

TIERONE CORP  
Form 10-K  
March 11, 2008

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

**FORM 10-K**

**Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the fiscal year ended December 31, 2007**

or

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the period from \_\_\_\_\_ to \_\_\_\_\_.**

Commission File Number 005-78774

**TierOne Corporation**

(Exact name of registrant as specified in its charter)

Wisconsin

(State of Incorporation)

04-3638672

(I.R.S. Employer Identification Number)

**Registrant's Address of Principal Executive Offices: 1235 N Street, Lincoln, Nebraska 68508**

**Registrant's Telephone Number, including area code: (402) 475-0521**

**Securities registered pursuant to Section 12(b) of the Act: None**

**Securities registered pursuant to Section 12(g) of the Act:**

**Title of Class Common Stock, Par Value \$0.01 Per Share**

Indicate by check mark whether the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes  No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Registrant's Address of Principal Executive Offices: 1235 N Street, Lincoln, Nebraska 68508 Registrant's Telephone

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Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The aggregate market value of the voting stock held by non-affiliates of the Registrant was \$543,431,480 as of June 30, 2007. As of March 10, 2008 there were 18,059,946 issued and outstanding shares of the Registrant's common stock.

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### Documents Incorporated by Reference

Portions of the definitive Proxy Statement for the Registrant's 2008 Annual Meeting of Shareholders are expected to be incorporated by reference in Part III, Items 10, 11, 12, 13 and 14. In the event that such Proxy Statement is not filed on or prior to 120 days after the Registrant's fiscal year end (April 29, 2008), the Annual Report on Form 10-K will be amended to include the information required in Part III, Items 10, 11, 12, 13 and 14.

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### TierOne Corporation

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### Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995

Statements contained in this Annual Report on Form 10-K which are not historical facts may be forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. Such forward looking statements are subject to risks and uncertainties which could cause actual results to differ materially from those currently anticipated due to a number of factors. In addition to the risk factors described in Item 1A. of this Annual Report on Form 10-K, factors that could result in material variations include, but are not limited to:

General economic conditions and trends, either nationally or in some or all of the areas in which we and our customers conduct our businesses;

Changes in interest rates or other competitive factors which could affect net interest margins, net interest income and noninterest income;

Changes in deposit flows, and in the demand for deposits, loans, investment products and other financial services in the markets we serve;

Changes in the quality or composition of our loan portfolios;

Changes in real estate values, which could impact the quality of the assets securing the loans in our portfolios;

Changes in the financial or operating performance of our customers' businesses;

Borrower bankruptcies, claims and assessments;

Our timely development of new lines of business and competitive products or services within our existing lines of business in a changing environment, and the acceptance of such products or services by our customers;

Any interruption or breach of security resulting in failures or disruptions in customer account management, general ledger, deposit operations, lending or other systems;

Changes in fiscal, monetary, regulatory, trade and tax policies and laws;

Increased competitive challenges and expanding product and pricing pressures among financial institutions;

Changes in accounting policies or procedures as may be required by various regulatory agencies;

Changes in consumer spending and saving habits;

Unanticipated issues relating to the recovery of insurance proceeds for claims arising out of our prior relationship with TransLand Financial Services, Inc;

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Conditions precedent to our proposed merger with a subsidiary of CapitalSource Inc. may not be satisfied or the merger agreement may be terminated pursuant to its terms;

Disruption from our proposed merger with a subsidiary of CapitalSource Inc. may make it more difficult to maintain customer relationships;

The required regulatory approvals for our proposed merger with a subsidiary of CapitalSource Inc. may not be obtained or if obtained may not be on the terms anticipated by, or acceptable to, the parties;

The outcome of pending or threatened litigation, or of other matters before regulatory agencies, or of matters resulting from regulatory exams, whether currently existing or commencing in the future; and

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Other factors discussed in documents we may file with the Securities and Exchange Commission from time to time.

These factors should be considered in evaluating the forward-looking statements and undue reliance should not be placed on such statements. We undertake no obligation, and disclaim any obligation, to update information contained in this Annual Report on Form 10-K, including these forward-looking statements, to reflect events or circumstances that occur after the date of the filing of this Annual Report on Form 10-K.

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### Part I

As used in this report, unless the context otherwise requires, the terms *we*, *us*, or *our* refer to TierOne Corporation and its wholly owned subsidiary, TierOne Bank.

#### Item 1. Business

##### General

TierOne Corporation ( *Company* ) is a Wisconsin corporation headquartered in Lincoln, Nebraska. TierOne Corporation is the holding company for TierOne Bank ( *Bank* ). The Bank has two wholly owned subsidiaries, TMS Corporation of the Americas ( *TMS* ) and United Farm & Ranch Management, Inc. ( *UFARM* ). TMS is the holding company of TierOne Investments and Insurance, Inc. (d/b/a TierOne Financial), a wholly owned subsidiary that administers the sale of securities and insurance products, and TierOne Reinsurance Company, a wholly owned subsidiary that reinsures credit life and disability insurance policies. UFARM provides agricultural customers with professional farm and ranch management and real estate brokerage services.

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The assets of the Company, on an unconsolidated basis, primarily consist of 100% of the Bank's common stock. The Company has no significant independent source of income and therefore depends on cash distributions from the Bank to meet its funding requirements.

Our results of operations are dependent primarily on net interest income, which is the difference between the interest earned on our assets, primarily our loan and securities portfolios, and our cost of funds, which consists of the interest paid on our deposits and borrowings. Our net income (loss) is also affected by our provision for loan losses, noninterest income, noninterest expense and income tax expense (benefit). Noninterest income generally includes fees and service charges, debit card fees, net income (loss) from real estate operations, net gain on sales of investment securities, loans held for sale and real estate owned and other operating income. Noninterest expense consists of salaries and employee benefits, occupancy, data processing, advertising and other operating expense. Our earnings are significantly affected by general economic and competitive conditions; particularly changes in market interest rates and U.S. Treasury yield curves, governmental policies and actions of regulatory authorities.

### United Nebraska Financial Co. Acquisition

On August 27, 2004, we acquired all of the issued and outstanding capital stock of United Nebraska Financial Co. ( UNFC ), the holding company of United Nebraska Bank ( UNB ), headquartered in Grand Island, Nebraska. The purchase price of the acquisition was approximately \$97.3 million. UNB had assets in excess of \$500 million and 16 banking offices located in Nebraska.

### Sale / Purchase of Branches and Deposits

On June 2, 2006, we completed the purchase of Marine Bank's only banking office in Omaha Nebraska. We acquired \$8.1 million of deposits as a result of this transaction. On December 15, 2006, we sold our Plainville and Stockton, Kansas bank offices to Stockton National Bank of Stockton, Kansas. As a result of this sale, we transferred \$21.7 million of deposits to the purchaser and recorded a gain on sale of \$1.0 million.

### Proposed Merger with CapitalSource Inc.

On May 17, 2007, the Company, CapitalSource Inc. ( CapitalSource ) and CapitalSource TRS Inc. ( CapitalSource TRS ) entered into and announced an Agreement and Plan of Merger ( Merger Agreement ). The Merger Agreement provides that, upon the terms and subject to conditions set forth in the Merger Agreement, the Company will merge with and into CapitalSource TRS ( Merger ), with CapitalSource TRS continuing as the surviving corporation. The Merger Agreement and the Merger were approved by the stockholders of the Company at a special meeting held on November 29, 2007.

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Subject to the terms and conditions of the Merger Agreement, at the effective time and as a result of the Merger, each issued and outstanding share of Company common stock (other than certain shares owned by the Company) would be converted into the right to receive the following (collectively, the Merger Consideration ):

- \$6.80 in cash; plus
- 0.675 shares of CapitalSource common stock; plus
- if the ten-day average closing price of CapitalSource common stock prior to the closing of the Merger is:
  - (a) less than or equal to \$25.1852, then 0.405 shares of CapitalSource common stock; or
  - (b) greater than \$25.1852, then Company stockholders can elect to receive either \$10.20 in cash or \$10.20 of CapitalSource common stock.

If, on the day the last governmental approval to complete the Merger is obtained, the ten-day average closing price of CapitalSource common stock is less than \$21.98 and the trading price of CapitalSource common stock has underperformed by more than 15% the S&P 500 Financial Sector Index during the period from May 17, 2007 to that date, then the Board of Directors of the Company has the right, in accordance with the terms of the Merger Agreement, to request that CapitalSource provide additional financial consideration, either in stock or cash. The Company previously informed CapitalSource that, under such circumstances, its Board of Directors would intend to make such a request. If, following such a request, the parties are unable to agree on such additional consideration, then the Board of Directors of the Company would have the right to terminate the Merger Agreement.

The Company and CapitalSource have made customary representations, warranties and covenants in the Merger Agreement, including, among others, covenants regarding the conduct of their businesses and other activities between the execution of the Merger Agreement and the consummation of the Merger, and have agreed to use their reasonable best efforts to consummate the Merger. During the time that the Merger Agreement is in effect, the Company is not permitted to solicit or facilitate proposals relating to alternative business combination transactions,

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or, subject to certain exceptions, enter into discussions concerning alternative business combination transactions.

Consummation of the Merger is subject to customary conditions, including, without limitation, the accuracy of the representations and warranties of the parties (subject generally to a material adverse effect standard) and regulatory approval. Although CapitalSource has filed an application with the Office of Thrift Supervision ( OTS ) for approval of transactions contemplated by the Merger Agreement, the OTS has yet to deem the application either complete or approved, and no assurance can be given that the OTS will approve the transaction.

The Merger Agreement further provides that either the Company or CapitalSource (each acting through its respective Board of Directors) has the right at any time after February 17, 2008 to unilaterally terminate the Merger Agreement, unless the failure to effect the Merger by such date was due to the terminating party's failure to perform its obligations and covenants under the Merger Agreement. The Company has indicated that its present intent is not to terminate the Merger Agreement pending receipt of further comment from the OTS. Conversely, CapitalSource has publicly advised that its Board of Directors has authorized its Chairman and Chief Executive Officer to either terminate the Merger Agreement or negotiate new terms for the transaction. In light of the preceding sentence, the Company can provide no assurance that the Merger will be completed even if all conditions precedent to the transaction (including receipt of regulatory approval) are satisfied.

In addition to other factors affecting the Company's financial performance discussed elsewhere in this Annual Report on Form 10-K, due to the proposed Merger, the Company has been subject to or experienced limitations on the operation of its business including restrictions on certain funding opportunities; certain one-time Merger-related expenses; an increased commitment of time by Company personnel working with federal regulatory agencies in connection with Merger-related issues; and restrictions on the Company's ability to repurchase its common stock. These activities have and may continue to further impact the Company's financial performance and earnings per share.

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### Government Monetary Policy

We are affected by the credit policies of monetary authorities, including the Board of Governors of the Federal Reserve System ( Federal Reserve Board ). An important objective of the Federal Reserve System is to regulate the national supply of bank credit. Among the instruments of monetary policy used by the Federal Reserve Board are open market operations in U.S. Government securities, changes in the discount rate, reserve requirements on member bank deposits and funds availability regulations. The monetary policies of the Federal Reserve Board have in the past had a significant effect on operations of financial institutions, including the Bank, and will continue to do so in the future. Changing conditions in the national economy and in the money markets make it difficult to predict future changes in interest rates, deposit levels, loan demand or their effects on the business and earnings of the Company.

### Market Area and Competition

We are a regional community bank offering a variety of financial products and services to meet the needs of the customers we serve. Our deposit gathering is concentrated in the communities surrounding our 69 banking offices located in Nebraska, seven counties in southwest Iowa and one county in northern Kansas. We compete for customers by emphasizing convenience and service, and by offering a full range of traditional and non-traditional products and services. We offer 24-hour ATM banking at 68 of our banking offices and currently offer 31 ATM banking locations at supermarkets, convenience stores and shopping malls.

In addition to loans generated through our banking offices, our lending efforts have been expanded in recent years to include nine loan production offices located in Arizona, Colorado, Florida, Minnesota, Nevada and North Carolina whose primary purpose is to originate commercial real estate and construction, land and land development and/or residential construction loans in their respective states.

We face significant competition, both in generating loans as well as in attracting deposits. Our market area is highly competitive and we face direct competition from a significant number of financial service providers, many with a statewide or regional presence and, in some cases, a national presence. Many of these financial service providers are significantly larger and have greater financial resources. Our competition for loans comes principally from commercial banks, savings banks and associations, credit unions, mortgage brokers, mortgage-banking companies and insurance companies. Our most direct competition for deposits has historically come from commercial banks, savings banks and associations and credit unions. In addition, we face increasing competition for deposits from non-bank institutions such as brokerage firms and insurance companies in such instruments as short-term money market funds, corporate and government securities funds, equity securities, mutual funds and annuities.

### Subsequent Event

Subsequent to the filing of the Company's March 4, 2008 Form 8-K Report of financial results for the quarter and year ended December 31, 2007, an appellate court decision in our federal goodwill litigation (see Item 3. Legal Proceedings for additional information) was issued. As a result of this decision, we recorded a 2007 fourth quarter pretax charge of \$560,000 in other operating expense to reflect fees and expenses

### Subsequent Event

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incurred during the appeal process which had previously been capitalized. The impact after income tax benefits of \$202,000, was \$358,000. The 2007 Consolidated Statement of Operations and related loss per share data reported in this Annual Report on Form 10-K have been updated accordingly.

### Available Information

We are a public company and are required to file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission ( SEC ). We maintain a website at [www.tieronebank.com](http://www.tieronebank.com) and make available, free of charge, copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and any amendments to such documents as soon as reasonably practicable after the reports have been electronically filed or furnished to the SEC. In addition, we provide our Code of Conduct and Ethics, Audit Committee Charter, Compensation Committee Charter and Nominating and Corporate Governance Committee Charter on our website. We are not including the information contained on or available through our website as a part of, nor are we incorporating such information by reference into, this Annual Report on Form 10-K.

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### Lending Activities

**General.** We directly originate loans to customers located in Nebraska, Iowa, Kansas, Arizona, Colorado, Florida, Minnesota, Nevada and North Carolina ( Primary Lending Market Area ). This Primary Lending Market Area is comprised of states in which we have banking or loan production offices. We also purchase loans and loan participation interests from financial institutions, loan correspondents and mortgage brokers located throughout the United States. At December 31, 2007 and 2006, approximately 20.2% and 20.8%, respectively, of our total loan portfolio consisted of loans secured by properties located outside of our Primary Lending Market Area.

In recent years, we have become a regional community bank by shifting our focus to multi-family residential, commercial real estate, land and land development, construction, agricultural, business, warehouse mortgage lines of credit and consumer lending. These loans typically have relatively higher yields, adjustable interest rates and/or shorter terms to maturities. Such loans, however, generally involve a higher degree of risk than financing one-to-four family residential loans because collateral is more difficult to appraise, the collateral may be difficult to obtain or liquidate following an uncured default and it can be difficult to predict the borrower's ability to generate future cash flows.

The decrease in net loans at December 31, 2007 was primarily attributable to steps taken to reduce exposure to certain lending markets, loan payoffs and periodic payments. Additionally, lower demand, more stringent underwriting guidelines and macro-economic factors have resulted in a decreased volume of residential real estate, land and land development and commercial construction related loan originations.

**Loan Approval Procedures and Authority.** General lending policies and procedures are established by our Asset/Liability Committee which is composed of the following officers of the Bank: Chief Executive Officer, Chief Operating Officer, Director of Lending, Director of Administration, Director of Retail Banking, Chief Financial Officer, Controller and Senior Financial Analysis Manager. Our Board of Directors reviews and approves lending policies and procedures established by the Asset/Liability Committee. Under policies approved by the Board of Directors, various officers or combinations of officers have loan approval authority, the specific amounts and requirements being set forth for each loan type. Generally, for loan amounts in excess of \$10.0 million, approval of our Board of Directors is required.

**Loan Portfolio Composition.** At December 31, 2007, our total loans receivable amounted to \$3.3 billion. We have, in recent years, shifted the focus of our lending strategy to place an increased emphasis on multi-family residential, commercial real estate, land and land development, construction, agricultural, business, warehouse mortgage lines of credit and consumer lending. The types of loans that we may purchase and originate are subject to federal and state laws and regulations. The interest rates we charge on loans are affected by the demand for such loans and the supply of money available for lending purposes and the rates offered by competitors. These factors are, in turn, affected by general and local economic conditions, monetary policies of the Federal Government, including the Board of Governors of the Federal Reserve System and legislative tax policies.

**Residential Mortgage Lending.** One-to-four family residential mortgage loan originations are generally obtained from our in-house loan representatives, from existing or past customers and from mortgage brokers. We also originate and/or purchase from correspondent lenders second mortgage loans in amounts up to 90% of the appraised value of the collateral with maturities of up to 30 years.

We currently originate fixed-rate, one-to-four family residential mortgage loans generally with terms of up to 30 years. We sell substantially all newly originated fixed-rate, one-to-four family residential loans into the secondary market on a servicing retained basis which produces noninterest income in the form of net gains and losses on sales and loan servicing fees.

We originate or purchase adjustable-rate, one-to-four family residential mortgage loans with terms of up to 30 years and interest rates which generally adjust one to seven years from the outset of the loan and thereafter annually for the duration of the loan. The interest rates for

such adjustable-rate loans are normally tied to indices such as the U.S. Treasury CMT or LIBOR, plus a margin. Our adjustable-rate loans generally provide for periodic caps (generally not more than 2.0%) on the increase or decrease in the interest rate at any adjustment date. The maximum amount the rate can increase or decrease from the initial rate during the life of the loan is 5.0% 6.0% over the start rate.

The origination or purchase of adjustable-rate, one-to-four family residential mortgage loans allows us to control our exposure to interest rate risk. However, adjustable-rate loans generally pose risks not inherent in fixed-rate loans, primarily because as interest rates rise, the underlying payments of the borrower rise, thereby increasing the potential for default. Periodic and lifetime caps on interest rate increases help to reduce the risks associated with adjustable-rate loans but also limit the interest rate sensitivity of such loans.

Generally, we originate one-to-four family residential mortgage loans in amounts up to 80% of the lower of the appraised value or the selling price of the property and up to 100% if private mortgage insurance is obtained. Mortgage loans originated by us generally include due-on-sale provisions which provide us with the contractual right to deem the loan immediately due and payable in the event the borrower transfers ownership of the property without our consent. We require fire, casualty, title and, in certain cases, flood insurance on properties securing mortgage loans made by us.

We maintain a corporate policy of not participating in subprime residential real estate lending or negative amortizing mortgage products. The Office of Thrift Supervision, our federal regulatory agency, defines subprime loans as loans to borrowers displaying one or more credit risk characteristics including lending to a borrower with a credit bureau risk score (FICO) of 660 or below. Furthermore, we have not engaged in collateralized loan obligations (CLO), collateralized debt obligations (CDO), structured investment vehicles (SIV) or asset-backed commercial paper (ABCP).

**Multi-Family Residential, Commercial Real Estate and Land and Land Development Lending.** We offer multi-family residential, commercial real estate and land and land development loans for permanent financing collateralized by real property. These loans are generally used for business purposes such as apartment buildings, office and retail facilities and land being held for commercial and residential development. The properties securing these loans are generally located in our Primary Lending Market Area. At December 31, 2007, 62.6%, 86.9% and 95.9% of our multi-family residential, commercial real estate and land and land development loans, respectively, were located within our Primary Lending Market Area.

Our underwriting procedures generally provide that multi-family residential, commercial real estate and land and land development loans may be made in amounts up to 80% of the value of the property if it is located within our Primary Lending Market Area and 75% of the value if it is outside our Primary Lending Market Area. Loans exceeding prescribed loan-to-value ratios must be reviewed by our Board of Directors and supported by documentation of the relevant factors justifying the deviation from policy.

Loans secured by multi-family residential, commercial real estate and land and land development properties generally involve larger principal amounts and a greater degree of risk than one-to-four family residential mortgage loans. Payments on these loan types are often dependent on the successful operation or management of the properties. Repayment of such loans may be subject to adverse conditions in the real estate market or the economy and a concentration of loans in a geographic region may be subject to greater risk because of the potential for adverse economic conditions affecting that region. We seek to minimize these risks through our underwriting standards.

**Construction Lending.** We offer residential construction loans for either pre-sold houses (a purchase contract has been signed) or speculative houses (properties for which no buyer yet exists). We originate most of our residential construction loans within our Primary Lending Market Area typically through direct contact with home builders. At December 31, 2007, approximately 80.2% of our residential construction loans were located in our Primary Lending Market Area. During the years ended December 31, 2007 and 2006, we purchased \$55.4 million and \$161.5 million, respectively, of residential construction loans.

We also originate commercial real estate construction loans as well as purchase participation interests in such loans. We provide commercial construction loans to real estate developers for the purpose of constructing a variety of commercial projects such as retail facilities, industrial buildings and warehouses. At December 31, 2007, 72.5% of our commercial construction loans were located in our Primary Lending Market Area.

Commercial construction lending involves a higher degree of risk than one-to-four family residential lending, therefore, we closely monitor our concentration in such loans. We also seek a broad diversification of project types, borrowers and geographic areas to reduce the level of risk associated with this lending type.



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Risk of loss on construction loans is dependent largely upon the accuracy of the initial estimate of the property's value when completed or developed compared to the projected cost (including interest) of construction and other assumptions, including the approximate time to build, sell or lease the properties. If the appraised collateral value proves to be inaccurate, we may be confronted with a project, when completed, having a value which is insufficient to assure full repayment.

**Agricultural Loans.** Agricultural loans are made predominantly to farmers and ranchers in Nebraska, Iowa and Kansas. At December 31, 2007, 100.0% of our agricultural loans were located in our Primary Lending Market Area. Agricultural operating loans are made to finance day-to-day operations, including crop and livestock production. Intermediate term loans are used to purchase breeding livestock and machinery. Real estate loans are used to purchase or refinance farm and ranchland.

Overall credit worthiness is determined by evaluation of the borrower, including management experience and skills, financial strength and the ability to service debt. Loans are generally repaid using cash flows from agricultural activities, including the sale of agricultural commodities, produced by the operation. Underwriting standards include maximum advance rates on collateral, minimum cash flow coverage and review of the historical net worth and cash flow trends of the operation.

Risk of loss is related to the effects of the external risk factors such as adverse weather conditions and poor commodity prices. The impact of external risk factors is significantly affected by the borrower's ability to mitigate the effect of risk on the borrower's operation. Commodity-based agricultural chattel assets are relatively easy to liquidate and there is also a stable demand for agricultural real estate. Our agricultural lenders are responsible for validating the existence, value and condition of the collateral. This monitoring may include periodic on-site inspections and the use of borrowing base reports.

**Warehouse Mortgage Lines of Credit.** We are actively involved in originating revolving lines of credit to mortgage brokers. These lines are drawn upon by mortgage brokers to fund the origination of one-to-four family residential mortgage loans. Prior to funding the advance, the mortgage broker must have an approved commitment for the purchase of the loan which reduces credit exposure associated with the line. The lines are repaid upon sale of the mortgage loan to a third party which usually occurs within 30 days of origination of the loan. In connection with extending the line of credit to the mortgage broker, we enter into agreements with the purchaser to which such mortgage broker intends to sell loans. Under such agreements, the loan purchaser agrees to hold the mortgage documents issued by the mortgage brokers on our behalf and for our benefit until such time that the purchaser remits to us the purchase price for such loans. As part of the structure of the lines of credit, the mortgage brokers are required to maintain commercial deposits with us, with the amount of such deposits dependent upon the amount of the line and other factors. The lines are structured with adjustable rates indexed to the Wall Street Journal prime rate. Maximum amounts permitted to be advanced by us under existing warehouse mortgage lines of credit range in amounts from \$1.5 million to \$30.0 million.

**Business Lending.** Business loans are made predominantly to small- and mid-sized businesses located within Nebraska, Iowa and Kansas. At December 31, 2007, 98.0% of our business loans were located in our Primary Lending Market Area. The business lending products we offer include lines of credit, receivable and inventory financing and equipment loans. We have established minimum underwriting standards in regard to business loans which set forth the criteria for sources of repayment, borrower's capacity to repay, specific financial and collateral margins and financial enhancements such as guarantees. Generally, the primary source of repayment is cash flow from the business and the financial strength of the borrower.

Business loans generally involve a greater degree of risk than real estate loans, primarily because collateral is more difficult to appraise, the collateral may be difficult to obtain or liquidate following default and it is difficult to foresee the borrower's ability to generate cash flows. These loans, however, typically offer relatively higher yields and have shorter expected terms to maturity. The availability of business loans enables potential depositors to establish full-service banking relationships with us.

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**Consumer and Other Lending.** Consumer loans are generally originated directly through our network of banking offices. We offer home equity loans, home improvement loans and home equity lines of credit in amounts up to \$100,000 with a term of 15 years or less and a loan-to-value ratio up to 90% of the appraised value of the collateral. A portion of our home improvement loans consist of participation interests we have purchased from a third party. Under the terms of our third party arrangement, if any loan becomes more than 120 days past due, we can require the seller to repurchase such loan at a price equal to our total investment in the loan, including any uncollected and accrued interest. We also offer automobile loans in amounts up to \$50,000 with maximum 72 month and 60 month terms for new and used cars, respectively, and purchase price ratios of generally not more than 95% and 85% for new and used cars, respectively. Most of our automobile loans are obtained through a network of 81 new and used automobile dealers located primarily in Lincoln and Omaha, Nebraska. Although employees of the automobile dealership take the application, the loan is made pursuant to our underwriting standards and must be approved by one of our authorized loan officers. Our consumer loan portfolio also includes manufactured housing, recreational vehicle, boat, motorcycle and unsecured loans.

Unsecured loans and loans secured by rapidly depreciating assets, such as automobiles, entail greater risks than one-to-four family residential mortgage loans. In such cases, repossessed collateral, if any, for a defaulted loan may not provide an adequate source of repayment of

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the outstanding loan balance. Further, consumer loan collections on these loans are dependent on the borrower's continuing financial stability and, therefore, are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Finally, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans in the event of a default.

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**Loan Portfolio Composition.** The following table shows the composition of our loan portfolio by type of loan at the dates indicated:

<i>(Dollars in thousands)</i>	At December 31,				
	2007	2006	2005	2004	2003
<b>Real estate loans:</b>					
One-to-four family residential (1)	\$ 314,623	\$ 339,080	\$ 384,722	\$ 418,270	\$ 559,134
Second mortgage residential	95,477	120,510	160,208	255,222	258,121
Multi-family residential	106,678	148,922	166,579	142,454	99,078
Commercial real estate	370,910	396,620	402,504	444,269	353,177
Land and land development	473,346	494,887	289,916	152,845	95,975
Residential construction	513,560	780,991	943,378	601,075	245,782
Commercial construction	540,797	491,997	351,767	282,399	154,247
Agriculture	91,068	68,459	57,008	66,830	--
<b>Total real estate loans</b>	<b>2,506,459</b>	<b>2,841,466</b>	<b>2,756,082</b>	<b>2,363,364</b>	<b>1,765,514</b>
Business	252,712	220,669	177,592	142,675	64,522
Agriculture - operating	100,365	94,455	72,518	71,223	--
Warehouse mortgage lines of credit	86,081	112,645	95,174	132,928	78,759
<b>Consumer loans:</b>					
Home equity	72,517	71,476	61,600	56,441	33,874
Home equity lines of credit	120,465	130,071	141,021	142,725	117,899
Home improvement	46,045	55,513	69,165	73,386	74,915
Automobile	87,079	87,575	85,515	80,512	67,351
Other	71,141	68,365	49,812	25,956	15,621
<b>Total consumer loans</b>	<b>397,247</b>	<b>413,000</b>	<b>407,113</b>	<b>379,020</b>	<b>309,660</b>
<b>Total loans</b>	<b>3,342,864</b>	<b>3,682,235</b>	<b>3,508,479</b>	<b>3,089,210</b>	<b>2,218,455</b>
Unamortized premiums, discounts and deferred loan fees	9,451	5,602	4,778	7,228	10,790
Loans in process (2)	(376,186)	(637,677)	(668,587)	(441,452)	(193,063)
<b>Net loans</b>	<b>2,976,129</b>	<b>3,050,160</b>	<b>2,844,670</b>	<b>2,654,986</b>	<b>2,036,182</b>
Allowance for loan losses	(66,540)	(33,129)	(30,870)	(26,831)	(19,586)

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At December 31,

Net loans after allowance for loan losses	\$ 2,909,589	\$ 3,017,031	\$ 2,813,800	\$ 2,628,155	\$ 2,016,596
(1) Includes loans held for sale	\$ 9,348	\$ 19,285	\$ 8,666	\$ 11,956	\$ 7,083

(2) Loans in process represents the undisbursed portion of construction and land development loans.

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**Loan Portfolio Concentration by State.** The following table details the concentration of our total loan portfolio by state at the dates indicated:

(Dollars in thousands)	At December 31,					
	2007	%	2006	%	2005	%
<b>Within our Primary Lending Market Area:</b>						
Nebraska	\$ 1,367,659	40.91%	\$ 1,326,374	36.02%	\$ 1,248,165	35.58%
Nevada	247,260	7.40	252,990	6.87	32,704	0.93
Colorado	237,441	7.10	283,543	7.70	277,184	7.90
Florida	168,765	5.05	317,454	8.62	508,792	14.50
Arizona	161,339	4.83	205,912	5.59	222,397	6.34
Minnesota	157,985	4.73	172,134	4.68	151,734	4.33
Iowa	135,885	4.06	106,949	2.90	103,286	2.94
North Carolina	121,594	3.64	175,666	4.77	123,221	3.51
Kansas	69,180	2.07	75,362	2.05	60,807	1.73
Total within our primary lending market area	2,667,108	79.79	2,916,384	79.20	2,728,290	77.76
<b>Outside our Primary Lending Market Area:</b>						
South Carolina	103,153	3.09	132,508	3.60	137,640	3.92
California	78,817	2.36	95,453	2.59	114,286	3.26
Texas	74,390	2.22	83,050	2.26	72,696	2.07
Illinois	70,891	2.12	55,011	1.49	19,980	0.57
Oregon	37,266	1.11	44,168	1.20	30,360	0.87
Washington	29,736	0.89	53,698	1.46	62,081	1.77
Other States	281,503	8.42	301,963	8.20	343,146	9.78
Total outside our primary lending market area	675,756	20.21	765,851	20.80	780,189	22.24
Total loans	\$ 3,342,864	100.00%	\$ 3,682,235	100.00%	\$ 3,508,479	100.00%

No individual state in the Other States category comprises more than one percent of total loans at December 31, 2007. Total loans declined \$339.4 million, or 9.2%, to \$3.3 billion at December 31, 2007 compared to \$3.7 billion at December 31, 2006. Our total loans in Florida at December 31, 2007 were \$168.8 million, a decrease of \$148.7 million, or 46.8%, compared to \$317.5 million at December 31, 2006.

During the latter half of 2007 the nation's equity, housing, credit and economic markets faced unprecedented pressures which have significantly impacted much of the financial sector. We have taken a number of steps related to the realignment of certain credit administration functions, including the addition of personnel with extensive depth and expertise in credit analysis, and we continue to tighten credit policies.

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**Contractual Terms to Final Maturities.** The following table shows the scheduled contractual maturities of our loans at December 31, 2007. Demand and overdraft loans, which have no stated schedule of repayments and no stated maturity, are reported as due in 2008. The following amounts do not take into account loan prepayments.

**Principal Payments Contractually Due in Years**

<i>(Dollars in thousands)</i>	<b>2008</b>	<b>2009 - 2012</b>	<b>2013 - 2017</b>	<b>After 2017</b>	<b>Total</b>
<b>Real estate loans:</b>					
One-to-four family residential	\$ 3,269	\$ 6,703	\$ 11,621	\$ 293,030	\$ 314,623
Second mortgage residential	398	3,539	12,804	78,736	95,477
Multi-family residential	9,871	35,518	16,565	44,724	106,678
Commercial real estate	25,566	135,475	196,519	13,350	370,910
Land and land development	303,966	165,688	3,609	83	473,346
Residential construction	488,289	11,089	187	13,995	513,560
Commercial construction	186,873	280,955	71,809	1,160	540,797
Agriculture	8,511	18,577	55,796	8,184	91,068
<b>Total real estate loans</b>	<b>1,026,743</b>	<b>657,544</b>	<b>368,910</b>	<b>453,262</b>	<b>2,506,459</b>
Business	98,114	131,753	21,730	1,115	252,712
Agriculture - operating	67,873	30,026	2,199	267	100,365
Warehouse mortgage lines of credit	86,081	--	--	--	86,081
Consumer	38,581	248,359	38,440	71,867	397,247
<b>Total loans (1) (2)</b>	<b>\$ 1,317,392</b>	<b>\$ 1,067,682</b>	<b>\$ 431,279</b>	<b>\$ 526,511</b>	<b>\$ 3,342,864</b>

(1) Gross of unamortized premiums, discounts and deferred loan fees, loans in process and allowance for loan losses.

(2) Total loans due after one year from December 31, 2007 with fixed interest rates totaled \$1.0 billion.

Total loans due after one year from December 31, 2007 with floating or adjustable interest rates totaled \$1.0 billion.

**Originations, Purchases and Sales of Loans.** Our lending activities are subject to underwriting standards and loan origination procedures established by our Asset/Liability Committee and approved by our Board of Directors. Applications for mortgages and other loans are primarily taken at our banking and loan production offices. In the past, we have relied on a network of loan correspondents and mortgage brokers to originate a substantial part of our loans. We significantly reduced our utilization of third-party originators of residential construction loans throughout 2006 and 2007. In recent years, we have greatly expanded our capacity to originate loans through the expansion of our loan production office network and the employment of a number of experienced loan officers. We also use loan correspondents and mortgage brokers to originate one-to-four family residential loans to supplement our origination efforts. A substantial portion of such loans consists of fixed-rate, one-to-four family residential mortgage loans which we sell into the secondary market on a servicing retained basis.

Although we originate both adjustable-rate and fixed-rate loans, our ability to originate and purchase fixed- or adjustable-rate loans is dependent upon customer demand for such loans, which is affected by the current and expected future level of interest rates. The loans purchased during 2007 consisted of one-to-four family residential, construction, consumer (primarily home improvement loans and automobile financing), business, land and land development (including participation interests), agricultural and second mortgage residential loans.

Generally, we originate adjustable-rate mortgage loans for retention in our portfolio. It is our current policy to sell substantially all the fixed-rate, one-to-four family residential mortgage loans we originate or purchase. Substantially all fixed-rate loans sold are sold to either Fannie Mae ( FNMA ), the Federal Home Loan Mortgage Corporation ( FHLMC ) or the FHLBank Topeka ( FHLBank ) pursuant to the Mortgage Partnership Finance Program. Upon receipt of an application to make a fixed-rate loan, we typically enter into agreements to sell such loans to FNMA, FHLMC or the FHLBank pursuant to forward sale commitments, with delivery being required in approximately 90 days. We generally agree to deliver a somewhat smaller dollar amount of loans in the event that not all the loans for which applications are submitted actually close. Loans are delivered pursuant to such sale contracts upon their origination or purchase and are not aggregated for sale as loan packages. As a result, we typically do not have a significant amount of loans held for sale at any given point in time. We recognize, at the time of disposition, the gain or loss on the sale of the loans. The gain or loss is based on the difference between the net proceeds received and the carrying value of the loans sold excluding the value of servicing rights retained.

**Loan Portfolio Activity.** The following table shows total loans originated, purchased, sold and repaid during the years indicated:

<i>(Dollars in thousands)</i>	<b>Year Ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Net loans after allowance for loan losses at beginning of year	\$ 3,017,031	\$ 2,813,800	\$ 2,628,155
<b>Loan originations:</b>			
One-to-four family residential	168,077	161,672	150,744
Second mortgage residential	2,518	2,988	3,867
Multi-family residential	3,415	11,600	13,008
Commercial real estate	52,879	56,612	44,905
Land and land development	139,832	316,344	176,553
Residential construction	262,902	500,283	560,322
Commercial construction	111,451	249,732	218,368
Agriculture - real estate	47,179	27,376	25,054
Business	406,369	373,489	348,450
Agriculture - operating	275,042	235,845	188,591
Warehouse mortgage lines of credit (1)	2,706,073	2,946,983	3,640,622
Consumer	141,084	152,143	148,538
<b>Total loan originations</b>	<b>4,316,821</b>	<b>5,035,067</b>	<b>5,519,022</b>
<b>Loan purchases:</b>			
One-to-four family residential (2)	212,277	115,827	191,725
Second mortgage residential	872	1,649	1,191
Multi-family residential	--	10,000	61,133
Commercial real estate	--	--	81
Land and land development	10,246	7,917	34,088
Residential construction	55,387	161,461	589,506
Commercial construction	54,808	83,389	47,587
Agriculture - real estate	2,836	--	--
Business	15,842	15,463	9,235
Agriculture - operating	501	--	--
Consumer	58,647	88,429	120,466
<b>Total loan purchases</b>	<b>411,416</b>	<b>484,135</b>	<b>1,055,012</b>
<b>Total loan originations and purchases</b>	<b>4,728,237</b>	<b>5,519,202</b>	<b>6,574,034</b>
<b>Sales and loan principal repayments:</b>			
<b>Loan sales:</b>			
One-to-four family residential	(339,013)	(242,991)	(254,578)
Consumer	(5,018)	(4,421)	(4,777)
<b>Loan principal repayments:</b>			
Real estate, business, agriculture-operating and consumer	(1,992,193)	(2,166,909)	(2,224,703)
Warehouse mortgage lines of credit (1)	(2,732,637)	(2,929,512)	(3,678,376)
<b>Total loan sales and principal repayments</b>	<b>(5,068,861)</b>	<b>(5,343,833)</b>	<b>(6,162,434)</b>
Increase (decrease) due to other items (3)	233,182	27,862	(225,955)
Net loans after allowance for loan losses at			

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Year Ended December 31,

end of year	\$	2,909,589	\$	3,017,031	\$	2,813,800
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- (1) Reflects amounts advanced and repaid under such lines of credit during the years presented.
- (2) Substantially all of these fixed-rate loans were acquired from mortgage brokers and sold to Fannie Mae, Freddie Mac or the FHLBank Topeka with servicing retained.
- (3) Other items consist of unamortized premiums, discounts and deferred loan fees, loans in process and changes in the allowance for loan losses.

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**Loan Servicing.** We sell substantially all fixed-rate, one-to-four family residential mortgage loans with servicing retained in order to develop additional sources of noninterest income. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, holding escrow funds for the payment of real estate taxes and insurance premiums, contacting delinquent borrowers and supervising foreclosures and property dispositions in the event of unremedied defaults. The gross servicing fee income from loans sold is generally 0.25% to 0.50% of the total balance of each loan serviced. At December 31, 2007 and 2006, we were servicing \$1.5 billion and \$1.3 billion, respectively, of loans for others, primarily consisting of one-to-four family residential loans sold by us in the secondary market.

**Loan Commitments.** We generally issue written commitments to individual borrowers and mortgage brokers for the purposes of originating and purchasing loans. These loan commitments establish the terms and conditions under which we will fund the loans. At December 31, 2007 and 2006, we had issued commitments totaling \$666.2 million and \$865.9 million, respectively, excluding loans in process, to fund and purchase loans, extend credit on commercial and consumer unused lines of credit and to extend credit under unused warehouse mortgage lines of credit. These outstanding loan commitments do not necessarily represent future cash requirements since many of the commitments may expire without being drawn.

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**Asset Quality**

Reports listing all delinquent loans (loans 30 or more days delinquent), classified assets and real estate owned are reviewed by management and our Board of Directors no less frequently than quarterly. The procedures we take with respect to delinquencies vary depending on the nature of the loan, period and cause of delinquency and whether the borrower is habitually delinquent. When a borrower fails to make a required payment on a loan, we take a number of steps to have the borrower cure the delinquency and restore the loan to current status. In the event payment is not then received or the loan not otherwise satisfied, letters and telephone calls generally are made. If the loan is still not brought current or satisfied and it becomes necessary for us to take legal action, which typically occurs after a loan is 90 days or more delinquent, we will commence recovery proceedings against the property securing the loan. If a legal action is instituted and the loan is not brought current, paid in full, or refinanced before the recovery sale, the property securing the loan generally is sold and, if purchased by us, becomes real estate owned or a repossessed asset.

During 2007, our levels of delinquent loans, nonperforming loans (loans 90 or more days delinquent) and impaired loans increased significantly. These increases were primarily attributable to the continued deterioration in the real estate market and the economy in general. We have been further impacted by the erosion of property values and an overall increase in housing inventory (both developed lots and completed houses) in many of the areas of the country in which we do business and where the collateral for our loans reside. Additionally, significantly tightened credit standards have made it more difficult for potential borrowers to obtain financing and for current borrowers to refinance existing loans.

In light of current market conditions, we have taken a number of steps related to the realignment of certain credit administration functions, including the addition of personnel with extensive depth and expertise in credit analysis, and we continue to tighten credit policies.

**Delinquent Loans.** The following table shows loans delinquent 30 - 89 days in our loan portfolio as of the dates indicated:

	At December 31,				
(Dollars in thousands)	2007	2006	2005	2004	2003
One-to-four family residential	\$ 5,798	\$ 1,532	\$ 2,081	\$ 8,203	\$ 1,844

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At December 31,

Second mortgage residential	1,499	2,085	1,844	1,426	1,051
Multi-family residential	2,019	--	--	--	--
Commercial real estate	5,268	728	269	643	68
Land and land development	15,997	144	2,373	--	74
Residential construction	8,263	17,524	8,287	1,529	2,501
Agriculture - real estate	4,723	164	586	120	--
Business	3,247	620	1,740	1,122	126
Agriculture - operating	93	47	180	566	--
Consumer	5,560	4,818	6,416	3,448	2,945
Total delinquent loans	\$ 52,467	\$ 27,662	\$ 23,776	\$ 17,057	\$ 8,609
Delinquent loans as a percentage of net loans before allowance for loan losses	1.76%	0.91%	0.84%	0.64%	0.42%

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**Nonperforming Loans and Real Estate Owned.** The following table sets forth information regarding nonperforming loans (90 or more days delinquent) and real estate owned. It is our policy to cease accruing interest on loans contractually delinquent 90 days or more and charge-off all accrued interest. We did not have any accruing loans 90 days or more past due at the dates shown.

At December 31,

<i>(Dollars in thousands)</i>	2007	2006	2005	2004	2003
<b>Nonperforming loans:</b>					
One-to-four family residential	\$ 7,029	\$ 1,611	\$ 1,902	\$ 1,914	\$ 1,461
Second mortgage residential	487	234	609	739	224
Multi-family residential	603	1,152	5,731	2,374	--
Commercial real estate	590	324	1,007	707	--
Land and land development	38,708	4,696	915	--	--
Residential construction	57,709	18,074	1,840	2,256	1,012
Commercial construction	19,184	--	--	--	--
Agriculture - real estate	159	50	113	349	--
Business	1,268	2,280	526	771	219
Agriculture - operating	134	139	308	1	--
Consumer	2,619	1,490	1,454	1,121	700
Total nonperforming loans	128,490	30,050	14,405	10,232	3,616
Real estate owned, net (1)	6,405	5,264	2,446	382	678
Total nonperforming assets	134,895	35,314	16,851	10,614	4,294
Troubled debt restructurings	19,569	8,904	5,180	3,469	468
Total nonperforming assets and troubled debt restructurings	\$ 154,464	\$ 44,218	\$ 22,031	\$ 14,083	\$ 4,762
Total nonperforming loans as a percentage of net loans	4.32%	0.99%	0.51%	0.39%	0.18%
Total nonperforming assets as a percentage of total assets	3.81%	1.03%	0.52%	0.35%	0.19%

Total nonperforming assets and troubled debt restructurings

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At December 31,

as a percentage of total assets	4.37%	1.29%	0.68%	0.46%	0.22%
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(1) Real estate owned balances are shown net of related loss allowances. Includes both real property and other repossessed collateral consisting primarily of automobiles.

**Nonperforming Loans.** As a result of economic conditions in the latter half of 2007, we have experienced deteriorating asset quality. At December 31, 2007, nonperforming loans totaled \$128.5 million, an increase of \$98.4 million, or 327.6%, compared to \$30.1 million at December 31, 2006. The increase in the nonperforming loans is primarily attributable to the following:

**Residential Construction Loans.** Due to the continued erosion of housing values and increased housing inventory in several markets throughout the country, especially Florida, we have, and may continue to experience, increased levels of nonperforming residential construction loans. At December 31, 2007 we had classified \$57.7 million of our total residential construction loans as nonperforming, of which \$31.8 million relate to loans collateralized by property in Florida. As previously disclosed in regulatory filings with the Securities and Exchange Commission, we reported that we have a group of residential construction loans we purchased from TransLand Financial Services Inc. ( TransLand ) which were primarily located in the Cape Coral area of southwest Florida. These loans were originally made to individual homebuyers wishing to build a second or retirement home. Subsequent to the filing of our June 30, 2007 Quarterly Report on Form 10-Q, we assumed servicing of all loans purchased from TransLand. During our due diligence process related to the transfer of residential construction loan servicing from TransLand to the Bank, alleged fraudulent servicing practices were discovered. The majority of the alleged fraud related to the withholding of loan payoff proceeds and periodic payments. A joint petition for involuntary Chapter 11 bankruptcy was filed on August 23, 2007 in the United States Bankruptcy Court for the Middle District of Florida ( Court ) by the Bank and two other financial institutions against TransLand. A court-appointed examiner furnished a detailed report documenting the alleged fraudulent activity. In December 2007, the Court entered an order approving the petitioning banks' plan to agree to dismiss the bankruptcy petition in return for the agreement by TransLand and certain of its principal creditors to proceed with the liquidation and proportional distribution of TransLand's remaining assets. The liquidation of TransLand's assets is currently in process.

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Despite these challenging economic conditions, we have reduced our total residential construction loan disbursements for TransLand-related homebuyers to \$58.5 million, prior to recording loan charge-offs, at December 31, 2007 compared to \$114.9 million at December 31, 2006. Approximately \$26.5 million of total nonperforming residential construction loans at December 31, 2007 had been purchased from TransLand. During the three months ended December 31, 2007, we charged off \$25.5 million of TransLand-related residential construction loans, due in large part to a decline in the estimated fair value of undeveloped residential lots, and set up additional provisions for loan losses relating to the loans acquired from TransLand.

The increase in nonperforming residential construction loans at December 31, 2007 was also attributable to an increase in nonperforming residential construction loans located in the Las Vegas, Nevada area. At December 31, 2007, we had three residential development construction loans totaling \$7.6 million in the Las Vegas, Nevada area which were classified as nonperforming.

**Land and Land Development.** Our nonperforming land development loans at December 31, 2007 totaled \$38.7 million which consisted of eight residential land development properties. Of the eight nonperforming residential land development properties, three were located in the Las Vegas, Nevada area which totaled \$30.4 million, one project in Colorado at \$5.7 million, two projects in the Minneapolis, Minnesota area totaling \$2.3 million and two projects in Florida totaling \$300,000. The three Las Vegas, Nevada area properties entered nonperforming status during the three months ended December 31, 2007. Currently, we are actively engaged in discussions with the developers or guarantors of these loans for purposes of bringing the loans current or developing workout solutions.

**Commercial Construction.** Nonperforming commercial construction loans totaled \$19.2 million at December 31, 2007. This balance represents two loans for the construction of upscale condominiums adjacent to a golf course located in a suburban area of Las Vegas, Nevada. We provided funding to construct 33 units, of which 23 units are under contract for purchase, within a planned 113-unit development. The units we have funded have been completed and the balance of the remaining units are in various stages of construction. Following the builder's voluntary bankruptcy filing, a trustee was appointed by the court and the trustee is identifying local builders and sales agents to complete the project and sell the remaining units.

Interest income that would have been recognized had nonperforming loans and troubled debt restructurings been current or in accordance with their original terms approximates \$10.8 million and \$1.8 million for the years ended December 31, 2007 and 2006, respectively.



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**Impaired Loans.** Included in the preceding table, within nonperforming loans and troubled debt restructurings, are impaired loans of \$125.9 million and \$3.8 million at December 31, 2007 and 2006, respectively. At December 31, 2007, impaired loans consisted primarily of \$51.9 million of residential construction loans, \$51.1 million of land and land development loans and \$19.2 million of commercial construction loans. At December 31, 2007 we had \$24.8 million of loans which were not classified as nonperforming but were classified as impaired due to a decline in the fair market value of the underlying collateral securing such loans.

The average balance of impaired and restructured loans for the years ended December 31, 2007 and 2006 totaled \$58.4 million and \$11.4 million, respectively. Interest recognized on impaired and restructured loans for the years ended December 31, 2007 and 2006 was \$675,000 and \$725,000, respectively. We had established an allowance for loan losses related to impaired loans of \$24.6 million and \$152,000 at December 31, 2007 and 2006, respectively.

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**Real Estate Owned and Repossessed Assets.** When we acquire real estate owned property or other assets through foreclosure, deed in lieu of foreclosure or repossession, it is initially recorded at the lower of the recorded investment in the corresponding loan or the fair value of the related assets at the date of foreclosure, less costs to sell. If there is a further deterioration in value, we provide for a specific valuation allowance and charge operations for the decline in value. We generally obtain an appraisal or broker's price opinion on all real estate subject to foreclosure proceedings prior to the time of foreclosure. It is our policy to require appraisals on a periodic basis on foreclosed properties as well as conduct inspections of such properties.

**Real Estate Owned and Repossessed Asset Activity.** The following table sets forth the activity of our real estate owned and repossessed assets for the periods indicated:

<i>(Dollars in thousands)</i>	<b>Year Ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Balance at beginning of year	\$ 5,264	\$ 2,446	\$ 382
Loan foreclosures and other additions	9,292	10,495	3,485
Sales	(7,290)	(7,172)	(1,433)
Provisions for losses	(636)	(370)	(73)
Gain (loss) on disposal	(225)	(135)	85
Balance at end of year	\$ 6,405	\$ 5,264	\$ 2,446

At December 31, 2007, real estate owned consisted primarily of 36 residential properties totaling \$3.6 million and three commercial properties totaling \$2.8 million.

**Classified Assets.** Federal regulations and our Asset Classification Policy require that we utilize an internal asset classification system as a means of reporting problem and potential problem assets. We have incorporated the OTS's internal asset classifications as a part of our credit monitoring system. All assets are subject to classification. Asset quality ratings are divided into three asset classifications: Pass (unclassified), special mention and classified (adverse classification). Additionally, there are three adverse classifications: substandard, doubtful and loss. A pass asset is considered to be of sufficient quality to preclude a special mention or an adverse rating. The 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 our credit position at a future date. Classified assets receive an adverse classification. An asset is considered substandard if it is inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. When we classify one or more assets, or portions thereof, as substandard, doubtful or loss, we establish a valuation allowance for loan losses in an amount deemed prudent by management based on the specific facts of the asset.

Our Asset Classification Committee reviews and classifies assets no less frequently than quarterly and our Board of Directors reviews the asset classification reports on a quarterly basis. The Asset Classification Committee is composed of the following officers of the Bank: Chief Executive Officer, Chief Operating Officer, Director of Lending, Chief Credit Officer, Director of Real Estate Lending, Chief Financial Officer, Controller, Director of Corporate Banking, Senior Financial Analysis Manager and External Reporting Manager.

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**Allowance for Loan Losses.** A provision for loan losses is charged to earnings when it is determined by management to be required based on our analysis. The allowance for loan losses is maintained at a level to cover all known and inherent losses in the loan portfolio that are both probable and reasonable to estimate at each reporting date. Management reviews the loan portfolio no less frequently than quarterly in order to identify those inherent losses and to assess the overall collection probability of the portfolio. Our review includes a quantitative analysis by loan category, using historical loss experience, classifying loans pursuant to a grading system and consideration of a series of qualitative loss factors. These loss factors are developed using our historical loan loss experience for each group of loans as further adjusted for specific factors, including the following:

- Trends and levels of delinquent, nonperforming or impaired loans;
- Trends and levels of charge-offs and recoveries;
- Underwriting terms or guarantees for loans;
- Impact of changes in underwriting standards, risk tolerances or other changes in lending practices;
- Changes in the value of collateral securing loans;
- Total loans outstanding and the volume of loan originations;
- Type, size, terms and geographic concentration of loans held;
- Changes in qualifications or experience of the lending staff;
- Changes in local or national economic or industry conditions;
- Number of loans requiring heightened management oversight;
- Changes in credit concentration; and
- Changes in regulatory requirements.

Management believes that, based on information currently available to us at this time, our allowance for loan losses is maintained at a level which covers all known and inherent losses that are both probable and reasonable to estimate at each reporting date. Actual losses are dependent upon future events and, as such, further changes to the level of allowances for loan losses may become necessary.

The allowance for loan losses consists of two elements. The first element is an allocated allowance established for specific loans identified by the credit review function that are evaluated individually for impairment and are considered to be impaired. A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Impairment is measured by: (a) the fair value of the collateral if the loan is collateral dependent; (b) the present value of expected future cash flows; or (c) the loan's observable market price. The second element is an estimated allowance established for losses which are probable and reasonable to estimate on each category of outstanding loans. While we utilize available information to recognize probable losses on loans inherent in the portfolio, future additions to the allowance may be necessary based on changes in economic conditions and other factors. In addition, various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to recognize additions to the allowance based on their judgment of information available to them at the time of their examination.

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**Allowance for Loan Losses.** The following table shows changes in our allowance for loan losses during the years presented:

<i>(Dollars in thousands)</i>	At or For the Year Ended December 31,				
	2007	2006	2005	2004	2003
Allowance for loan losses at beginning of year	\$ 33,129	\$ 30,870	\$ 26,831	\$ 19,586	\$ 17,108
Allowance for loan losses acquired	--	--	--	4,221	--
<b>Charge-offs:</b>					
One-to-four family residential	(302)	(6)	(11)	(16)	(6)
Second mortgage residential	(328)	(389)	(402)	(520)	(107)
Multi-family residential	(40)	--	(729)	--	--
Commercial real estate	(1,766)	(14)	(7)	--	(330)
Land and land development	(2)	(532)	--	--	--
Residential construction	(26,385)	(368)	(114)	(138)	(13)
Business	(1,964)	(1,021)	(608)	(57)	(5)

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At or For the Year Ended December 31,

Agriculture - operating	--	(227)	--	(64)	--
Warehouse mortgage lines of credit	--	--	--	(20)	(110)
Consumer	(2,250)	(1,550)	(1,192)	(1,421)	(1,368)
<b>Total charge-offs</b>	<b>(33,037)</b>	<b>(4,107)</b>	<b>(3,063)</b>	<b>(2,236)</b>	<b>(1,939)</b>
Recoveries on loans previously charged-off	1,066	313	666	373	146
Provision for loan losses	65,382	6,053	6,436	4,887	4,271
<b>Allowance for loan losses at end of year</b>	<b>\$ 66,540</b>	<b>\$ 33,129</b>	<b>\$ 30,870</b>	<b>\$ 26,831</b>	<b>\$ 19,586</b>
Allowance for loan losses as a percentage of net loans	2.24%	1.09%	1.09%	1.01%	0.96%
Allowance for loan losses as a percentage of nonperforming loans	51.79%	110.25%	214.30%	262.23%	541.65%
Ratio of net charge-offs during the year as a percentage of average loans outstanding during the year	1.07%	0.13%	0.09%	0.08%	0.10%

We generally discontinue funding of loans which become nonperforming or are deemed impaired unless additional funding is required to protect the asset. In addition, due to certain laws and regulations in selected states, some additional funding may be required. Our reserve for unfunded loan commitments at December 31, 2007 totaled \$2.7 million which represents potential future losses associated with these unfunded commitments.

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**Allowance for Loan Losses by Loan Type.** The following table shows how our allowance for loan losses is allocated by type of loan at each of the dates indicated:

	At December 31,					
	2007		2006		2005	
(Dollars in thousands)	Amount of Allowance	Loan Category as a % of Total Loans	Amount of Allowance	Loan Category as a % of Total Loans	Amount of Allowance	Loan Category as a % of Total Loans
One-to-four family residential	\$ 6,234	9.41%	\$ 339	9.21%	\$ 740	10.96%
Second mortgage residential	716	2.86	904	3.27	1,502	4.57
Multi-family residential	1,480	3.19	1,874	4.05	2,659	4.75
Commercial real estate	4,599	11.10	4,708	10.77	5,376	11.47
Land and land development	11,963	14.16	4,387	13.44	3,363	8.27
Residential construction	20,619	15.36	7,019	21.21	4,455	26.89
Commercial construction	7,893	16.18	3,123	13.36	2,681	10.03
Agriculture - real estate	953	2.72	702	1.86	687	1.62
Business	3,717	7.56	3,353	5.99	2,531	5.06
Agriculture - operating	1,257	3.00	1,185	2.56	941	2.07
Warehouse mortgage lines of credit	172	2.58	225	3.06	190	2.71
Consumer	6,937	11.88	5,310	11.22	5,715	11.60
Unallocated	--	--	--	--	30	--
<b>Total</b>	<b>\$ 66,540</b>	<b>100.00%</b>	<b>\$ 33,129</b>	<b>100.00%</b>	<b>\$ 30,870</b>	<b>100.00%</b>

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At December 31,

	2004		2003	
	Amount of Allowance	Loan Category as a % of Total Loans	Amount of Allowance	Loan Category as a % of Total Loans
<i>(Dollars in thousands)</i>				
One-to-four family residential	\$ 805	13.54%	\$ 1,069	25.20%
Second mortgage residential	2,369	8.26	2,343	11.63
Multi-family residential	2,468	4.61	2,002	4.47
Commercial real estate	6,041	14.38	4,579	15.92
Land and land development	1,282	4.95	903	4.33
Residential construction	3,140	19.46	1,570	11.08
Commercial construction	2,000	9.14	1,011	6.95
Agriculture - real estate	873	2.16	--	--
Business	1,796	4.62	788	2.91
Agriculture - operating	990	2.31	--	--
Warehouse mortgage lines of credit	266	4.30	207	3.55
Consumer	4,795	12.27	5,003	13.96
Unallocated	6	--	111	--
Total	\$ 26,831	100.00%	\$ 19,586	100.00%

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### Investment Activities

Federally chartered savings institutions have the authority to invest in various types of liquid assets, including United States Treasury obligations, securities of various federal agencies, time deposits of insured banks and savings institutions, bankers' acceptances, repurchase agreements and federal funds. Subject to various restrictions, federally chartered savings institutions may also invest in commercial paper, investment-grade corporate debt securities and mutual funds whose assets conform to the investments that a federally chartered savings institution is otherwise authorized to make directly. Historically, we have maintained liquid assets at a level considered to be adequate to meet our normal daily activities.

Our investment policy, as approved by our Board of Directors, requires management to maintain adequate liquidity and to generate a favorable return on investment without incurring undue interest rate and credit risk. We primarily utilize investments to collateralize deposits. Additionally, we may use investment securities for liquidity management, as a method of deploying excess funding not utilized for loan originations and purchases. We have invested in U.S. Government securities and agency obligations, corporate securities, municipal obligations, agency equity securities, mutual funds, U.S. Government sponsored agency issued mortgage-backed securities and collateralized mortgage obligations. As required by SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, we have established an investment portfolio of securities that are categorized as held to maturity or available for sale. We do not currently maintain a portfolio of securities categorized as trading. Substantially all of our investment securities are purchased for the available for sale portfolio which totaled \$130.5 million, or 3.7% of total assets, at December 31, 2007. At such date, we had net unrealized losses with respect to such securities of \$161,000. Losses due to other-than-temporary impairment were \$188,000 for the year ended December 31, 2007. At December 31, 2007, the held to maturity securities portfolio totaled \$70,000.

At December 31, 2007, our mortgage-backed security portfolio (which was classified as available for sale) totaled \$6.7 million, or 0.2% of total assets. At such date, we had net unrealized losses with respect to our mortgage-backed securities of \$66,000. Investments in mortgage-backed securities involve a risk that actual prepayments will be greater than estimated prepayments over the life of the security, which may require adjustments to the amortization of any premium or accretion of any discount relating to such instruments thereby changing the net yield on such securities. There is also reinvestment risk associated with the cash flows from such securities or in the event the issuer redeems such securities. In addition, the fair value of such securities may be adversely affected by changes in interest rates.

The Government National Mortgage Association ( GNMA ) is a government agency within the Department of Housing and Urban Development which is intended to help finance government-assisted housing programs. GNMA securities are backed by loans insured by the

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Federal Housing Administration or guaranteed by the Veterans Administration. The timely payment of principal and interest on GNMA securities is guaranteed by GNMA and backed by the full faith and credit of the U.S. Government. FHLMC is a private corporation chartered by the U.S. Government. FHLMC issues participation certificates backed principally by conventional mortgage loans. FHLMC guarantees the timely payment of interest and the ultimate return of principal on participation certificates. FNMA is a private corporation chartered by the U.S. Congress with a mandate to establish a secondary market for mortgage loans. FNMA guarantees the timely payment of principal and interest on FNMA securities. FHLMC and FNMA securities are not backed by the full faith and credit of the U.S. Government, but because FHLMC and FNMA are U.S. Government-sponsored enterprises, these securities are considered to be among the highest quality investments with minimal credit risks.

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**Investment Securities Portfolio Composition.** The following table sets forth certain information relating to our available for sale investment securities portfolio at the dates indicated:

	At December 31,					
	2007		2006		2005	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<i>(Dollars in thousands)</i>						
U.S. Government securities and agency obligations	\$ 105,428	\$ 105,413	\$ 78,201	\$ 77,569	\$ 68,949	\$ 67,761
Corporate securities	4,935	4,920	5,245	5,130	10,249	10,264
Municipal obligations	13,931	13,914	15,970	15,928	18,301	18,220
Agency equity securities	536	422	547	537	546	521
Asset Management Fund - ARM Fund	5,812	5,812	6,000	5,836	6,000	5,848
Total investment securities	130,642	130,481	105,963	105,000	104,045	102,614
FHLBank Topeka stock	65,837	65,837	62,022	62,022	58,491	58,491
Total investment securities and FHLBank Topeka stock	\$ 196,479	\$ 196,318	\$ 167,985	\$ 167,022	\$ 162,536	\$ 161,105

**Investment Security Maturity and Yield.** The following table sets forth the fair value of available for sale investment securities which mature during each of the years indicated and the weighted average yields for each range of maturities at December 31, 2007. No tax-exempt yields have been adjusted to a tax-equivalent basis.

	Maturing During the Year Ending December 31,				
	2008	2009 - 2012	2013 - 2017	After 2017	Total
<i>(Dollars in thousands)</i>					
<b>Bonds and other debt securities:</b>					
U.S. Government securities and agency obligations					
Balance	\$ 101,692	\$ 3,721	\$ --	\$ --	\$ 105,413
Weighted average yield	3.84%	4.11%	--	--	3.85%
Corporate securities					
Balance	\$ 1,350	\$ 3,570	\$ --	\$ --	\$ 4,920
Weighted average yield	3.71%	6.48%	--	--	5.72%
Municipal obligations					
Balance	\$ 935	\$ 6,070	\$ 6,589	\$ 320	\$ 13,914
Weighted average yield	4.03%	4.33%	4.52%	4.74%	4.41%
<b>Equity Securities:</b>					
Asset Management Fund - ARM Fund					
Balance	\$ 5,812	\$ --	\$ --	\$ --	\$ 5,812
Weighted average yield	5.29%	--	--	--	5.29%
Agency equity securities					
Balance	\$ 10	\$ --	\$ --	\$ 412	\$ 422

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Maturing During the Year Ending December 31,

Weighted average yield	1.93%	--	--	7.49%	7.36%
FHLBank Topeka stock					
Balance	\$ 65,837	\$ --	\$ --	\$ --	\$ 65,837
Weighted average yield	5.49%	--	--	--	5.49%
Total fair value	\$ 175,636	\$ 13,361	\$ 6,589	\$ 732	\$ 196,318
Weighted average yield	4.51%	4.84%	4.52%	6.29%	4.54%

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**Mortgage-Backed Securities Portfolio Composition.** The following table sets forth the composition of our mortgage-backed securities portfolio at the dates indicated:

At December 31,

	2007		2006		2005	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<i>(Dollars in thousands)</i>						
<b>Fixed-rate:</b>						
FHLMC	\$ 820	\$ 802	\$ 1,146	\$ 1,100	\$ 1,548	\$ 1,490
FNMA	654	637	1,110	1,068	1,810	1,768
GNMA	458	445	654	604	902	835
FHLMC/FNMA CMOs	2,406	2,374	5,936	5,833	9,910	9,691
Total fixed-rate	4,338	4,258	8,846	8,605	14,170	13,784
<b>Adjustable-rate:</b>						
GNMA	1,299	1,325	1,932	1,966	2,901	2,914
FNMA	988	979	1,535	1,541	2,828	2,870
FHLMC	130	127	163	160	188	184
Total adjustable-rate	2,417	2,431	3,630	3,667	5,917	5,968
Total mortgage-backed securities	\$ 6,755	\$ 6,689	\$ 12,476	\$ 12,272	\$ 20,087	\$ 19,752

**Mortgage-Backed Security Maturity and Yield.** Information regarding the contractual maturities and weighted average yield of our mortgage-backed securities portfolio at December 31, 2007 is presented below. Due to repayments of the underlying loans, the actual maturities of mortgage-backed securities generally are less than the scheduled maturities.

Maturing During the Year Ending December 31,

	2008	2009 - 2012	After 2012	Total
<i>(Dollars in thousands)</i>				
<b>Fixed-rate:</b>				
FHLMC				
Balance	\$ 380	\$ 386	\$ 36	\$ 802
Weighted average yield	4.17%	4.08%	7.82%	4.29%
FNMA				
Balance	\$ 112	\$ 244	\$ 281	\$ 637
Weighted average yield	5.99%	3.36%	6.44%	5.18%
GNMA				

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Maturing During the Year Ending December 31,

Balance	\$	--	\$	1	\$	444	\$	445
Weighted average yield		--		10.00%		6.04%		6.05%
FHLMC/FNMA CMOs								
Balance	\$	--	\$	397	\$	1,977	\$	2,374
Weighted average yield		--		5.39%		3.85%		4.11%
<b>Adjustable-rate:</b>								
FHLMC								
Balance	\$	--	\$	--	\$	127	\$	127
Weighted average yield		--		--		6.89%		6.89%
FNMA								
Balance	\$	--	\$	--	\$	979	\$	979
Weighted average yield		--		--		7.17%		7.17%
GNMA								
Balance	\$	--	\$	--	\$	1,325	\$	1,325
Weighted average yield		--		--		5.96%		5.96%
<hr/>								
Total fair value	\$	492	\$	1,028	\$	5,169	\$	6,689
<hr/>								
Weighted average yield		4.58%		4.42%		5.45%		5.23%
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**Unrealized Losses.** At December 31, 2007 and 2006, all unrealized losses related to investment and mortgage-backed securities are considered temporary in nature. Investment and mortgage-backed securities with unrealized losses at December 31, 2007 and 2006, are summarized in the following tables:

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<i>(Dollars in thousands)</i>						
<b>At December 31, 2007:</b>						
U.S. Government securities and agency obligations	\$ 19,994	\$ 3	\$ 11,999	\$ 30	\$ 31,993	\$ 33
Corporate securities	3,570	3	1,350	12	4,920	15
Municipal obligations	1,424	21	1,570	14	2,994	35
Agency equity securities	5	1	412	113	417	114
Mortgage-backed securities	1,871	17	3,062	81	4,933	98
<hr/>						
Total temporarily impaired securities	\$ 26,864	\$ 45	\$ 18,393	\$ 250	\$ 45,257	\$ 295
<hr/>						
<b>At December 31, 2006:</b>						
U.S. Government securities and agency obligations	\$ 3,602	\$ 73	\$ 39,063	\$ 563	\$ 42,665	\$ 636
Corporate securities	4,002	91	1,128	24	5,130	115
Municipal obligations	933	3	6,893	58	7,826	61
Agency equity securities	6	--	525	10	531	10
Asset Management Fund - ARM Fund	--	--	5,836	164	5,836	164
Mortgage-backed securities	591	9	8,224	246	8,815	255
<hr/>						
Total temporarily impaired securities	\$ 9,134	\$ 176	\$ 61,669	\$ 1,065	\$ 70,803	\$ 1,241
<hr/>						

We believe all unrealized losses at December 31, 2007 and 2006 to be market related, with no permanent sector or issuer credit concerns or impairments. The unrealized losses are believed to be temporarily impaired in value. Impairment is deemed temporary if the positive evidence indicating that an investment's carrying amount is recoverable within a reasonable time period outweighs negative evidence to the contrary. At

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December 31, 2007, we had the ability and intent to hold these securities until maturity.

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### Sources of Funds

**General.** Our primary sources of funds are deposits; amortization of loans, loan prepayments and maturity of loans; repayment, maturity or sale of investment and mortgage-backed securities; and other funds provided from operations. While scheduled payments from the amortization of loans and mortgage-backed securities and maturing investment securities are relatively predictable sources of funds, deposit flows and loan prepayments can be greatly influenced by general interest rates, economic conditions and competition. We utilize FHLBank advances and other borrowings and brokered time deposits as additional funding sources.

**Deposits.** As a regional community bank, we offer a variety of products designed to attract deposits from the general public, local businesses and governmental entities. Our product offerings consist of checking (both interest- and noninterest-bearing), money market, savings, time deposits and individual retirement accounts. We also may use brokered time deposits as an alternative source of funds. During 2007, deposits generated through our retail banking facilities increased \$378.2 million or 18.4%. At December 31, 2005 we had brokered time deposits of \$78.0 million. We did not have any brokered time deposits at December 31, 2007 and 2006.

**Deposit Composition.** The following table shows the distribution of, and certain other information relating to, our deposits by type of deposit, as of the dates indicated:

(Dollars in thousands)	At December 31,					
	2007		2006		2005	
	Amount	%	Amount	%	Amount	%
<b>Time deposits:</b>						
0.00% - 0.99%	\$ 20	--%	\$ --	--%	\$ 161	0.01%
1.00% - 1.99%	101	--	542	0.03	53,915	2.65
2.00% - 2.99%	3,879	0.16	27,594	1.34	134,712	6.60
3.00% - 3.99%	129,910	5.34	151,499	7.38	702,599	34.47
4.00% - 4.99%	398,325	16.39	348,777	16.99	208,277	10.22
5.00% - 5.99%	866,878	35.67	592,013	28.85	6,375	0.31
6.00% - 6.99%	--	--	128	0.01	53	0.00
<hr/>						
Total time deposits (1)	1,399,113	57.56	1,120,553	54.60	1,106,092	54.26
<hr/>						
<b>Transaction accounts:</b>						
Noninterest-bearing checking	164,275	6.76	154,123	7.51	138,578	6.80
Savings	188,613	7.76	45,452	2.21	57,037	2.80
Interest-bearing checking	328,267	13.51	349,033	17.01	398,094	19.53
Money market	350,276	14.41	383,182	18.67	338,518	16.61
<hr/>						
Total transaction accounts	1,031,431	42.44	931,790	45.40	932,227	45.74
<hr/>						
Total deposits	\$ 2,430,544	100.00%	\$ 2,052,343	100.00%	\$ 2,038,319	100.00%

(1) Includes \$78.0 million of brokered time deposits at December 31, 2005. We did not have any brokered time deposits at December 31, 2007 or 2006.

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**Deposit Average Balances and Average Rates Paid.** The following table shows the average balance of each type of deposit and the average rate paid on each type of deposit for the years indicated:



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Year Ended December 31,

	2007		2006		2005	
	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid
<i>(Dollars in thousands)</i>						
Interest-bearing checking	\$ 326,545	1.13%	\$ 361,056	1.15%	\$ 386,968	0.79%
Savings	90,036	2.70	51,643	0.51	68,909	0.59
Money market	385,210	3.04	393,807	2.82	313,802	1.62
Time deposits	1,287,195	4.98	1,085,350	4.12	1,059,876	3.15
Total interest-bearing deposits	2,088,986	3.92	1,891,856	3.18	1,829,555	2.29
Noninterest-bearing checking	135,617	--	119,394	--	112,902	--
Total deposits	\$ 2,224,603	3.69%	\$ 2,011,250	2.99%	\$ 1,942,457	2.16%

**Deposit Account Activity.** The following table shows our deposit flows during the years indicated:

	Year Ended December 31,		
	2007	2006	2005
<i>(Dollars in thousands)</i>			
Total deposits	\$ 14,161,490	\$ 11,860,601	\$ 11,605,730
Total withdrawals	(13,859,852)	(11,903,159)	(11,468,940)
Interest credited	76,563	56,582	36,768
Total increase in deposits	378,201	14,024	173,558
Deposits acquired in Marine Bank transaction	--	(8,106)	--
Deposits transferred due to Kansas branch sale transaction	--	21,740	--
Net increase in deposits	\$ 378,201	\$ 27,658	\$ 173,558

**Time Deposit Maturity.** The following table presents, by various interest rate categories and maturities, the amount of time deposits at December 31, 2007:

	Balance at December 31, 2007				
	Maturing in the 12 Months Ending December 31,				
	2008	2009	2010	Thereafter	Total
<i>(Dollars in thousands)</i>					
<b>Time deposits:</b>					
0.00% - 0.99%	\$ 20	\$ --	\$ --	\$ --	\$ 20
1.00% - 1.99%	8	--	--	93	101
2.00% - 2.99%	3,580	287	12	--	3,879
3.00% - 3.99%	107,004	20,639	1,843	424	129,910
4.00% - 4.99%	351,582	30,429	5,726	10,588	398,325
5.00% - 5.99%	852,999	11,451	1,333	1,095	866,878
Total time deposits	\$ 1,315,193	\$ 62,806	\$ 8,914	\$ 12,200	\$ 1,399,113

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**Time Deposits Exceeding \$100,000.** The following table shows the maturities of our time deposits exceeding \$100,000 at December 31, 2007 by the time remaining to maturity. There are no brokered time deposits included in the following table as we did not have any brokered time deposits at December 31, 2007.

<i>(Dollars in thousands)</i>	Amount	Weighted Average Rate
<b>Quarter ending:</b>		
March 31, 2008	\$ 96,410	5.17%
June 30, 2008	105,466	5.21
September 30, 2008	73,140	5.12
December 31, 2008	43,678	4.80
After December 31, 2008	18,622	4.85
<hr/>		
Total time deposits exceeding \$100,000	\$ 337,316	5.10%

**Borrowings.** We utilize advances from the FHLBank as an alternative to retail deposits to fund our operations as part of our operating strategy. The FHLBank is part of a system of 12 regional Federal Home Loan Banks, each subject to Federal Housing Finance Board supervision and regulation, that function as a central reserve bank providing credit to financial institutions. As a condition of membership in the FHLBank we are required to own stock of the FHLBank. Our FHLBank advances are collateralized by our qualifying residential, multi-family residential and commercial real estate mortgages, residential construction, commercial construction and agricultural real estate loans, and secondarily by our investment in capital stock of the FHLBank. FHLBank advances are made pursuant to several different credit programs, each of which has its own interest rate and range of maturities. The maximum amount that the FHLBank will advance to member institutions, including us, fluctuates from time to time in accordance with the policies of the FHLBank. At December 31, 2007 and 2006, we had \$634.2 million and \$907.2 million, respectively, in outstanding FHLBank advances.

On April 26, 2004, we formed TierOne Capital Trust I ( TierOne Capital Trust ), which issued capital securities ( Trust Preferred Securities ) to investors. The proceeds from the sale of the Trust Preferred Securities were used to purchase \$30.9 million of our junior subordinated debentures ( debentures ). The debentures are callable at par in June 2009 and mature in June 2034. Our obligation under the debentures constitutes a full and unconditional guarantee of TierOne Capital Trust s obligations under the Trust Preferred Securities. In accordance with Interpretation No. 46 (Revised), *Consolidation of Variable Interest Entities* ( FIN 46R ), the trust is not consolidated and related amounts are treated as debt of the Company.

In connection with our acquisition of UNFC on August 27, 2004, we assumed \$7.0 million of variable rate debentures that had been issued on November 28, 2001 by United Nebraska Capital Trust, a trust formed by UNFC. We exercised our right to call and retire these debentures in December 2006.

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**FHLBank Advances and Other Borrowings.** The following table shows certain information regarding our borrowings at or for the dates indicated:

<i>(Dollars in thousands)</i>	At or For the Year Ended December 31,		
	2007	2006	2005
<b>FHLBank Topeka advances:</b>			
Average balance outstanding during the year	\$ 745,337	\$ 824,101	\$ 766,265
Maximum amount outstanding at any month-end during the year	\$ 844,268	\$ 907,920	\$ 890,354
Balance outstanding at end of the year	\$ 634,195	\$ 907,164	\$ 747,125
Average interest rate during the year	4.27%	4.07%	3.55%
Weighted average interest rate at end of the year	4.39%	4.29%	3.60%
<hr/>			
<b>Other borrowings:</b>			
Average balance outstanding during the year	\$ 67,011	\$ 69,400	\$ 68,330
Maximum amount outstanding at any month-end during the year	\$ 82,990	\$ 84,403	\$ 74,511

At or For the Year Ended December 31,

Balance outstanding at end of the year	\$	55,093	\$	55,212	\$	67,799
Average interest rate during the year		6.13%		6.17%		4.74%
Weighted average interest rate at end of the year		5.76%		6.12%		5.60%

For more information regarding our borrowings, see Note 13 FHLBank Topeka Advances and Other Borrowings included in Item 8. Financial Statements and Supplementary Data in Part II of this Annual Report on Form 10-K.

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## Subsidiary Activities

TierOne Bank is the wholly owned subsidiary of TierOne Corporation. TMS Corporation of the Americas is the wholly owned subsidiary of TierOne Bank and holds all of the stock of TierOne Investments and Insurance, Inc. (d/b/a TierOne Financial) and TierOne Reinsurance Company. TierOne Financial provides a wide selection of investment and insurance products, equity securities, mutual funds and annuities. These products are made available to consumers via licensed representatives in our banking offices. TierOne Reinsurance Company reinsures credit life and disability insurance which is sold in conjunction with the origination of consumer loans by TierOne Bank. United Farm & Ranch Management, Inc. is a wholly owned subsidiary of TierOne Bank that provides agricultural customers with professional farm and ranch management and real estate brokerage services.

## Personnel

As of December 31, 2007, 2006 and 2005, we had 862, 850 and 772 full-time equivalent employees, respectively. Employees are not represented by a collective bargaining unit and we consider our relationship with our employees to be good.

## Regulation and Supervision

*The following is not intended to be a complete discussion but is intended to be a summary of some of the more significant provisions of laws and regulations which are applicable to the Company and the Bank. This regulatory framework is intended to protect depositors, federal deposit insurance funds and the banking system as a whole, and not to protect security holders. To the extent that the information describes statutory and regulatory provisions, it is qualified in its entirety by reference to those provisions. Additionally, such statutes, regulations and policies are continually under review by Congress and state legislatures, and federal and state regulatory agencies. A change in statutes, regulations or regulatory policies applicable to the Company or the Bank, including changes in interpretations, could have a material effect on our business.*

**General.** The Bank, as a federally chartered stock savings bank, is subject to OTS regulations, examinations and reporting requirements. The Bank is also subject to regulation and examination by the Federal Deposit Insurance Corporation ( FDIC ), which insures the deposits of the Bank to the maximum extent permitted by law and requirements established by the Board of Governors of the Federal Reserve System. The investment and lending authority of savings institutions is prescribed by federal laws and regulations and such institutions are prohibited from engaging in any activities not permitted by such laws and regulations. Such regulation and supervision primarily is intended for the protection of depositors and not for the purpose of protecting stockholders.

The OTS regularly examines the Bank and prepares reports for consideration by our Board of Directors on any deficiencies that it may find in the Bank's operations. The FDIC also has the authority to examine the Bank in its role as the administrator of the Deposit Insurance Fund. The Bank's relationship with its depositors and borrowers is also regulated to a great extent by both federal, and to a lesser extent, state laws, especially in such matters as the ownership of deposit accounts and the form and content of the Bank's mortgage requirements. The OTS enforcement authority over all savings institutions and their holding companies includes, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to initiate injunctive actions. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with the OTS. Any change in such laws or regulations, whether by the FDIC, the OTS or the Congress, could have a material adverse impact on our operations.

**Insurance of Deposit Accounts.** Deposit accounts are insured by the FDIC generally up to a maximum of \$100,000 per account and up to a maximum of \$250,000 for self-directed retirement accounts. Our deposits, therefore, are subject to FDIC deposit insurance assessments.

On November 2, 2006, the FDIC adopted final regulations that assess insurance premiums based on risk. As a result, the new regulations will enable the FDIC to more closely tie each financial institution's deposit insurance premiums to the risk it poses to the Deposit Insurance Fund. Under the new risk-based assessment system, the FDIC will evaluate the risk of each financial institution based on its supervisory rating, financial ratios and its long-term debt issuer rating. The new rates for most financial institutions vary between five and seven cents for every

\$100 of domestic deposits.

We were not required to pay any deposit insurance assessments for the year ended December 31, 2007. Under the Federal Deposit Insurance Reform Act of 2005, which became law in 2006, we received a one-time assessment credit of \$1.9 million that could be applied against future premiums, subject to certain limitations. This credit was utilized during the year ended December 31, 2007 to offset \$1.5 million of deposit insurance assessments. We estimate that we will exhaust our remaining credit during the first quarter of 2008.

All FDIC-insured depository institutions must pay an annual assessment to provide funds for the payment of interest on bonds issued by the Financing Corporation ( FICO ), a federal corporation chartered under the authority of the Federal Housing Finance Board. The bonds (referred to as FICO bonds) were issued to capitalize the Federal Savings and Loan Insurance Corporation. The FICO has assessment authority, separate from the FDIC's authority to assess risk-based premiums for deposit insurance, to collect funds from FDIC-insured institutions sufficient to pay interest on FICO bonds. The FDIC acts as a collection agent for the FICO. The FICO assessment rate effective for the first quarter of 2008 is 1.14 cents annually per \$100 of assessable deposits. These assessments will continue until the FICO bonds mature in 2019.

**Regulatory Capital Requirements.** Pursuant to the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ( FIRREA ), the OTS adopted regulations implementing new capital standards applicable to all savings associations, including the Bank. Such capital standards require that savings associations maintain: (a) capital of not less than 1.5% of adjusted total assets (Tangible Capital); (b) core (Tier 1) capital of not less than 4% of adjusted total assets; and (c) total risk-based capital of not less than 8% of risk-weighted assets. As of December 31, 2007, the Bank met all regulatory capital requirements. The OTS is authorized to impose capital requirements in excess of those standards on individual institutions on a case-by-case basis.

Under the tangible capital requirement, a savings bank must maintain tangible capital in an amount equal to at least 1.5% of adjusted total assets. Tangible capital is defined as core capital less all intangible assets and goodwill, plus a specified amount of purchased mortgage servicing rights.

Under the Core (Tier 1) capital requirement adopted by the OTS, savings banks must maintain core capital in an amount equal to at least 4.0% of adjusted total assets. Core (Tier 1) capital consists of: common stockholders' equity (including retained earnings), non-cumulative perpetual preferred stock, certain non-withdrawable and pledged deposits; and minority interests in the equity accounts of consolidated subsidiaries plus purchased mortgage servicing rights valued at the lower of 90% of fair value, 90% of original cost or the current amortized book value as determined in conformity with U.S. generally accepted accounting principles ( GAAP ) and goodwill, less non-qualifying intangible assets.

Under the risk-based capital requirement, a savings bank must maintain total capital (which is defined as core capital plus supplementary capital) equal to at least 8.0% of risk-weighted assets. A savings bank must calculate its risk-weighted assets by multiplying each asset and off-balance sheet item by various risk factors, which range from 0% for cash and securities issued by the United States Government or its agencies to 100% for repossessed assets or loans more than 90 days past due. Supplementary capital may include, among other items, cumulative perpetual preferred stock, perpetual subordinated debt, mandatory convertible subordinated debt, intermediate-term preferred stock and general allowances for loan losses. The allowance for loan losses includable in supplementary capital is limited to 1.25% of risk-weighted assets. The amount of supplementary capital that can be included is limited to 100% of core capital.

Certain exclusions from capital and assets are required to be made for the purpose of calculating total capital, in addition to the adjustments required for calculating core capital. However, in calculating regulatory capital, institutions can add back unrealized losses and deduct unrealized gains net of taxes, on debt securities reported as a separate component of capital calculated according to GAAP.

OTS regulations establish special capitalization requirements for savings banks that own service corporations and other subsidiaries, including subsidiary savings banks. According to these regulations, certain subsidiaries are consolidated for capital purposes and others are excluded from assets and capital. In determining compliance with the capital requirements, all subsidiaries engaged solely in activities permissible for national banks, engaged solely in mortgage-banking activities or engaged in certain other activities solely as agent for its customers are includable subsidiaries that are consolidated for capital purposes in proportion to the Bank's level of ownership, including the assets of includable subsidiaries in which the Bank has a minority interest that is not consolidated for GAAP purposes. For excludable subsidiaries, the debt and equity investments in such subsidiaries are deducted from assets and capital. At December 31, 2007, the Bank had \$1.2 million of investments subject to a deduction from tangible capital.

Under current OTS policy, savings institutions must value securities available for sale at amortized cost for regulatory capital purposes. This means that in computing regulatory capital, savings institutions should add back any unrealized losses and deduct any unrealized gains, net

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of income taxes, on securities reported as a separate component of capital calculated according to GAAP.

The OTS and the FDIC generally are authorized to take enforcement action against a savings bank that fails to meet its capital requirements, which action may include restrictions on operations and banking activities, the imposition of a capital directive, a cease-and-desist order, civil money penalties or harsher measures such as the appointment of a receiver or conservator or a forced merger into another institution. In addition, under current regulatory policy, a savings bank that fails to meet its capital requirements is prohibited from paying any dividends.

At December 31, 2007, the Bank exceeded all of its regulatory capital requirements. For more information see *Note 19 Regulatory Capital Requirements* included in Item 8. Financial Statements and Supplementary Data, in Part II of this Annual Report on Form 10-K.

**Prompt Corrective Action.** Under the prompt corrective action regulations, the OTS is required and authorized to take supervisory actions against undercapitalized savings associations. For this purpose, a savings institution is placed in one of the following five categories based on the savings institutions capital:

well-capitalized (at least 5% leverage capital, 6% Tier 1 risk-based capital and 10% total risk-based capital);  
adequately capitalized (at least 4% leverage capital, 4% Tier 1 risk-based capital and 8% total risk-based capital);  
undercapitalized (less than 3% leverage capital, 4% Tier 1 risk-based capital or 8% total risk-based capital);  
significantly undercapitalized (less than 3% leverage capital, 3% Tier 1 risk-based capital or 6% total risk-based capital); and  
critically undercapitalized (less than 2% tangible capital)

Generally, the banking regulator is required to appoint a receiver or conservator for a savings association that is critically undercapitalized within specific time frames. The regulations also provide that a capital restoration plan must be filed with the OTS within 45 days of the date a savings institution receives notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. Any holding company for a savings institution required to submit a capital restoration plan must guarantee the lesser of an amount equal to 5% of the savings institution's assets at the time it was notified or deemed to be undercapitalized by the OTS, or the amount necessary to restore the savings institution to adequately capitalized status. This guarantee remains in place until the OTS notifies the savings institution that it has maintained adequately capitalized status for each of four consecutive calendar quarters, and the OTS has the authority to require payment and collect payment under the guarantee. Failure by a holding company to provide the required guarantee will result in certain operating restrictions on the savings institution, such as restrictions on the ability to declare and pay dividends, pay executive compensation and management fees and increase assets or expand operations. The OTS may also take any number of discretionary supervisory actions against undercapitalized institutions, including the issuance of a capital directive and the replacement of senior executive officers and directors.

At December 31, 2007, the Bank met the criteria for being considered a well capitalized institution.

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**Safety and Soundness Guidelines.** Federal law requires each federal banking agency to prescribe certain standards for all insured depository institutions. These standards relate to, among other things, internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, compensation and other operational and managerial standards as the agency deems appropriate. The federal banking agencies adopted Interagency Guidelines Prescribing Standards for Safety and Soundness to implement the safety and soundness standards required under federal law. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to submit a compliance plan. The Bank believes that it is in compliance with these guidelines and standards.

**Capital Distributions.** OTS regulations govern capital distributions by savings institutions, which include cash dividends, stock repurchases and other transactions charged to the capital account of a savings institution. A savings institution must file an application for OTS approval of the capital distribution if any of the following occur or would occur as a result of the capital distribution:

the total capital distributions for the applicable calendar year exceed the sum of the institution's net income for that year to date plus the institution's retained net income for the preceding two years;  
the institution would not be at least adequately capitalized following the distribution;  
the distribution would violate any applicable statute, regulation, agreement or OTS-imposed condition; or  
the institution is not eligible for expedited treatment of its filings.

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Even if an application is not otherwise required, every savings institution that is a subsidiary of a holding company must still file a notice with the OTS at least 30 days before the board of directors declares a dividend or approves a capital distribution.

**Branching by Federal Savings Institutions.** OTS policy permits interstate branching to the full extent permitted by statute (which is essentially unlimited). Generally, federal law prohibits federal savings institutions from establishing, retaining or operating a branch outside the state in which the federal institution has its home office unless the institution meets the Internal Revenue Service ( IRS ) domestic building and loan test (generally, 60% of a thrift's assets must be housing-related) ( IRS Test ). The IRS Test requirement does not apply if: (a) the branch(es) result(s) from an emergency acquisition of a troubled savings institution (however, if the troubled savings institution is acquired by a bank holding company, does not have its home office in the state of the bank holding company bank subsidiary and does not qualify under the IRS Test, its branching is limited to the branching laws for state-chartered banks in the state where the savings institution is located); (b) the law of the state where the branch would be located would permit the branch to be established if the federal savings institution were chartered by the state in which its home office is located; or (c) the branch was operated lawfully as a branch under state law prior to the savings institution's reorganization to a federal charter.

Furthermore, the OTS will evaluate a branching applicant's record of compliance with the Community Reinvestment Act of 1977 ( CRA ). An unsatisfactory CRA record may be the basis for denial of a branching application.

**Community Reinvestment Act and the Fair Lending Laws.** Under the Community Reinvestment Act ( CRA ), as implemented by FDIC regulations, an institution has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions, nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the FDIC, in connection with its examinations, to assess the institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such institutions. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. An institution's failure to comply with the provisions of the CRA could, at a minimum, result in regulatory restrictions on its activities, and failure to comply with the fair lending laws could result in enforcement actions by the OTS, as well as other federal regulatory agencies and the Department of Justice. The Bank received a satisfactory CRA rating in its recent federal examination.

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**Loans-to-One Borrower Limitations.** Generally, a federal savings institution may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of unimpaired capital and surplus (this amount was approximately \$54.2 million at December 31, 2007). An additional amount may be loaned, equal to 10% of unimpaired capital and surplus, if the loan is secured by readily marketable collateral, which generally does not include real estate. As of December 31, 2007, we were in compliance with the loans-to-one borrower limitations.

**Qualified Thrift Lender Test.** As a federal savings institution, we are required to satisfy the qualified thrift lender ( QTL ) test. Under the QTL test, we must maintain at least 65% of our portfolio assets in qualified thrift investments (primarily residential mortgages and related investments, including mortgage-backed securities) in at least nine months of the most recent 12-month period. Portfolio assets generally means total assets of a savings institution, less the sum of specified liquid assets up to 20% of total assets, goodwill and other intangible assets and the value of property used to conduct the savings institutions business. We may also satisfy the QTL test by qualifying as a domestic building and loan association as defined in the Internal Revenue Code. A savings institution that fails the QTL test must either convert to a bank charter or operate under specified restrictions.

At December 31, 2007, approximately 78.1% of the portfolio assets of the Bank were qualified thrift investments.

**Federal Reserve System.** The Bank is subject to various regulations promulgated by the Federal Reserve, including, among others, Regulation B (Equal Credit Opportunity), Regulation D (Reserves), Regulation E (Electronic Funds Transfers), Regulation Z (Truth in Lending), Regulation CC (Availability of Funds), and Regulation DD (Truth in Savings). Regulation D requires noninterest-bearing reserve maintenance in the form of either vault cash or funds on deposit at Federal Reserve Bank of Kansas City or another designated depository institution in an amount calculated by formula. The balances maintained to meet the reserve requirements imposed by the Federal Reserve may be used to satisfy liquidity requirements. At December 31, 2007, the Bank was in compliance with these reserve requirements.

Savings banks are authorized to borrow from a Federal Reserve Bank ( FRB ) discount window, but FRB regulations require savings banks to exhaust other reasonable alternative sources of funds, including FHLBank advances, before borrowing from a Federal Reserve Bank.

**Affiliate Restrictions.** Section 11 of the Home Owners Loan Act provides that transactions between an insured subsidiary of a holding company and an affiliate thereof will be subject to the restrictions that apply to transactions between banks that are members of the Federal Reserve System and their affiliates pursuant to Sections 23A and 23B of the Federal Reserve Act.

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Generally, Section 23A and 23B and OTS regulations issued in connection therewith limit the extent to which a savings institution or its subsidiaries may engage in certain covered transactions with affiliates to an amount equal to 10% of the institution's capital stock and surplus, in the case of covered transactions with any one affiliate, and to an amount equal to 20% of such capital stock and surplus, in the case of covered transactions with all affiliates. Section 23B applies to covered transactions and certain other transactions and requires that all such transactions be on terms and under circumstances that are substantially the same, or at least as favorable to the savings institution or its subsidiary, as those prevailing at the time for comparable transactions with nonaffiliated companies. A covered transaction is defined to include a loan or extension of credit to an affiliate; a purchase of investment securities issued by an affiliate; a purchase of assets from an affiliate, with certain exceptions; the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any party; or the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate. Section 23B transactions also apply to the provision of services and the sale of assets by a savings association to an affiliate.

In addition, under OTS regulations, a savings institution may not make a loan or extension of credit to an affiliate unless the affiliate is engaged only in activities permissible for bank holding companies; a savings institution may not purchase or invest in securities of an affiliate other than shares of a subsidiary; a savings institution and its subsidiaries may not purchase a low-quality asset from an affiliate; and covered transactions and certain other transactions between a savings institution or its subsidiaries and an affiliate must be on terms and conditions that are consistent with safe and sound banking practices. With certain exceptions, each loan or extension of credit by a savings institution to an affiliate must be secured by collateral with a fair value of at least 100% (depending on the type of collateral) of the amount of the loan or extension of credit.

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The OTS regulation generally excludes all non-bank and non-savings institution subsidiaries of savings institutions from treatment as affiliates, except to the extent that the OTS or the FRB decides to treat such subsidiaries as affiliates. The regulation also requires savings institutions to make and retain records that reflect affiliate transactions in reasonable detail, and provides that certain classes of savings institutions may be required to give the OTS prior notice of affiliate transactions.

**The U.S.A. Patriot Act.** In December 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ( USA Patriot Act ) became effective. The USA Patriot Act is designed to combat money laundering and terrorist financing while protecting the United States financial system. The USA Patriot Act imposes enhanced policy, record keeping and due diligence requirements on domestic financial institutions. The USA Patriot Act also amended the Bank Secrecy Act to facilitate access to customer account information by government officials while immunizing banks from liability for releasing such information. Among other requirements, Title III of the USA Patriot Act and related OTS regulations impose the following requirements with respect to financial institutions:

- Establishment of anti-money laundering programs;
- Establishment of a program specifying procedures for obtaining identifying information from customers seeking to open new accounts, including verifying the identity of customers within a reasonable period of time;
- Establishment of enhanced due diligence policies, procedures and controls designed to detect and report money laundering; and
- Prohibition on correspondent accounts for foreign shell banks and compliance with record keeping obligations with respect to correspondent accounts of foreign banks.

In addition, bank regulators are directed to consider a holding company's effectiveness in combating money laundering when ruling on Federal Reserve Act and Bank Merger Act applications.

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### Item 1A. Risk Factors

In addition to other information contained in this Annual Report on Form 10-K, the following risk factors should be considered in evaluating our business. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may adversely affect our business, financial condition and/or results of operations.

***No assurance can be given that we will complete our proposed Merger with CapitalSource.***

The Merger Agreement provides that either the Company or CapitalSource (each acting through its respective Board of Directors) has the right at any time after February 17, 2008 to unilaterally terminate the Merger Agreement, unless the failure to effect the Merger by such date was due to the terminating party's failure to perform its obligations and covenants under the Merger Agreement. The Company has indicated that its present intent is not to terminate the Merger Agreement pending receipt of further comment from the OTS. Conversely, CapitalSource has

No assurance can be given that we will complete our proposed Merger with CapitalSource.

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publicly advised that its Board of Directors has authorized its Chairman and Chief Executive Officer to either terminate the Merger Agreement or negotiate new terms for the transaction. In light of the preceding sentence, the Company can provide no assurance that the Merger will be completed even if all conditions precedent to the transaction (including receipt of regulatory approval) are satisfied.

***CapitalSource and the Company must obtain regulatory approvals to complete the Merger, which, if delayed, not granted, or granted with unacceptable conditions, may jeopardize or postpone the completion of the Merger, result in additional expenditures of money and resources or reduce the anticipated benefits of the Merger.***

CapitalSource and the Company must obtain certain approval in a timely manner from the OTS prior to completion of the Merger. If CapitalSource and the Company do not receive the OTS's approval, or do not receive it on terms that satisfy the conditions set forth in the Merger Agreement, then neither party will be obligated, or in some cases permitted, to complete the Merger. The OTS has broad discretion in administering the governing statutes and regulations. As a condition to approval of the Merger, the OTS may impose requirements, limitations or costs that could negatively affect the way the combined companies conduct business. These requirements, limitations or costs could jeopardize or delay the completion of the Merger.

***Companies holding more than 10% of the outstanding shares of CapitalSource common stock may affect or delay the approval of the Merger by the OTS. If these holders do not become savings and loan holding companies, or the OTS does not accept a rebuttal of control from them, regulatory approval of the Merger would not be obtainable, and the Merger could not be completed.***

Under the OTS's regulations, companies holding more than 10% of CapitalSource's outstanding common stock may be presumed to control CapitalSource, subject to the opportunity to rebut this presumption by obtaining the OTS's acceptance of a rebuttal submission. If a company holding 10% or more of CapitalSource's outstanding common stock does not rebut the presumption of control, or reduce its holdings to less than 10% of CapitalSource's outstanding common stock, it would be required to obtain the approval of the OTS to become a savings and loan holding company prior to completion of the Merger. Some or all of CapitalSource's 10% or greater stockholders may not be willing to become a savings and loan holding company. As a result, if the OTS does not accept a rebuttal of control from them, then regulatory approval of the Merger would not be obtainable, and the Merger could not be completed.

***Failure to complete the Merger could negatively impact our stock price and future business and operations.***

If the Merger is not completed, we may be subject to a number of material risks, including the following:

the price of our common stock may decline if the current market price of our common stock reflects a market assumption that the Merger will be completed; and  
our costs related to the Merger, such as legal, accounting and certain financial advisor fees, generally must be paid even if the Merger is not completed.

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In addition, our customers and suppliers may, in response to the announcement of the Merger, delay or defer decisions concerning us. Any delay or deferral in those decisions by our customers or suppliers could have a material adverse effect on our business, regardless of whether or not the Merger is ultimately completed. Similarly, current and prospective employees may experience uncertainty about their future role with CapitalSource until CapitalSource's strategies with regard to us are announced or executed. This uncertainty may adversely affect our ability to attract and retain key management, sales, marketing and technical personnel.

Further, if the Merger is terminated and our Board of Directors decides to pursue another merger or business combination, there can be no assurance that we will be able to find a partner willing to pay an equivalent or more attractive price than CapitalSource would have paid in the Merger.

***Because the market price of CapitalSource common stock will fluctuate, our stockholders cannot be sure of the value of the merger consideration they will receive if the Merger is effected.***

If the Merger is completed, the holders of each share of Company common stock owned prior to the closing of the Merger will be entitled to receive for each such share:

\$6.80 in cash; plus  
0.675 shares of CapitalSource common stock; plus  
If the ten-day average closing price of CapitalSource common stock prior to the closing of the Merger is:

Because the market price of CapitalSource common stock will fluctuate, our stockholders cannot be sure of the value of the merger consideration they will receive if the Merger is effected.



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- a) less than or equal to \$25.1852, then 0.405 shares of CapitalSource common stock; or
- b) greater than \$25.1852, then TierOne Corporation stockholders can elect to receive either \$10.20 in cash or \$10.20 of CapitalSource common stock.

Under the Merger Agreement, the stated maximum amount of CapitalSource stock that a Company stockholder may receive is 1.08 shares. To the extent the merger consideration is paid in CapitalSource shares, any change in the market price of CapitalSource common stock prior to completion of the Merger will affect the value of the merger consideration that our stockholders will receive upon completion of the Merger. Because of this market risk, prior to the election deadline, our stockholders will not know or be able to calculate the number or the value of the shares of CapitalSource common stock they will receive upon completion of the Merger. Accordingly, the specific dollar value of CapitalSource common stock a stockholder will receive will depend on the market value of CapitalSource common stock at the time the Merger is completed and may decrease from the date the stockholder makes an election as to the third component of the merger consideration. Stock price changes may result from a variety of factors, including general market and economic conditions, changes in the Company's or CapitalSource's respective businesses, operations and prospects, and regulatory considerations. Many of these factors are beyond our control.

***In the event the Merger is completed, CapitalSource and the Company may fail to realize all of the anticipated benefits of the Merger.***

We entered into the Merger Agreement with the expectation that the Merger will result in significant benefits for both companies. Achieving the benefits of the Merger will depend in part on integrating the operations and personnel of the two companies in a timely and efficient manner to minimize the risk that the Merger will result in the loss of customers or key employees or the diversion of management's attention from other important issues. This integration may or may not be successful. Assuming that the Merger is effected, we cannot offer any assurances that we and CapitalSource can successfully integrate or realize any of the anticipated benefits.

***Applicable regulations affecting savings and loan holding companies could negatively impact both CapitalSource's commercial lending and investing business and the business of the Bank following the Merger.***

Currently, CapitalSource is not regulated as a savings and loan holding company or bank holding company and does not control any FDIC-insured depository institution. Savings banks such as the Bank are subject to extensive regulation of their activities and investments, their capitalization, their risk management policies and procedures, and their relationships with affiliated companies. Upon acquiring control of the Bank and becoming a savings and loan holding company assuming that the Merger is effected, CapitalSource's operations would be limited to financial and certain real estate-related activities. These limitations may require CapitalSource to curtail or divest some of its current commercial lending and investment business activities. For instance, in connection with its loans used by financial sponsors to finance purchases of companies, CapitalSource commonly is granted the opportunity to acquire equity in a borrower at the same time and on substantially the same terms as the financial sponsor. Some of these equity investments exceed 5% of the borrower's equity. If CapitalSource does not acquire merchant banking authority that will enable it to conform these equity investments of more than 5% in non-financial entities to the requirements of the Home Owners' Loan Act within two years of the acquisition of the Company, it will be required to divest them.

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In addition, as a condition to approving the Merger, the OTS may impose restrictions on the integration of the Bank's banking and CapitalSource's commercial lending and investing businesses, and may require prior approval of any future material changes to the Bank's business plans. These regulations and conditions could constrain CapitalSource in pursuing future business opportunities following the Merger. These regulations and conditions, and CapitalSource's inexperience with them, could also affect CapitalSource's ability to realize synergies from the Merger, and could negatively affect both CapitalSource and the Bank following the Merger.

***The value of the CapitalSource common stock our stockholders receive in the Merger may fluctuate after the Merger. Neither CapitalSource nor the Company can predict how the CapitalSource common stock will trade subsequent to the closing of the Merger if the Merger is completed.***

Stock price changes may result from a variety of factors, including general market and economic conditions, changes in CapitalSource's businesses, operations and prospects, and regulatory considerations. Many of these factors are beyond CapitalSource's control. The market price of CapitalSource common stock may decline as a result of the Merger if:

- the integration of CapitalSource and the Company is unsuccessful;
- CapitalSource and the Company do not achieve the perceived benefits of the Merger as rapidly or to the extent anticipated by financial or industry analysts; or
- the effect of the Merger on the combined company's financial results is not consistent with the expectations of financial or industry analysts.

***The Merger Agreement limits our ability to pursue alternatives to the Merger.***

The Merger Agreement, so long as it is in effect, contains terms and conditions that make it more difficult for us to sell our business to a party other than CapitalSource. These no shop provisions impose restrictions on us that, subject to certain exceptions, limit our ability to discuss or facilitate competing third-party proposals to acquire all or a significant part of our company.

***As a bank holding company, our earnings are dependent upon the performance of the Bank and the Bank's subsidiaries.***

Since we are a holding company with no significant assets other than the Bank, we currently depend upon dividends from the Bank for a substantial portion of our revenues. These dividends are the primary funding source for the dividends we pay on our common stock. Our ability to pay dividends will continue to depend in large part upon our receipt of dividends or other capital distributions from the Bank. Various state and federal laws and regulations limit the amount of dividends that a bank may pay to a parent holding company. In addition, our right to participate in a distribution of assets upon the liquidation or reorganization of a subsidiary may be subject to prior claims of the subsidiary's creditors. In the event the Bank is unable to pay dividends to the Company, we may not be able to service our debt, pay our obligations or pay dividends on our common stock. The inability to receive dividends from the Bank could therefore have a material adverse effect on our business, our financial condition and our results of operations.

***If economic conditions decline further, our financial condition and results of operations could continue to be adversely affected.***

Our operating results are affected by national and local economic and competitive conditions, including changes in market interest rates, the strength of the local economy, governmental policies of the communities in which we do business and actions of regulatory authorities. A further decline in the local or national economy could continue to adversely affect our financial condition and results of operations. Deterioration in economic conditions could result in the following consequences, any of which could have a material adverse effect on our business, financial condition, results of operations and cash flows:

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- A decline in the demand for the products and services we offer;
  - An increase in nonperforming loans and loan charge-offs;
  - An increase in provisions for loan losses;
  - An increase in losses on real estate owned (acquired through foreclosure); and
  - A migration from low-yielding or noninterest bearing deposits to higher-yielding deposit products such as time deposits.

***Our loan origination and purchase activity is highly concentrated in certain types of loans.***

At December 31, 2007, \$1.7 billion, or 52.2%, of our total loans consisted of multi-family residential, commercial real estate, land and land development, commercial construction and business loans. These types of loans generally expose a lender to a greater risk of non-payment and loss than one-to-four family residential mortgage loans because repayment of such loans is dependent upon the successful operation of the property and the income stream of the borrowers. Additionally, these types of loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one-to-four family residential mortgage loans. Also, many of the Bank's commercial borrowers have more than one loan outstanding. Consequently, an adverse development with respect to one loan or one credit relationship may expose us to a significantly greater risk of loss compared to an adverse development with respect to a one-to-four family residential mortgage loan.

At December 31, 2007, \$513.6 million, or 15.4%, of our total loans consisted of residential construction loans. Our portfolio of residential construction loans increased dramatically in 2004, 2005 and 2006 as a result of our emphasis on loans with relatively higher yields, adjustable interest rates and/or shorter terms to maturity. Risk of loss on a residential construction loan is dependent largely upon the accuracy of the initial estimate of the property's value when completed compared to the projected cost (including interest) of construction and other assumptions, including the approximate time to sell the property. Our ability to continue to originate and/or purchase residential construction loans may be impaired by adverse changes in local and regional economic conditions in the real estate markets, or by acts of nature. Due to the concentration of real estate collateral, these events could have a material adverse impact on the value of collateral, resulting in delinquencies and/or losses. Customer demand for loans secured by real estate could be reduced by a weaker economy, an increase in unemployment, a decrease in real estate values or an increase in interest rates.

***Our concentration of loans in certain areas of Florida and the Las Vegas, Nevada area may expose us to increased credit risk that may cause us to record additional provisions for loan losses and/or may result in future loan charge-offs.***

At December 31, 2007, \$168.8 million, or 5.1%, of our total loans were collateralized by properties in the state of Florida. Among our Florida loans, \$31.8 million were considered nonperforming residential construction loans at December 31, 2007. Approximately \$26.5 million

Our concentration of loans in certain areas of Florida and the Las Vegas, Nevada area may expose us to increased credit risk that may cause us to record additional provisions for loan losses and/or may result in future loan charge-offs.

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of our total nonperforming residential construction loans in Florida were purchased from TransLand. During the three months ended December 31, 2007 we charged off \$25.5 million of TransLand residential construction loans, due in large part to a permanent decline in the estimated fair value of residential lots.

At December 31, 2007, \$247.3 million, or 7.4%, of our total loans were collateralized by properties in the state of Nevada, primarily in the Las Vegas, Nevada area. Our loans in the Las Vegas, Nevada area are primarily composed of land development, commercial construction and residential construction loans. At December 31, 2007, our nonperforming land development, commercial construction and residential construction loans in the Las Vegas, Nevada area totaled \$30.4 million, \$19.2 million and \$7.6 million, respectively.

***Our results of operations are significantly affected by the fiscal and monetary policies of the federal government and the governments of the states in which we operate.***

The Board of Governors of the Federal Reserve System, also known as the Federal Reserve Board, regulates the supply of money and credit in the United States. Its policies determine in large part our cost of funds for lending and investing and the return we earn on those loans and investments, both of which impact our net interest margin, and can significantly affect the value of financial instruments such as debt securities and mortgage servicing rights. Its policies can also affect our borrowers, potentially increasing the risk that they may fail to repay their loans. Changes in Federal Reserve Board policies are beyond our control and difficult to predict or anticipate.

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The amount of income taxes we are required to pay on our earnings is based on federal and state legislation and regulations. We have provided for current and deferred income taxes in our financial statements, based on our results of operations, business activity, and interpretations of tax statutes. We may take filing positions or follow tax strategies that may be subject to challenge by federal and state taxing authorities. Our net income and earnings per share may be reduced if a federal, state or local authority assessed charges for taxes that have not been provided for in our consolidated financial statements.

***If the interest payments on our interest-bearing liabilities increase relative to the interest we earn on our interest-earning assets, our net interest income may decline.***

When interest-bearing liabilities mature or reprice more quickly than interest-earning assets, a significant increase in market interest rates could adversely affect net interest income. Conversely, a significant decrease in market interest rates could result in increased net interest income. We seek to manage our exposure to interest rate fluctuations, however, changes in market interest rates are neither predictable nor controllable and may have an adverse impact on our financial condition and results of operations.

Prevailing interest rates may significantly affect the overall demand for loans and could also impact the extent to which borrowers repay and refinance loans. Loan prepayments and refinancings, as well as prepayments of mortgage-backed securities, may increase in a declining interest rate environment. Call provisions associated with our investment in U.S. government securities and agency obligations and corporate securities may also negatively impact net interest income in a declining interest rate environment. Such prepayment, refinancing and security call activity may negatively impact the yield of our loan portfolio and investment and mortgage-backed security portfolios, as we would reinvest the prepaid funds in a lower interest rate environment. Additionally, adjustable-rate mortgage loans and mortgage-backed securities generally contain interim and lifetime caps that limit the amount interest rates can increase or decrease at repricing dates.

In a decreasing interest rate environment, our level of core deposits may decline if our depositors seek higher-yielding instruments or other investment products we are unwilling to offer. This may increase our cost of funds and decrease our net interest margin to the extent that alternative funding sources are utilized to fund our business activities. In an increasing interest rate environment, depositors tend to prefer higher-yielding time deposits which could adversely affect our net interest income if rates were to subsequently decline.

***Potential future loan losses may increase.***

We maintain an allowance for loan losses that represents management's best estimate of probable losses within our existing loan portfolio. The level of the allowance for loan losses reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Over the past several years, historical loan losses had been low and our loan loss ratios had performed better than industry averages. During 2007, our levels of delinquent loans, nonperforming loans (loans 90 or more days delinquent), impaired loans and charge-offs increased significantly. These increases were primarily attributable to the continued deterioration in the real estate market and the economy in general. We have been further impacted by the erosion of property values and an overall increase in housing inventory (both developed lots and completed houses) in many of the areas of the country in which we do business and where the collateral for our loans reside. Additionally, significantly tightened credit standards have made it more difficult for potential borrowers to obtain financing and for current borrowers to refinance existing loans. Loan losses related to residential construction loans increased during the year ended December 31, 2007. If the recent

trend is prolonged and losses continue to increase, our results of operations will continue to be negatively impacted.

***Our allowance for loan losses may be inadequate.***

An inadequate allowance for loan losses could adversely affect our results of operations. We are exposed to the risk that our customers may be unable to repay their loans according to their terms and that any collateral securing the payment of their loans may not be sufficient to assure full repayment. We evaluate the collectibility of our loan portfolio and provide for an allowance for loan losses which is based on our historical loan loss experience for each group of loans as further adjusted for specific factors.

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If our evaluation is incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in the loan portfolio, resulting in additions to our allowance for loan losses. Increases in the allowance for loan losses result in an expense for the period. If, as a result of general economic conditions or a decrease in asset quality, management determines that additional increases in the allowance for loan losses are warranted, we may incur additional expenses. We can make no assurances that our allowance for loan losses will be adequate to cover loan losses inherent in our portfolio.

Our loans are primarily secured by real estate, including regional concentrations of loans in areas of the United States that are susceptible to tornados, earthquakes, hurricanes or other natural disasters. If a natural disaster were to occur in one of our major market areas, loan losses could occur that are not incorporated in the existing allowance for loan losses.

***We could be held responsible for environmental liabilities of properties acquired through foreclosure.***

If we are forced to foreclose on a defaulted mortgage loan to recover our investment, we may be subject to environmental liabilities related to the underlying real property. Hazardous substances or wastes, contaminants, pollutants or sources thereof may be discovered on properties under our ownership or after a sale to a third party. The amount of environmental liability could exceed the value of the real property. There can be no assurance that we would not be fully liable for the entire cost of any removal, remediation or other clean-up on the acquired property, that the cost of removal and clean-up would not exceed the value of the property or that costs could be recovered from any third party. Additionally, it may be difficult or impossible to sell the property prior to or following any environmental remediation.

***Our cost of funds may increase as a result of general economic conditions, interest rates or competitive pressures.***

Our cost of funds may increase because of general economic conditions, unfavorable conditions in capital markets, interest rates and competitive pressures. We have traditionally obtained funds primarily through deposits and borrowings. Generally, deposits are a preferable source of funds than borrowings because interest rates paid for deposits are typically less than interest rates charged for borrowings. If deposit growth is inadequate to fund our operations we may have to rely on borrowings as a source of funds. Relying on borrowings as a primary funding source may have an adverse impact on our net interest margin.

***Competition could result in our loan portfolios and deposit base declining.***

The banking and financial services businesses in our market areas are highly competitive. Our market area has a high density of financial institutions, some of which have greater financial resources, name recognition and market presence than us, and all of which are our competitors. Competition within the banking, mortgage and finance industries may limit our ability to attract and retain customers. Our competition for loans comes primarily from commercial banks, savings banks, savings and loan associations, mortgage banking companies, insurance companies, finance companies and credit unions. Our most direct competition for deposits historically has come from commercial banks, savings banks, savings and loan associations and credit unions. In addition, we face competition for deposits from products offered by brokerage firms, insurance companies and other financial intermediaries, such as money market and other mutual funds and annuities. If we are unable to attract and retain customers, our loan and deposit growth may be inhibited which could have an adverse impact on our financial condition and results of operations.

***Legislative and regulatory issues could adversely affect our financial condition and results of operations.***

We are subject to extensive regulation, supervision and examination by the OTS as our primary federal regulator, and by the FDIC, which insures our deposits. As a member of the FHLBank, we must also comply with applicable regulations of the Federal Housing Finance Board and the FHLBank. Regulation by these agencies is intended primarily for the protection of our depositors and the Deposit Insurance Fund and not for the benefit of our stockholders. Our activities are also regulated under consumer protections laws applicable to our lending, deposit and other activities. A sufficient claim against us under these laws could have a material adverse affect on our financial condition and results of operations.

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Legislative and regulatory issues could adversely affect our financial condition and results of operations. 36

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*We may not be able to retain or replace key members of management or attract and retain qualified customer relationship managers.*

We depend on the services of existing management personnel to carry out our business and investment strategies. It is critical that we are able to attract and retain management and other qualified personnel. Competition for qualified personnel is significant in our geographical market areas. The loss of services of any management personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our financial condition and results of operations.

*We rely on communications, information, operating and financial control systems technology from third-party service providers. An interruption in these third-party systems could have an adverse effect on our business.*

We rely heavily on third-party service providers for much of our communications, information, operating and financial control systems technology. Any failure, interruption or breach in security of these systems could result in failures or interruptions in our customer relationship management, general ledger, deposit, loan servicing and loan origination systems. We can make no assurances that such failures or interruptions will not occur or, if they do occur, that they will be adequately addressed by us or the third parties on which we rely. Any failure or interruption could have a material adverse effect on our business, financial condition and results of operations. If any of our third-party service providers experience financial, operational or technological difficulties, or if there is any other disruption in our relationships with them, we may be required to locate alternative sources of such services. We can make no assurances that we could negotiate terms that are favorable to us, or could obtain comparable services without the need to expend substantial resources.

*Our stock price can be volatile.*

Our stock price can fluctuate in response to a variety of factors, including issues related to the consummation of the Merger with CapitalSource and the CapitalSource stock price; actual or anticipated variations in quarterly operating results; changes in our stockholder dividend policy; recommendations of securities analysts; and news media reports relating to trends, concerns and other issues in the financial services industry. Other factors that may influence our stock price include products or services offered by our competitors; operating and stock price performance of other companies that investors or analysts deem comparable to us; and changes in governmental regulations.

General market fluctuations, industry factors and general economic conditions and political conditions and events, such as future terrorist activities, economic slowdowns or recessions, interest rate changes or credit loss trends, also could cause our stock price to decline regardless of our operating results.

*If we fail to maintain effective systems of internal and disclosure control, we may not be able to accurately report our financial results or prevent fraud.*

Effective internal and disclosure controls are necessary for us to provide reliable financial reports, to effectively prevent fraud and to operate successfully as a public company. If we were unable to provide accurate and reliable financial reports or prevent fraud, our reputation and results of operations would be adversely effected. As part of our ongoing monitoring of internal controls, we may discover material weaknesses or significant deficiencies in our internal controls as defined under standards adopted by the Public Company Accounting Oversight Board ( PCAOB ) that require remediation. Under PCAOB standards, a *material weakness* is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the company's financial reporting.

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Any failure to maintain effective internal and disclosure controls, or to make necessary improvements in such controls in a timely manner, could harm operating results or cause us to fail in meeting our financial reporting obligations. Such a failure could have an impact on our ability to remain listed on the NASDAQ Global Select Market. Ineffective internal and disclosure controls could also cause investors to lose confidence in our reported financial information, which would likely have a negative effect on our stock price.

**Item 1B. Unresolved Staff Comments**

Not applicable.

**Item 2. Properties**

We currently operate 69 banking offices in Nebraska (59), Iowa (9) and Kansas (1) of which 51 are owned by us and 18 are under operating leases. Additionally, we operate three loan production offices located in Colorado, two loan production offices located in North Carolina and one loan production office in each of Arizona, Florida, Minnesota and Nevada all of which are under operating leases. We own our corporate headquarters located in Lincoln, Nebraska.

For further information regarding our properties, see *Note 20 Lease Commitments* included in Item 8. Financial Statements and Supplementary Data, in Part II of this Annual Report on Form 10-K.

**Item 3. Legal Proceedings**

Except for litigation relating to certain goodwill claims against the United States ( U.S. ) and a court action filed by the Bank and two other financial institutions against a Florida-based mortgage broker, both of which are described below, we are not involved in any pending legal proceedings other than routine legal proceedings occurring in the ordinary course of business. Such routine legal proceedings, in the aggregate, are believed by management to be immaterial to our consolidated financial statements.

On October 31, 2006, the U.S. Court of Federal Claims ( Federal Claims Court ) issued an opinion finding the U.S. liable to the Bank for lost franchise value related to our damages claim against the U.S. for breach of contract following changes to the rules for computing our regulatory capital that were required by the adoption of the Financial Institution Reform Recovery and Enforcement Act of 1989. The Federal Claims Court's opinion awarding the Bank \$4.5 million in damages was appealed to the United States Court of Appeals for the Federal Circuit ( Court of Appeals ) by the U.S. on December 29, 2006. The Bank subsequently filed a cross-appeal seeking review of earlier liability rulings which absolved the U.S. of liability in connection with two other related merger transactions and reduced the amount of the Bank's potential recovery.

Oral argument of the appeal was heard before a three-judge panel of the Court of Appeals on November 8, 2007. On March 5, 2008, the Court of Appeals panel rendered a split decision. The majority found in favor of the U.S. thereby reversing the Federal Claims Court's damage award and denying the cross-appeal. A separate dissenting opinion would have sustained the Federal Claims Court's award for the Bank. We are currently evaluating our legal options and have not made a determination as to what, if any, further actions will be taken. There can be no assurance as to the type or amount of damages, if any, that we may recover or the timing, if we are successful, for receipt by us of any damages from the U.S.

A joint petition for involuntary Chapter 11 bankruptcy was filed on August 23, 2007 in the United States Bankruptcy Court for the Middle District of Florida by the Bank and two other financial institutions against TransLand Financial Services, Inc. ( TransLand ), a mortgage brokerage firm headquartered in Maitland, Florida. The petition cites TransLand for alleged failure to remit loan payoffs and periodic payments to the Bank involving approximately \$12.9 million of residential loans. On October 8, 2007 a court-appointed examiner furnished a detailed report documenting the alleged fraudulent activity. The Bank has notified its insurance carrier of a claim against a bond insuring the Bank for up to \$7.5 million against fraudulent losses by loan servicers. The Bank believes that it is probable it will collect the proceeds on the insurance bond.

Pursuant to an Inter-Creditor Settlement Agreement dated November 25, 2007, the petitioning banks agreed to dismiss the involuntary Chapter 11 bankruptcy petition that had been filed against TransLand in return for the agreement by TransLand and certain of its principal creditors to proceed with the liquidation and distribution of TransLand's remaining assets. The Bank will receive a proportionate share of the net proceeds, if any, realized from such liquidation. On December 4, 2007 the Bankruptcy Court entered an order approving the dismissal of the involuntary bankruptcy. The liquidation of TransLand's assets is currently in process.

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**Item 4. Submission of Matters to a Vote of Security Holders**

On November 29, 2007, the Company held a special meeting of stockholders to obtain approval for the Agreement and Plan of Merger, dated May 17, 2007, by and among TierOne Corporation, CapitalSource Inc. and CapitalSource TRS Inc. Following is a summary of the result of the vote.

Proposal	Number of Votes		
	For	Against	Abstain
To approve Merger Agreement and Plan of Merger	10,216,926	5,457,113	42,082

## Number of Votes

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## PART II

## Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

**Common Stock Price Summary.** Our common stock trades on the NASDAQ Global Select Market under the symbol TONE. As of December 31, 2007, we had 1,454 stockholders of record, which does not include those persons or entities holding stock in nominee or street name through brokerage firms or others. The following table shows the high and low bid prices of our common stock during the periods indicated as well as the period end closing sales price and the dividend paid each quarter.

	2007				2006			
	High	Low	Close	Dividend	High	Low	Close	Dividend
First Quarter	\$ 32.04	\$ 24.88	\$ 27.04	\$ 0.07	\$ 34.00	\$ 27.60	\$ 33.95	\$ 0.06
Second Quarter	32.98	24.01	30.10	0.08	35.58	30.69	33.77	0.07
Third Quarter	30.57	18.62	26.47	0.08	34.88	31.25	33.93	0.07
Fourth Quarter	28.16	18.62	22.15	0.08	34.12	30.36	31.61	0.07

**Common Stock Repurchase Activity.** The following table details our purchases of common stock during the three months ended December 31, 2007:

	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs*	Maximum Number of Shares that May Yet Be Purchased Under Plans or Programs
<b>October 2007</b>				
Beginning Date - October 1, 2007				
Ending Date - October 31, 2007	942	\$ 23.44	942	1,519,006
<b>November 2007</b>				
Beginning Date - November 1, 2007				
Ending Date - November 30, 2007	--	--	--	1,519,006
<b>December 2007</b>				
Beginning Date - December 1, 2007				
Ending Date - December 31, 2007	314	23.45	314	1,518,692
Total shares purchased during the three months ended December 31, 2007	1,256	\$ 23.44	1,256	1,518,692

\* Information related to our publicly announced plan authorizing purchases of common stock during the three months ended December 31, 2007, is as follows:

Date Purchase Plan Announced	Number of Shares Approved for Purchase	Expiration Date of Purchase Plan
July 27, 2004	1,828,581	No stated expiration date

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**Performance Graph.** The following graph represents \$100.00 invested in our common stock at the closing price of the common stock on December 31, 2002, and assumes the reinvestment of all dividends. The graph demonstrates comparison of the cumulative total returns for the common stock of TierOne Corporation, the Russell 2000 Index and the SNL Securities \$1B \$5B Thrift Index for the periods indicated.

The following information in this Item 5 of this Annual Report on Form 10-K is not deemed to be soliciting material or to be filed with the SEC or subject to Regulation 14A or 14C under the Securities Act of 1934 or to the liabilities of Section 18 of the Securities Exchange Act of 1934, and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent the Company specifically incorporates it by reference into such a filing.

Source: SNL Financial LC, Charlottesville, VA © 2007

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## Item 6. Selected Financial Data

At or For the Year Ended December 31,

(Dollars in thousands, except per share data)

### Selected Statement of Income Data:

	2007	2006	2005	2004	2003
Total interest income	\$ 234,021	\$ 223,887	\$ 177,343	\$ 124,980	\$ 110,820
Total interest expense	117,901	98,019	72,428	47,769	40,871
Net interest income	116,120	125,868	104,915	77,211	69,949
Provision for loan losses	68,101	6,053	6,436	4,887	4,271
Net interest income after provision for loan losses	48,019	119,815	98,479	72,324	65,678
Total noninterest income	30,337	29,084	26,585	23,905	19,859
Total noninterest expense	95,057	81,769	72,450	58,212	47,520
Income (loss) before income taxes	(16,701)	67,130	52,614	38,017	38,017
Income tax expense (benefit)	(4,276)	25,815	19,782	14,152	14,202
Net income (loss)	\$ (12,425)	\$ 41,315	\$ 32,832	\$ 23,865	\$ 23,815
Net income (loss) per common share, basic	\$ (0.74)	\$ 2.50	\$ 2.02	\$ 1.42	\$ 1.18
Net income (loss) per common share, diluted	\$ (0.74)	\$ 2.41	\$ 1.97	\$ 1.39	\$ 1.16
Dividends declared per common share	\$ 0.31	\$ 0.27	\$ 0.23	\$ 0.20	\$ --

### Selected Financial Condition Data:

Total assets	\$ 3,537,766	\$ 3,431,169	\$ 3,222,275	\$ 3,048,081	\$ 2,207,868
Cash and cash equivalents	241,461	86,808	88,034	70,030	34,901
Investment securities	130,551	105,090	102,725	127,883	43,657
Mortgage-backed securities	6,689	12,272	19,752	36,175	15,712
Net loans after allowance for loan losses	2,909,589	3,017,031	2,813,800	2,628,155	2,016,596
Deposits	2,430,544	2,052,343	2,038,319	1,864,761	1,216,763
FHLBank Topeka advances and other borrowings	689,288	962,376	814,924	841,666	645,696
Stockholders' equity	345,590	353,283	308,867	277,023	295,089

### Selected Operating Ratios:



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At or For the Year Ended December 31,

Average yield on interest-earning assets	7.21%	7.24%	6.05%	5.33%	5.51%
Average rate on interest-bearing liabilities	4.06%	3.52%	2.72%	2.31%	2.46%
Average interest rate spread (1)	3.15%	3.72%	3.33%	3.02%	3.05%
Net interest margin (1)	3.58%	4.07%	3.58%	3.29%	3.48%
Average interest-earning assets to average interest-bearing liabilities	111.80%	110.95%	110.10%	113.29%	120.94%
Net interest income after provision for loan losses to noninterest expense	50.52%	146.53%	135.93%	124.24%	138.21%
Total noninterest expense to average assets (2)	2.74%	2.48%	2.31%	2.35%	2.26%
Efficiency ratio (2)(3)	63.78%	51.64%	53.70%	56.95%	52.91%
Return on average assets (2)	-0.36%	1.25%	1.05%	0.96%	1.13%
Return on average equity (2)	-3.39%	12.48%	11.28%	8.53%	7.04%
Average equity to average assets (2)	10.56%	10.04%	9.29%	11.29%	16.11%
Return on tangible equity (2)(4)	-3.89%	14.59%	13.58%	9.08%	7.04%

(1) Excluding the receipt of a \$2.7 million loan prepayment fee, our average interest rate spread and net interest margin would have been 3.63% and 3.99%, respectively, for the year ended December 31, 2006.

(2) Employee stock options were expensed beginning January 1, 2006.

(3) Efficiency ratio is calculated as total noninterest expense, less amortization expense of other intangible assets, as a percentage of the sum of net interest income and noninterest income.

(4) Return on tangible equity is calculated as annualized net income (loss) as a percentage of average stockholders' equity adjusted for goodwill and other intangible assets.

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

### Introduction

We are a Nebraska-based financial services holding company that offers customers a wide variety of full-service consumer, commercial and agricultural banking products and services through TierOne Bank, our wholly owned banking subsidiary. TierOne Bank's franchise network includes 69 banking offices located in Nebraska, Iowa and Kansas and nine loan production offices located in Arizona, Colorado, Florida, Minnesota, Nevada and North Carolina.

As a regional community bank, our goal is to provide our customers competitive financial services through a positive, quality service environment that distinguishes us from our competition. This is achieved by our strategic focus on our core businesses of mortgage and business lending and retail banking that has contributed to the Bank's history of growth. At December 31, 2007, the Company had total assets of \$3.5 billion, net loan receivables of \$3.0 billion, total deposits of \$2.4 billion and stockholders' equity of \$345.6 million.

The following is a discussion and analysis of the Company's financial condition and results of operations including information on the Company's critical accounting policies, asset/liability management, liquidity and capital resources and contractual obligations. Information contained in this Management's Discussion and Analysis should be read in conjunction with the disclosure regarding Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995, as well as the discussion set forth in Item 1A. Risk Factors and Item 8. Financial Statements and Supplementary Data.

### Critical Accounting Policies

See *Note 1 Summary of Significant Accounting Policies* included in Item 8. Financial Statements and Supplementary Data, in Part II of this Annual Report on Form 10-K for a summary of our significant accounting policies. Various elements of our accounting policies, by nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. Our policies with respect to the methodologies used to recognize income, determine the allowance for loan losses, evaluating investment and mortgage-backed securities for impairment, evaluating goodwill and other intangible assets, valuation of mortgage servicing rights, valuation and measurement of derivatives and commitments, valuation of real estate owned and estimating income taxes are our most critical accounting policies because they are important to the presentation of our financial condition and results of operations, involve a higher degree of complexity and require management to make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. The use of different judgments, assumptions and estimates could result in material differences in our financial condition and results of operations.

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**Income Recognition.** We recognize interest income by methods that conform to GAAP. In the event management believes collection of all or a portion of contractual interest on a loan has become doubtful, which generally occurs after a loan is contractually delinquent 90 days or more, we discontinue the accrual of interest and charge-off all previously accrued interest. Interest received on nonperforming loans is included in income only if principal recovery is reasonably assured. A nonperforming loan is restored to accrual status when it is brought current and the collectibility of the total contractual principal and interest is no longer in doubt.

**Allowance for Loan Losses.** We have identified the allowance for loan losses as a critical accounting policy where amounts are subject to material variation. This policy is significantly affected by our judgment and uncertainties and there is a likelihood that materially different amounts could be reported under different, but reasonably plausible, conditions or assumptions. The allowance for loan losses is considered a critical accounting estimate because there is a large degree of judgment in:

- Assigning individual loans to specific risk levels (pass, special mention, substandard, doubtful and loss);
- Valuing the underlying collateral securing the loans;
- Determining the appropriate reserve factor to be applied to specific risk levels for special mention loans and those adversely classified (substandard, doubtful and loss); and

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Determining reserve factors to be applied to pass loans based upon loan type.

We establish provisions for loan losses, which are charges to our operating results, in order to maintain a level of total allowance for loan losses that, in management's belief, covers all known and inherent losses that are both probable and reasonably estimable at each reporting date. Management reviews the loan portfolio no less frequently than quarterly in order to identify those inherent losses and to assess the overall collection probability of the loan portfolio. Management's review includes a quantitative analysis by loan category, using historical loss experience, classifying loans pursuant to a grading system and consideration of a series of qualitative loss factors. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available or as future events occur.

The allowance for loan losses consists of two elements. The first element is an allocated allowance established for specific loans identified by the credit review function that are evaluated individually for impairment and are considered to be impaired. A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Impairment is measured by:

- The fair value of the collateral if the loan is collateral dependent;
- The present value of expected future cash flows; or
- The loan's observable market price.

The second element is an estimated allowance established for losses that are probable and reasonable to estimate on each category of outstanding loans. While management uses available information to recognize probable losses on loans inherent in the portfolio, future additions to the allowance may be necessary based on changes in economic conditions and other factors. In addition, various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to recognize additions to the allowance based on their judgment of information available to them at the time of their examination.

**Investment Securities.** We evaluate our available for sale and held to maturity investment securities for impairment on a quarterly basis. An impairment charge in the Consolidated Statements of Income is recognized when the decline in the fair value of investment securities below their cost basis is judged to be other-than-temporary. Various factors are utilized in determining whether we should recognize an impairment charge, including, but not limited to, the length of time and extent to which the fair value has been less than its cost basis and our ability and intent to hold the investment security for a period of time sufficient to allow for any anticipated recovery in fair value.

**Goodwill and Other Intangible Assets.** Goodwill represents the excess price paid over the fair value of the tangible and intangible assets and liabilities acquired in connection with the August 27, 2004 acquisition of United Nebraska Financial Co. ( UNFC ). There was no goodwill recorded in connection with our Marine Bank branch purchase on June 2, 2006. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill and indefinite-lived intangible balances are not being amortized, but are tested for impairment annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires intangible assets with estimated useful lives to be amortized over their respective estimated useful lives to their residual values, and reviewed for impairment in accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*.

Our policy is to evaluate annually the carrying value of our reporting unit goodwill and identifiable assets not subject to amortization. Goodwill was established in connection with the UNFC acquisition.

We have identified a single reporting unit for purposes of goodwill impairment testing. The impairment test is therefore performed on a consolidated basis. We perform our goodwill impairment analysis on an annual basis during the third quarter. Additional impairment analysis may be performed if circumstances or events occur which may have an impact on the fair value of our goodwill. Potential impairment is indicated when the carrying value of the entity, including goodwill, exceeds its fair value. If potential for impairment exists, the fair value of the entity is subsequently measured against the fair value of its underlying assets and liabilities, excluding goodwill, to estimate an implied fair value of the entity's goodwill. Impairment loss is recognized for any excess of the carrying value of the entity's goodwill over the implied fair value. We performed our impairment analysis as of September 30, 2007 and concluded that no potential impairment of goodwill existed as the fair value of our goodwill exceeded its carrying value. Additionally, we performed our impairment analysis as of December 31, 2007 due to the decline in our stock price and prevailing economic conditions and concluded that no potential impairment existed.

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The value of core deposit intangible assets acquired in connection with the UNFC and Marine Bank transactions, which is subject to amortization, is included in the Consolidated Statements of Financial Condition as other intangible assets. Determining the amount of identifiable intangible assets and their average lives involves multiple assumptions and estimates and is typically determined by performing a discounted cash flow analysis, which involves a combination of any or all of the following assumptions: customer attrition, account runoff, alternative funding costs, deposit servicing costs and discount rates. Core deposit intangible assets are amortized using an accelerated method of amortization which is recorded in the Consolidated Statements of Operations as other operating expense.

We review our core deposit intangible assets for impairment whenever events or changes in circumstances indicate that we may not recover our investment in the underlying assets or liabilities which gave rise to the identifiable intangible assets. For the years ended December 31, 2007, 2006 and 2005, no events or circumstances triggered an impairment charge against our core deposit intangible assets.

**Mortgage Servicing Rights.** On January 1, 2007 we adopted SFAS No. 156, *Accounting for Servicing of Financial Assets – an Amendment of FASB Statement No. 140* ( SFAS No. 156 ). In accordance with SFAS No. 156, we have elected to continue to utilize the amortization method for all of our mortgage servicing right assets, thus, carrying our mortgage servicing rights at the lower of cost or market (fair value). Under the amortization method, we amortize mortgage servicing rights in proportion to and over the period of net servicing income. Income generated as a result of new servicing assets is reported as net gain on sale of loans held for sale in the Consolidated Statements of Operations. Loan servicing fees, net of amortization of mortgage servicing rights, is recorded in fees and service charges in the Consolidated Statements of Operations.

We capitalize the estimated value of mortgage servicing rights upon the sale of loans. The estimated value takes into consideration contractually known amounts, such as loan balance, term and interest rate. These estimates are impacted by loan prepayment speeds, servicing costs and discount rates used to compute a present value of the cash flow stream. We evaluate the fair value of mortgage servicing rights on a quarterly basis using current prepayment speed, cash flow and discount rate estimates. Changes in these estimates impact fair value and could require us to record a valuation allowance or recovery. The fair value of mortgage servicing rights is highly sensitive to changes in assumptions. Changes in prepayment speed assumptions have the most significant impact on the fair value of mortgage servicing rights. Generally, as interest rates decline, prepayments accelerate with increased refinance activity, which results in a decrease in the fair value of mortgage servicing rights. As interest rates rise, prepayments generally slow, which results in an increase in the fair value of mortgage servicing rights. All assumptions are reviewed for reasonableness on a quarterly basis and adjusted as necessary to reflect current and anticipated market conditions. Thus, any measurement of fair value is limited by the conditions existing and the assumptions utilized as of a particular point in time, and those assumptions may not be appropriate if applied at a different point in time. We currently do not utilize direct financial hedges to mitigate the effect of changes in the fair value of our mortgage servicing rights.

**Derivatives and Commitments.** We account for our derivatives and hedging activities in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activity*, as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* and SFAS No. 149, *Amendment of Statement No. 133 on Derivative Instruments and Hedging Activities*.

In the normal course of business, we enter into contractual commitments, including loan commitments and rate lock commitments, to extend credit to finance residential mortgages. These commitments, which contain fixed expiration dates, offer the borrower an interest rate guarantee provided the loan meets underwriting guidelines and closes within the time frame established by us. Interest rate risk arises on these commitments and subsequently closed loans if interest rates increase or decrease between the time of the interest rate lock and the delivery of the loan to the investor. Loan commitments related to mortgage loans that are intended to be sold are considered derivatives in accordance with the guidance of SEC Staff Accounting Bulletin No. 105, *Application of Accounting Principles to Loan Commitments*. Accordingly, the fair value of these derivatives at the end of the reporting period is based on a quoted market price that closely approximates the amount that would have been recognized if the loan commitment was funded and sold.

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To mitigate the effect of interest rate risk inherent in providing loan commitments, we hedge our commitments by entering into mandatory or best efforts delivery forward sale contracts. These forward contracts are marked-to-market through earnings and are not designated as accounting hedges under SFAS No. 133. The change in the fair value of loan commitments