerships

Investment in limited partnerships includes \$689,000 and \$723,000 at June 30, 2013 and 2012, respectively, representing an 11 percent partnership interest in the Great Lakes Capital Fund Indiana Community LP XIX (Great Lakes), a limited partnership organized to build, own and operate housing and apartment complexes around the state of Indiana. Tax credits generated from these investments totaled \$102,000 and \$71,000 for the years ended June 30, 2013 and 2012, respectively. Condensed unaudited financial statements for Great Lakes at December 31, 2012 and 2011 and for each of the years then ended are as follows:

	December 31	
	2012	2011
Condensed balance sheets		
Assets		
Cash	\$ 124	\$ 387
Land and property	5,345	5,762
Other assets	433	452
Total assets	\$ 5,902	\$ 6,601
Liabilities		
Notes payable	\$ 303	\$ 2,272
Other liabilities	12	21
Total liabilities	315	2,293
Partners' equity	5,587	4,308
Total liabilities and partners' equity	\$ 5,902	\$ 6,601
	2012	2011
Condensed statements of operations		
Total revenue	\$ 1	\$ 2
Total expenses	(465)	(216)
Net loss	\$ (464)	\$ (214)

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Investment in limited partnerships also includes \$492,000 and \$0 at June 30, 2013 and 2012, respectively, representing a 6 percent partnership interest in the Great Lakes Capital Fund Indiana Community LP XIX-2 (Great Lakes), a limited partnership organized to build, own and operate housing and apartment complexes around the state of Indiana. Tax credits generated from these investments totaled \$2,000 and \$0 for the years ended June 30, 2013 and 2012, respectively. Condensed unaudited financial statements for Great Lakes at December 31, 2012 and for the year then ended are as follows:

	December 31 2012
Condensed balance sheets	
Assets	
Cash	\$ 281
Land and property	7,262
Other assets	424
Total assets	\$ 7,967
Liabilities	
Notes payable	\$ 6,425
Other liabilities	54
Total liabilities	6,479
Partners' equity	1,488
Total liabilities and partners' equity	\$ 7,967
	2012
Condensed statements of operations	
Total revenue	\$ —
Total expenses	(61)
Net loss	\$ (61)

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Note 7: Deposits

	2013	2012
Noninterest-bearing demand	\$ 6,707	\$ 4,619
Interest-bearing demand	4,104	3,698
Money market deposits	7,168	6,809
Savings	9,003	9,403
Certificates of \$100,000 or more	13,038	15,101
Other certificates	11,555	13,716
Total deposits	\$ 51,575	\$ 53,346

Certificates maturing in years ending June 30:

2014	\$ 9,647
2015	5,384
2016	4,120
2017	2,226
2018	3,216
Thereafter	—
	\$ 24,593

Brokered deposits totaled approximately \$7,696,000 and \$9,584,000 at June 30, 2013 and 2012, respectively.

Note 8: Borrowings

The Federal Home Loan Bank (FHLB) advances totaled \$12,000,000 and \$13,000,000 at June 30, 2013 and 2012, respectively.

At June 30, 2013, the FHLB advances are secured by mortgage loans totaling \$24,352,000. Advances, at interest rates from 1.03 to 5.26 percent, are subject to restrictions or penalties in the event of prepayment. Advances totaling \$2,000,000 may, at certain dates, be converted to adjustable rate advances by the FHLB. If converted, the advances may be prepaid without penalty.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

FHLB advance maturities in years ending June 30:

2014	\$	3,000
2015		2,000
2016		1,500
2017		2,000
2018		1,500
Thereafter		<u>2,000</u>
	\$	<u><u>12,000</u></u>

Note 9: Income Tax

	<u>2013</u>	<u>2012</u>
Income tax expense		
Currently payable		
Federal	\$ 53	\$ 229
State	50	61
Deferred		
Federal	27	(120)
State	<u>9</u>	<u>(12)</u>
Total income tax expense	<u>\$ 139</u>	<u>\$ 158</u>

	<u>2013</u>	<u>2012</u>
Reconciliation of federal statutory to actual tax expense (benefit)		
Federal statutory income tax at 34%	\$ 234	\$ 228
Effect of state income taxes	38	32
Tax-exempt interest	(26)	(28)
Tax credits	(105)	(71)
Other	<u>(3)</u>	<u>(3)</u>
Actual tax expense	<u>\$ 138</u>	<u>\$ 158</u>
Effective tax rate	<u>20.1%</u>	<u>23.5%</u>

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

A cumulative net deferred tax asset is included in other assets. The components of the asset are as follows:

	2013	2012
Assets		
Allowance for loan losses	\$ 275	\$ 278
Pension and employee benefit	20	16
Loan fees	5	8
Other real estate owned	32	78
Low income housing credit carry over	—	50
Partnership	85	29
Unrealized capital loss carryforward	—	36
Unrealized loss on available-for-sale securities	122	—
Other	21	21
Total assets	560	516
Liabilities		
Depreciation	(120)	(120)
State income tax	(12)	(15)
FHLB stock	(43)	(43)
Prepaid expenses	(52)	(56)
Unrealized capital loss carryforward	(14)	—
Unrealized gain on available-for-sale securities	—	(56)
Total liabilities	(241)	(290)
Valuation Allowance		
Beginning balance	(50)	(50)
Increase during the period	—	—
Ending balance	(50)	(50)
Net deferred tax asset	\$ 269	\$ 176

Management believes the low income housing credits will be utilized during the carryforward limitation period.

Retained earnings at June 30, 2013, include approximately \$700,000 for which no deferred federal income tax liability has been recognized. This amount represents an allocation of income to bad debt deductions as of June 30, 1988 for tax purposes only. Reduction of amounts so allocated for purposes other than tax bad debt losses including redemption of bank stock or excess dividends, or loss of “bank status” would create income for tax purposes only, which income would be subject to the then-current corporate income tax rate. The unrecorded deferred federal income tax liability on the above amount was approximately \$240,000 at June 30, 2013.

The Company’s tax years still subject to examination by authorities are years subsequent to 2009.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Note 10: Commitments and Contingent Liabilities

In the normal course of business, there are outstanding commitments and contingent liabilities, such as commitments to extend credit, which are not included in the accompanying consolidated financial statements. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit is represented by the contractual or notional amount of those instruments. The Company uses the same credit policies in making such commitments as it does for instruments that are included in the consolidated balance sheets.

Financial instruments whose contract amount represents credit risk as of June 30 were as follows:

	2013	2012
Commitments to extend credit	\$ 2,377	\$ 1,040
Unused lines of credit	266	421

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation. Collateral held varies, but may include residential real estate or other assets of the borrower.

The Company has entered into agreements with two officers, which provide for salary continuation for a three-year period under certain circumstances, primarily related to change of control of the Company or Bank, as defined. Under the terms of the agreements, these payments could occur if, following a change of control, such officers are terminated other than for cause or unreasonable changes are made in their employment relationships. These agreements extend automatically for one year on each anniversary date unless certain conditions are met.

The Company and Bank are also subject to claims and lawsuits, which arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate determination of such possible claims or lawsuits will not have a material adverse effect on the consolidated financial position of the Company or Bank.

Note 11: Stockholders' Equity

The Company's Board of Directors has approved the repurchase of up to 15 percent of the Company's outstanding shares of common stock. Such purchases will be made subject to market conditions in open market or block transactions.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Note 12: Dividends and Capital Restrictions

Without prior approval, current regulations allow the Bank to pay dividends to the Company not exceeding retained net profits for the current calendar year to date plus those for the previous two calendar years. At June 30, 2013, total stockholder's equity of the Bank was \$7,882,000 of which \$7,754,000 was restricted from dividend distribution to the Company. Under current regulations in effect, the Bank is considered a well-capitalized institution.

Note 13: Regulatory Capital

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies and is assigned to a capital category. The assigned capital category is largely determined by three ratios that are calculated according to the regulations: total risk adjusted capital, Tier 1 capital and Tier 1 leverage ratios. The ratios are intended to measure capital relative to assets and credit risk associated with those assets and off-balance sheet exposures of the entity. The capital category assigned to an entity can also be affected by qualitative judgments made by regulatory agencies about the risk inherent in the entity's activities that are not part of the calculated ratios.

There are five capital categories defined in the regulations, ranging from well capitalized to critically undercapitalized. Classification of a bank in any of the undercapitalized categories can result in actions by regulators that could have a material effect on a bank's operations. At June 30, 2013 and 2012, the Bank was categorized as well capitalized and met all subject capital adequacy requirements. There are no conditions or events since June 30, 2013 that management believes has changed the Bank's classification.

The Bank's actual and required capital amounts and ratios are as follows:

	Actual		2013 Required for Adequate Capital		Required To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total risk-based capital (to risk-weighted assets)	\$ 8,363	20.9%	\$ 3,197	8.0%	\$ 3,996	10.0%
Tier I capital (to risk-weighted assets)	7,852	19.6%	1,598	4.0%	2,398	6.0%
Core capital (to adjusted total assets)	7,852	10.8%	2,921	4.0%	3,651	5.0%
Core capital (to adjusted tangible assets)	7,852	10.8%	1,460	2.0%	N/A	N/A
Tangible capital (to adjusted total assets)	7,852	10.8%	1,095	1.5%	N/A	N/A

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

	Actual		2012 Required for Adequate Capital		Required To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total risk-based capital (to risk-weighted assets)	\$ 8,549	20.8%	\$ 3,284	8.0%	\$ 4,105	10.0%
Tier I capital (to risk-weighted assets)	8,026	19.6%	1,642	4.0%	2,463	6.0%
Core capital (to adjusted total assets)	8,026	10.6%	3,017	4.0%	3,772	5.0%
Core capital (to adjusted tangible assets)	8,026	10.6%	1,509	2.0%	N/A	N/A
Tangible capital (to adjusted total assets)	8,026	10.6%	1,131	1.5%	N/A	N/A

Note 14: Employee Benefit Plans

The Bank participates in the Pentegra Defined Benefit Plan for Financial Institutions (the Pentegra Plan), an industry-wide, tax-qualified defined-benefit pension plan. The Pentegra Plan's Employer Identification Number is 13-5645888 and the Plan Number is 333. The Pentegra Plan operates as a multi-employer plan for accounting purposes and as a multiple-employer plan under the *Employee Retirement Income Security Act of 1974* and the Internal Revenue Code. There are no collective bargaining agreements in place that require contributions to the Pentegra Plan. The Pentegra Plan is a single plan under Internal Revenue Code Section 413(c) and, as a result, all of the assets stand behind all of the liabilities.

The risks of participating in a multi-employer plan are different from a single-employer plan in the following aspects:

1. Assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of other participating employers.
2. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
3. If the Bank chooses to stop participating in some of its multi-employer plans, the Bank may be required to pay those plans an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

The Pentegra Plan has not required and does not require a financial improvement plan (FIP) or a rehabilitation plan (RP). Finally, the number of employees covered by the Bank's multi-employer plans has not decreased by 5% percent from 2012 to 2013, thus not affecting the period-to-period comparability of the contributions for years 2012 and 2013.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Total contributions by all employer participants in the Pentegra Plan, as reported on Form 5500, totaled \$196.5 million and \$299.7 million, respectively, for the plan years ended June 30, 2012 and 2011. The Bank's contributions to the Pentegra Plan totaled \$72,000 and \$67,000, respectively, for the years ended June 30, 2013 and 2012 and do not represent more than 5% of the total contributions made by all employer participants in the Pentegra Plan. There have been no significant changes that affect the comparability of 2012 and 2013 contributions. Given the current interest rate environment, the lower asset valuations, and other factors impacting the operations of the Pentegra Plan, it is likely that our future funding obligations will increase.

The Bank froze the benefits in the Pentegra Plan effective July 1, 2006. Full-time employees of the Bank who had attained at least 21 years of age and completed one year of service were eligible to participate. No further benefits will accrue subsequent to the freeze, and the freeze does not reduce the benefits accrued up to the date of the freeze.

The Company has a Retirement Savings Section 401(k) plan in which substantially all employees may participate. The Company matches participant contributions at the rate of 50 percent of the first 6 percent of base salary contributed by participants. The Company contributes an additional 2 percent of participant base salary regardless of participant contributions. The Company's expense for the plan was \$37,000 and \$31,000 for the years ended June 30, 2013 and 2012, respectively.

The Company has an ESOP covering substantially all employees of the Bank. At June 30, 2013, all 161,896 ESOP shares have been allocated. As of June 30, 2013, no unearned shares remained. The Company is obligated at the option of each beneficiary to repurchase shares of the ESOP upon the beneficiary's termination or after retirement. The trustee expense for the ESOP was \$26,000 and \$31,000 for the years ended June 30, 2013 and 2012.

The Company has a Recognition and Retention Plan and Trust (RRP). The RRP has acquired 130,948 shares of the Company's common stock, which is the maximum allowed by the Plan, for awards to management. Shares awarded to management under the RRP vest at a rate of 20 percent at the end of each full 12 months of service with the Bank after the date of grant. As of June 30, 2013, 130,948 shares of common stock have been awarded to management. Expense under the RRP was \$32,000 and \$47,000 for the years ended June 30, 2013 and 2012.

The Company has entered into employee agreements with certain officers that provide for the continuation of salary and certain benefits for a specified period of time.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Note 15: Related Party Transactions

The Bank has entered into transactions with certain directors and officers. Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features. The aggregate amount of loans, as defined, to such related parties were as follows:

Balances, July 1, 2012	\$	623
New loans, including renewals		292
Payments, etc. including renewals		<u>(318)</u>
Balances, June 30, 2013	\$	<u>597</u>

Deposits from related parties held by the Bank at June 30, 2013 and 2012 totaled \$1,746,000 and \$1,297,000, respectively.

Note 16: Stock Option Plan

The Company has reserved 202,370 shares of Company stock for the granting of options to certain directors, officers and other key employees of the Company and the Bank. As of June 30, 2013, there were no stock options outstanding.

Note 17: Earnings Per Share

Earnings per share were computed as follows:

	Net Income	2013 Weighted- Average Shares	Per- Share Amount
Basic Earnings Per Share			
Income available to common stockholders	\$ 549	1,296,029	\$.42
Effect of Dilutive Stock Options	<u>—</u>	<u>2,159</u>	
Diluted Earnings Per Share			
Income available to common stockholders and assumed conversions	<u>\$ 549</u>	<u>1,298,188</u>	<u>\$.42</u>

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

	Net Income	2012 Weighted- Average Shares	Per- Share Amount
Basic Earnings Per Share			
Income available to common stockholders	\$ 513	1,317,221	\$.39
Effect of Dilutive Stock Options	—	211	
Diluted Earnings Per Share			
Income available to common stockholders and assumed conversions	\$ 513	1,317,432	\$.39

Note 18: Condensed Financial Information (Parent Company Only)

Presented below is condensed financial information as to financial position, results of operations and cash flows of the Company:

Condensed Balance Sheets

	2013	2012
Assets		
Cash and cash equivalents	\$ 73	\$ 41
Securities available for sale	—	122
Premises and equipment	405	422
Investment in subsidiaries	7,899	8,396
Other assets	95	130
Total assets	\$ 8,472	\$ 9,111
Liabilities		
	\$ 213	\$ 313
Stockholders' Equity		
	8,259	8,798
Total liabilities and stockholders' equity	\$ 8,472	\$ 9,111

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Condensed Statements of Income

	2013	2012
Income		
Dividends from Bank	\$ 889	\$ 415
Interest and other income	<u>48</u>	<u>60</u>
Total income	<u>937</u>	<u>475</u>
Expenses		
Salaries and employee benefits	20	20
Legal and professional fees	69	42
Other expenses	<u>94</u>	<u>87</u>
Total expenses	<u>183</u>	<u>149</u>
Income before income tax benefit and equity in undistributed income of Bank	754	326
Income tax benefit	<u>(53)</u>	<u>(35)</u>
Income before equity in undistributed income of Bank	807	361
Equity in undistributed income (loss) of Bank	<u>(258)</u>	<u>152</u>
Net Income	<u>\$ 549</u>	<u>\$ 513</u>
Comprehensive Income	<u>\$ 276</u>	<u>\$ 597</u>

Condensed Statements of Cash Flows

	2013	2012
Operating Activities		
Net income	\$ 549	\$ 513
Items not requiring (providing) cash	<u>243</u>	<u>(301)</u>
Net cash provided by operating activities	<u>792</u>	<u>212</u>
Financing Activities		
Dividends paid	(154)	(161)
Purchase of stock	<u>(606)</u>	<u>(26)</u>
Net cash used in financing activities	<u>(760)</u>	<u>(187)</u>
Net Change in Cash and Cash Equivalents	32	25
Cash and Cash Equivalents at Beginning of Year	<u>41</u>	<u>16</u>
Cash and Cash Equivalents at End of Year	<u>\$ 73</u>	<u>\$ 41</u>

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Note 19: Disclosures About Fair Value of Financial Instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy.

Available-for-Sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but rather relying on the investment securities' relationship to other benchmark quoted investment securities. Level 2 securities include mortgage-backed securities, agencies, municipal securities and collateralized mortgage obligations not traded in an active market. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. At this time, the Bank has no securities classified as Level 3.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

The following tables present the fair value measurements of assets recognized in the accompanying consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2013 and 2012:

	2013			
	Fair Value Measurements Using			
Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Available-for-sale securities				
Federal agencies	\$ 3,813	\$ —	\$ 3,813	\$ —
Municipal bonds	<u>3,987</u>	<u>—</u>	<u>3,987</u>	<u>—</u>
	<u>\$ 7,800</u>	<u>\$ —</u>	<u>\$ 7,800</u>	<u>\$ —</u>

	2012			
	Fair Value Measurements Using			
Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Available-for-sale securities				
Federal agencies	\$ 4,020	\$ —	\$ 4,020	\$ —
Corporate bonds	120	—	120	—
Municipal bonds	3,334	—	3,334	—
Marketable equity securities	<u>3</u>	<u>3</u>	<u>—</u>	<u>—</u>
	<u>\$ 7,477</u>	<u>\$ 3</u>	<u>\$ 7,474</u>	<u>\$ —</u>

Following is a description of the inputs and valuation methodologies used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification pursuant to the valuation hierarchy. For assets classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is described below.

Collateral-Dependent Impaired Loans, Net of ALLL

The estimated fair value of collateral-dependent impaired loans is based on the appraised fair value of the collateral, less estimated cost to sell. Collateral-dependent impaired loans are classified within Level 3 of the fair value hierarchy.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

The Bank considers the appraisal or evaluation as the starting point for determining fair value and then considers other factors and events in the environment that may affect the fair value. Appraisals of the collateral underlying collateral-dependent loans are obtained when the loan is determined to be collateral-dependent and subsequently as deemed necessary by management. Appraisals are reviewed for accuracy and consistency by management. Appraisers are selected from the list of approved appraisers maintained by management. The appraised values are reduced by discounts to consider lack of marketability and estimated cost to sell if repayment or satisfaction of the loan is dependent on the sale of the collateral. These discounts and estimates are developed by management by comparison to historical results.

The following tables present the fair value measurements of assets recognized in the accompanying consolidated balance sheets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2013 and 2012:

	2013			
	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Fair Value	(Level 1)	(Level 2)	(Level 3)
Impaired loans	\$ <u>547</u>	\$ <u>—</u>	\$ <u>—</u>	\$ <u>547</u>

	2012			
	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Fair Value	(Level 1)	(Level 2)	(Level 3)
Impaired loans	\$ <u>504</u>	\$ <u>—</u>	\$ <u>—</u>	\$ <u>504</u>

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

Unobservable (Level 3) Inputs

The following table presents quantitative information about unobservable inputs used in nonrecurring Level 3 fair value measurements for the year ended June 30, 2013:

	Fair Value at June 30, 2013	Valuation Technique	Unobservable Inputs	Range
Collateral-dependent impaired loans	\$ 504,000	Market comparable properties	Marketability discount	7% - 17%

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying consolidated balance sheets at amounts other than fair value.

Cash and Cash Equivalents, Interest-Bearing Deposits, Federal Home Loan Bank Stock, Interest Receivable and Interest Payable

The carrying amount approximates fair value.

Loans

The fair value of loans is estimated by discounting the future cash flows using the market rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Loans with similar characteristics were aggregated for purposes of the calculations. The carrying amount of accrued interest approximates its fair value.

Deposits

Deposits include demand deposits, savings accounts, NOW accounts and certain money market deposits. The carrying amount approximates fair value. The fair value of fixed-maturity time deposits is estimated using a discounted cash flow calculation that applies the rates currently offered for deposits of similar remaining maturities.

Borrowings

Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate the fair value of existing debt. Fair value of long-term debt is based on quoted market prices or dealer quotes for the identical liability when traded as an asset in an active market. If a quoted market price is not available, an expected present value technique is used to estimate fair value.

Home Financial Bancorp
Notes to Consolidated Financial Statements
June 30, 2013 and 2012
(Table Dollar Amounts in Thousands, Except Share Data)

The following table presents estimated fair values of the Company's financial instruments at June 30, 2013 and 2012.

	2013		2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 3,964	\$ 3,964	\$ 6,764	\$ 6,764
Interest-bearing deposits	3,349	3,349	1,255	1,255
Available-for-sale securities	7,800	7,800	7,477	7,477
Loans, net	51,950	54,980	55,048	59,151
Federal Home Loan Bank stock	1,032	1,032	1,032	1,032
Interest receivable	325	325	345	345
Financial liabilities				
Deposits	\$ 51,575	\$ 51,926	\$ 53,346	\$ 53,779
Borrowings	12,000	12,510	13,000	13,664
Interest payable	16	16	21	21