

TIERONE CORP  
Form 10-Q  
August 09, 2007

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM \_\_\_\_ TO \_\_\_\_.

Commission file number: 000-50015

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**TierOne Corporation**

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Wisconsin

04-3638672

(State or Other Jurisdiction of Incorporation or Organization)

(I.R.S. Employer Identification No.)

1235 N Street  
Lincoln, Nebraska

68508

(Address of Principal Executive Offices)

(Zip Code)

(402) 475-0521

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of August 6, 2007, there were 18,054,202 issued and outstanding shares of the Registrant's common stock.

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**PART I - FINANCIAL INFORMATION**

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**Item 1 Financial Statements**

**TierOne Corporation and Subsidiaries  
Consolidated Statements of Financial Condition  
June 30, 2007 (Unaudited) and December 31, 2006**

| <i>(Dollars in thousands, except per share data)</i>   | <b>June 30, 2007</b> | <b>December 31, 2006</b> |
|--|----------------------|--------------------------|
| <b>ASSETS</b>  |                      |                          |
| Cash and cash equivalents  | \$ 79,653            | \$ 86,808                |
| <b>Investment securities:</b>  |                      |                          |
| Held to maturity, at cost which approximates fair value  | 80                   | 90                       |
| Available for sale, at fair value  | 136,178              | 105,000                  |
| Mortgage-backed securities, available for sale, at fair value  | 9,007                | 12,272                   |
| <b>Loans receivable:</b>   |                      |                          |
| Net loans (includes loans held for sale of \$29,829 and \$19,285 at June 30, 2007 and December 31, 2006, respectively) | 3,093,011            | 3,050,160                |
| Allowance for loan losses  | (43,213)             | (33,129)                 |

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| <i>(Dollars in thousands, except per share data)</i>   | <b>June 30, 2007</b> | <b>December 31, 2006</b> |
|--|----------------------|--------------------------|
| Net loans after allowance for loan losses  | 3,049,798            | 3,017,031                |
| FHLBank Topeka stock, at cost  | 63,943               | 62,022                   |
| Premises and equipment, net  | 39,164               | 39,821                   |
| Accrued interest receivable  | 23,067               | 23,023                   |
| Goodwill   | 42,162               | 42,228                   |
| Other intangible assets, net   | 7,544                | 8,391                    |
| Mortgage servicing rights (lower of cost or market), net   | 12,930               | 12,467                   |
| Other assets   | 31,656               | 22,016                   |
| <b>Total assets</b>  | <b>\$ 3,495,182</b>  | <b>\$ 3,431,169</b>      |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                      |                          |
| <b>Liabilities:</b>  |                      |                          |
| Deposits   | \$ 2,242,202         | \$ 2,052,343             |
| FHLBank Topeka advances and other borrowings   | 815,024              | 962,376                  |
| Advance payments from borrowers for taxes, insurance and other escrow funds  | 27,961               | 27,203                   |
| Accrued interest payable   | 6,230                | 6,620                    |
| Accrued expenses and other liabilities   | 35,766               | 29,344                   |
| <b>Total liabilities</b>   | <b>3,127,183</b>     | <b>3,077,886</b>         |
| <b>Stockholders equity:</b>  |                      |                          |
| Preferred stock, \$0.01 par value. 10,000,000 shares authorized; none issued   | --                   | --                       |
| Common stock, \$0.01 par value. 60,000,000 shares authorized; 18,054,202 and 18,041,413 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively | 226                  | 226                      |
| Additional paid-in capital   | 362,730              | 358,733                  |
| Retained earnings, substantially restricted  | 121,587              | 112,111                  |
| Treasury stock, at cost; 4,520,873 and 4,533,662 shares at June 30, 2007 and December 31, 2006, respectively   | (105,118)            | (105,406)                |
| Unallocated common stock held by Employee Stock Ownership Plan   | (10,911)             | (11,664)                 |
| Accumulated other comprehensive loss, net  | (515)                | (717)                    |
| <b>Total stockholders equity</b>   | <b>367,999</b>       | <b>353,283</b>           |
| <b>Total liabilities and stockholders equity</b>   | <b>\$ 3,495,182</b>  | <b>\$ 3,431,169</b>      |

See accompanying notes to consolidated financial statements.

**TierOne Corporation and Subsidiaries  
Consolidated Statements of Income  
(Unaudited)**

| <i>(Dollars in thousands, except per share data)</i> | <b>For the Three Months Ended<br/>June 30,</b> |             | <b>For the Six Months Ended<br/>June 30,</b> |             |
|--|--|-------------|--|-------------|
|  | <b>2007</b>                                    | <b>2006</b> | <b>2007</b>                                  | <b>2006</b> |

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|  | For the Three Months Ended<br>June 30, |                 | For the Six Months Ended<br>June 30, |                  |
|--|--|-----------------|--------------------------------------|------------------|
|  |  |                 |                                      |                  |
| <b>Interest income:</b>                                    |  |                 |                                      |                  |
| Loans receivable   | \$ 56,471                              | \$ 52,669       | \$ 112,536                           | \$ 100,771       |
| Investment securities                                      | 2,855                                  | 2,162           | 5,284                                | 4,177            |
| Other interest-earning assets                              | 215                                    | --              | 386                                  | 76               |
| <b>Total interest income</b>                               | <b>59,541</b>                          | <b>54,831</b>   | <b>118,206</b>                       | <b>105,024</b>   |
| <b>Interest expense:</b>                                   |  |                 |                                      |                  |
| Deposits   | 19,363                                 | 14,267          | 37,259                               | 27,409           |
| FHLBank Topeka advances and other borrowings               | 9,494                                  | 9,160           | 19,068                               | 17,075           |
| <b>Total interest expense</b>                              | <b>28,857</b>                          | <b>23,427</b>   | <b>56,327</b>                        | <b>44,484</b>    |
| Net interest income  | 30,684                                 | 31,404          | 61,879                               | 60,540           |
| Provision for loan losses                                  | 10,233                                 | 1,811           | 11,701                               | 3,142            |
| <b>Net interest income after provision for loan losses</b> | <b>20,451</b>                          | <b>29,593</b>   | <b>50,178</b>                        | <b>57,398</b>    |
| <b>Noninterest income:</b>                                 |  |                 |                                      |                  |
| Fees and service charges                                   | 5,698                                  | 5,636           | 11,199                               | 10,683           |
| Debit card fees  | 860                                    | 685             | 1,621                                | 1,301            |
| Loss from real estate operations, net                      | (145)                                  | (59)            | (279)                                | (65)             |
| <b>Net gain (loss) on sales of:</b>                        |  |                 |                                      |                  |
| Investment securities                                      | --                                     | --              | --                                   | 21               |
| Loans held for sale  | 934                                    | 625             | 1,562                                | 1,170            |
| Real estate owned  | (327)                                  | 6               | (332)                                | (64)             |
| Other operating income                                     | 304                                    | 302             | 557                                  | 555              |
| <b>Total noninterest income</b>                            | <b>7,324</b>                           | <b>7,195</b>    | <b>14,328</b>                        | <b>13,601</b>    |
| <b>Noninterest expense:</b>                                |  |                 |                                      |                  |
| Salaries and employee benefits                             | 13,178                                 | 12,168          | 26,296                               | 23,943           |
| Occupancy, net   | 2,391                                  | 2,158           | 4,804                                | 4,374            |
| Data processing  | 576                                    | 533             | 1,197                                | 1,101            |
| Advertising  | 1,263                                  | 1,373           | 2,265                                | 2,461            |
| Other operating expense                                    | 5,405                                  | 4,759           | 9,750                                | 8,458            |
| <b>Total noninterest expense</b>                           | <b>22,813</b>                          | <b>20,991</b>   | <b>44,312</b>                        | <b>40,337</b>    |
| Income before income taxes                                 | 4,962                                  | 15,797          | 20,194                               | 30,662           |
| Income tax expense   | 2,503                                  | 6,090           | 8,357                                | 11,753           |
| <b>Net income</b>  | <b>\$ 2,459</b>                        | <b>\$ 9,707</b> | <b>\$ 11,837</b>                     | <b>\$ 18,909</b> |
| Net income per common share, basic                         | \$ 0.15                                | \$ 0.59         | \$ 0.71                              | \$ 1.15          |
| Net income per common share, diluted                       | \$ 0.14                                | \$ 0.57         | \$ 0.69                              | \$ 1.11          |
| Dividends declared per common share                        | \$ 0.08                                | \$ 0.07         | \$ 0.15                              | \$ 0.13          |
| Average common shares outstanding, basic (000 s)           | 16,681                                 | 16,463          | 16,640                               | 16,425           |
| Average common shares outstanding, diluted (000 s)         | 17,184                                 | 17,129          | 17,181                               | 17,080           |

For the Three Months Ended  
June 30,

For the Six Months Ended  
June 30,

See accompanying notes to consolidated financial statements.

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**TierOne Corporation and Subsidiaries**  
**Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income**  
**For the Six Months Ended June 30, 2007 and 2006**  
**(Unaudited)**

| <i>(Dollars in thousands)</i>  | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings,<br>Substantially<br>Restricted | Treasury<br>Stock | Unallocated<br>Common Stock<br>Held by the<br>Employee Stock<br>Ownership Plan | Unearned<br>Common Stock<br>Held by the<br>Management<br>Retention Plan | Accumulated<br>Other<br>Comprehensive<br>Loss, Net | Total<br>Stockholders'<br>Equity |
|--|-----------------|----------------------------------|--|-------------------|--|---|--|----------------------------------|
| Balance at December 31, 2005   | \$ 226          | \$ 358,587                       | \$ 75,282  | \$ (101,584)      | \$ (13,169)  | \$ (9,368)  | \$ (1,107)   | \$ 308,867                       |
| Common stock earned by employees in Employee Stock Ownership Plan  | --              | 1,688                            | --   | --                | 753  | --  | --   | 2,441                            |
| Transfer of unearned common stock held by the Management Recognition and Retention Plan upon adoption of SFAS No. 123(R) | --              | (9,368)                          | --   | --                | --   | 9,368   | --   | --                               |
| Amortization of awards under the Management Recognition and Retention Plan   | --              | 1,452                            | --   | --                | --   | --  | --   | 1,452                            |
| Amortization of stock options under 2003 Stock Option Plan upon adoption of SFAS No. 123(R)                              | --              | 841                              | --   | --                | --   | --  | --   | 841                              |
| Repurchase of common stock (12,979 shares)   | --              | --                               | --   | (428)             | --   | --  | --   | (428)                            |
| Treasury stock reissued under 2003 Stock Option Plan   | --              | (52)                             | --   | 273               | --   | --  | --   | 221                              |
| Excess tax benefit realized from stock-based compensation plan   | --              | 809                              | --   | --                | --   | --  | --   | 809                              |
| Dividends paid (\$0.13 per common share)   | --              | --                               | (2,148)  | --                | --   | --  | --   | (2,148)                          |
| <b>Comprehensive income:</b>   |                 |                                  |  |                   |  |   |  |                                  |
| Net income   | --              | --                               | 18,909   | --                | --   | --  | --   | 18,909                           |
| Change in unrealized loss on available for sale securities, net of tax and reclassification adjustment                   | --              | --                               | --   | --                | --   | --  | (420)  | (420)                            |
| Total comprehensive income   | --              | --                               | 18,909   | --                | --   | --  | (420)  | 18,489                           |
| Balance at June 30, 2006   | \$ 226          | \$ 353,957                       | \$ 92,043  | \$ (101,739)      | \$ (12,416)  | \$ --   | \$ (1,527)   | \$ 330,544                       |
| Balance at December 31, 2006   | \$ 226          | \$ 358,733                       | \$ 112,111   | \$ (105,406)      | \$ (11,664)  | \$ --   | \$ (717)   | \$ 353,283                       |

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| <i>(Dollars in thousands)</i>  | Common Stock | Additional Paid-in Capital | Retained Earnings, Substantially Restricted | Treasury Stock | Unallocated Common Stock Held by the Employee Stock Ownership Plan | Unearned Common Stock Held by the Management Recognition and Retention Plan | Accumulated Other Comprehensive Loss, Net | Total Stockholders Equity |
|--|--------------|----------------------------|---|----------------|--|---|---|---------------------------|
|  |              |                            |   |                |  |   |   |                           |
| Amortization of awards under the Management Recognition and Retention Plan                             | --           | 1,452                      | --  | --             | --   | --  | --  | 1,452                     |
| Amortization of stock options under 2003 Stock Option Plan   | --           | 841                        | --  | --             | --   | --  | --  | 841                       |
| Repurchase of common stock (7,111 shares)  | --           | --                         | --  | (175)          | --   | --  | --  | (175)                     |
| Treasury stock reissued under 2003 Stock Option Plan   | --           | (108)                      | --  | 463            | --   | --  | --  | 355                       |
| Excess tax benefit realized from stock-based compensation plans  | --           | 418                        | --  | --             | --   | --  | --  | 418                       |
| Dividends paid (\$0.15 per common share)   | --           | --                         | (2,518)                                     | --             | --   | --  | --  | (2,518)                   |
| Cumulative effect of adoption of FASB Interpretation No. 48 on January 1, 2007                         | --           | --                         | 157   | --             | --   | --  | --  | 157                       |
| <b>Comprehensive income:</b>   |              |                            |   |                |  |   |   |                           |
| Net income   | --           | --                         | 11,837                                      | --             | --   | --  | --  | 11,837                    |
| Change in unrealized loss on available for sale securities, net of tax and reclassification adjustment | --           | --                         | --  | --             | --   | --  | 202                                       | 202                       |
| <b>Total comprehensive income</b>  | --           | --                         | 11,837                                      | --             | --   | --  | 202                                       | 12,039                    |
| Balance at June 30, 2007   | \$ 226       | \$ 362,730                 | \$ 121,587                                  | \$ (105,118)   | \$ (10,911)  | \$ --   | \$ (515)                                  | \$ 367,999                |

See accompanying notes to consolidated financial statements.

**TierOne Corporation and Subsidiaries  
Consolidated Statements of Cash Flows (Unaudited)**

| <i>(Dollars in thousands)</i>  | <b>For the Six Months Ended June 30,</b> |             |
|--|--|-------------|
|  | <b>2007</b>                              | <b>2006</b> |
| <b>Cash flows from operating activities:</b>   |  |             |
| Net income   | \$ 11,837                                | \$ 18,909   |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |  |             |
| Net premium amortization (accretion) of investment and mortgage-backed securities        | (340)                                    | 91          |
| Premises and equipment depreciation and amortization                                     | 2,017                                    | 1,823       |
| Amortization of intangible assets  | 847                                      | 886         |
| Amortization of discount on FHLBank Topeka advances                                      | (127)                                    | (128)       |
| Employee Stock Ownership Plan compensation expense                                       | 2,147                                    | 2,441       |

|  | <b>For the Six Months Ended<br/>June 30,</b> |                  |
|--|--|------------------|
|  |  |                  |
| 2003 Management Recognition and Retention Plan compensation expense  | 1,452  | 1,452            |
| 2003 Stock Option Plan compensation expense  | 841  | 841              |
| Accretion of discounts on net loans  | (2,063)                                      | (789)            |
| FHLBank Topeka stock dividend  | (1,921)                                      | (1,640)          |
| Deferred income tax expense (benefit)  | (3,932)                                      | 755              |
| Provision for loan losses  | 11,701                                       | 3,142            |
| Provision for real estate owned losses   | 92   | 70               |
| Proceeds from sales of loans held for sale   | 134,821                                      | 118,525          |
| Originations and purchases of loans held for sale  | (143,803)                                    | (119,814)        |
| Excess tax benefits from stock-based compensation plans  | (418)  | (809)            |
| <b>Net (gain) loss on sales of:</b>  |  |                  |
| Investment securities  | --   | (21)             |
| Loans held for sale  | (1,562)                                      | (1,170)          |
| Real estate owned  | 332  | 64               |
| Premises and equipment   | 2  | (102)            |
| <b>Changes in certain assets and liabilities:</b>  |  |                  |
| Accrued interest receivable  | (44)   | (881)            |
| Other assets   | (6,127)                                      | (1,054)          |
| Accrued interest payable   | (390)  | (1,251)          |
| Accrued expenses and other liabilities   | 6,997  | (2,192)          |
| <b>Net cash provided by operating activities</b>   | <b>12,359</b>                                | <b>19,148</b>    |
| <b>Cash flows from investing activities:</b>   |  |                  |
| Purchase of investment and mortgage-backed securities, available for sale  | (106,552)                                    | (16,851)         |
| Proceeds from sale of investment and mortgage-backed securities, available for sale                                      | 10   | 2,326            |
| Proceeds from maturities of investment securities, available for sale  | 76,015                                       | 13,711           |
| Proceeds from principal repayments of investment and mortgage-backed securities, available for sale and held to maturity | 3,292  | 3,586            |
| Increase in loans receivable   | (34,981)                                     | (128,010)        |
| Additions to premises and equipment  | (1,362)                                      | (3,308)          |
| Proceeds from sale of premises and equipment   | --   | 365              |
| Proceeds from sale of real estate owned  | 2,592  | 4,309            |
| Marine Bank branch purchase - net of cash acquired   | --   | 7,568            |
| <b>Net cash used in investing activities</b>   | <b>(60,986)</b>                              | <b>(116,304)</b> |

See accompanying notes to consolidated financial statements.

**TierOne Corporation and Subsidiaries**  
**Consolidated Statements of Cash Flows (continued) (Unaudited)**

|   | <b>For the Six Months Ended<br/>June 30,</b> |             |
|---|--|-------------|
|   | <b>2007</b>                                  | <b>2006</b> |
| <i>(Dollars in thousands)</i>   |  |             |
| <b>Cash flows from financing activities:</b>  |  |             |
| Net increase (decrease) in deposits   | \$ 189,859                                   | \$ (19,119) |
| Net advances (repayment) on FHLBank Topeka line of credit, short-term advances and other borrowings | (47,119)                                     | 151,515     |
| Proceeds from FHLBank Topeka long-term advances and other borrowings                                | 50,000                                       | 215,000     |
| Repayments of FHLBank Topeka long-term advances and other borrowings                                | (150,106)                                    | (275,101)   |
| Net increase in advances from borrowers for taxes, insurance and                                    |  |             |

|   | <b>For the Six Months Ended<br/>June 30,</b> |                 |
|---|--|-----------------|
| other escrow funds  | 758  | 2,371           |
| Repurchase of common stock  | (175)  | (428)           |
| Dividends paid on common stock  | (2,518)                                      | (2,148)         |
| Excess tax benefit realized from the exercise of stock options                    | 45   | --              |
| Excess tax benefit realized from Management Recognition and Retention Plan shares | 373  | 809             |
| Proceeds from the exercise of stock options                                       | 355  | 221             |
| <b>Net cash provided by financing activities</b>                                  | <b>41,472</b>                                | <b>73,120</b>   |
| <b>Net decrease in cash and cash equivalents</b>                                  | <b>(7,155)</b>                               | <b>(24,036)</b> |
| Cash and cash equivalents at beginning of period                                  | 86,808                                       | 88,034          |
| Cash and cash equivalents at end of period  | \$ 79,653                                    | \$ 63,998       |
| <b>Supplemental disclosures of cash flow information:</b>                         |  |                 |
| <b>Cash paid during period for:</b>   |  |                 |
| Interest  | \$ 56,717                                    | \$ 45,735       |
| Income taxes, net of refunds  | \$ 11,759                                    | \$ 11,230       |
| <b>Noncash investing activities:</b>  |  |                 |
| Transfers from loans to real estate owned and other assets through foreclosure    | \$ 3,120                                     | \$ 7,582        |

See accompanying notes to consolidated financial statements.

**TierOne Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
(Unaudited)

**Note 1 Basis of Presentation and Consolidation**

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. The accompanying unaudited consolidated financial statements include the accounts of the Bank and its wholly owned subsidiaries.

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.

The accompanying interim consolidated financial statements as of June 30, 2007 and for the three and six months ended June 30, 2007 and 2006 are unaudited. All significant intercompany accounts and transactions have been eliminated in consolidation. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the financial position and operating results for interim periods. The unaudited consolidated

financial statements have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) for interim financial information, in accordance with instructions to Form 10-Q and Article 10 of Regulation S-X promulgated by the Securities and Exchange Commission ( SEC ), and do not include all of the information and notes required for complete, audited financial statements. The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006. The results of operations for the three and six months ended June 30, 2007 are not necessarily indicative of the results which may be expected for the entire calendar year 2007.

As used in this report, unless the context otherwise requires, the terms we, us, or our refer to the Company and the Bank.

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**TierOne Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
(Unaudited)

**Note 2 Definitive Acquisition Agreement**

On May 17, 2007, TierOne Corporation, 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.

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), par value \$0.01 per share ( TierOne Common Stock ), will 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 TierOne Corporation stockholders can elect to receive either \$10.20 in cash or \$10.20 of CapitalSource common stock.

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. In addition, the Company has made certain additional covenants, including covenants to cause a stockholder meeting to be held to consider approval of the Merger and for the Company's Board of Directors to, subject to certain exceptions, recommend adoption by its stockholders of the Merger Agreement. Furthermore, the Company is not to solicit or facilitate proposals relating to alternative business combination transactions, or, subject to certain exceptions, enter into discussions concerning alternative business combination transactions.

If CapitalSource's average common stock price declines to certain specified levels in absolute terms and relative to a published industry index, the Merger Agreement contains triggers allowing the Company to renegotiate the Merger Consideration or terminate the transaction. The Merger Agreement also contains other termination rights for both the Company and CapitalSource. Upon termination of the Merger Agreement, under specified circumstances, CapitalSource may be required to pay the Company a termination fee of \$40.0 million or, under other specified circumstances, the Company may be required to pay CapitalSource a termination fee of \$24.0 million. The Merger Agreement also calls for a limited reimbursement of the other party's expenses under certain circumstances.

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**TierOne Corporation and Subsidiaries**  
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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), regulatory approval and Company stockholder approval. The Merger is currently expected to close in the fourth quarter of 2007. On June 29, 2007, CapitalSource filed a Form H-(e)1 Application for the Acquisition of TierOne Bank by the Merger of TierOne Corporation into CapitalSource TRS Inc. with the Office of Thrift Supervision. Additionally, on July 13, 2007 CapitalSource filed a joint proxy / prospectus statement relating to the merger on Form S-4 with the Securities and Exchange Commission.

Due to the proposed merger with CapitalSource, and as reflected in this Form 10-Q, the Company has experienced restrictions in 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 in the Company's ability to repurchase common stock. These activities have and may continue to further impact the Company's financial performance.

### Note 3 Critical 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 income taxes are our most critical accounting policies. These policies 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 reported financial condition and results of operations. The following discussion regarding our critical accounting policies should be read in conjunction with our 2006 Annual Report on Form 10-K.

**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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### TierOne Corporation and Subsidiaries Notes to Consolidated Financial Statements (Unaudited)

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. The evaluation process includes, among other things:

- Assigning individual loans to specific risk levels (pass, special mention, substandard, doubtful and loss);
- 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.

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.

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**TierOne Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
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The allowance for loan losses has 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 which 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.

**Mortgage Servicing Rights.** On January 1, 2007 we adopted Statement of Financial Accounting Standard (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 Income. Loan servicing fees, net of amortization of mortgage servicing rights, is recorded in fees and service charges in the Consolidated Statements of Income.

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.

**TierOne Corporation and Subsidiaries**  
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**Income Taxes.** We estimate income taxes payable based on the amount we expect to owe various tax authorities. Accrued income taxes represent the net estimated amount due to, or to be received from, taxing authorities. In estimating accrued income taxes, we assess the relative merits and risks of the appropriate tax treatment of transactions, taking into account the applicable statutory, judicial and regulatory guidance in the context of our tax position. Although we utilize current information to record income taxes, underlying assumptions may change over time as a result of unanticipated events or circumstances.

We utilize estimates of future earnings to support our position that the benefit of our deferred tax assets will be realized. If future pre-tax income should prove nonexistent or less than the amount of temporary differences giving rise to the net deferred tax assets within the tax years to which they may be applied, the assets will not be realized and our net income will be adversely affected.

**TierOne Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
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**Note 4 Earnings Per Share**

Basic earnings per share ( EPS ) is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised. Diluted earnings per share is computed after giving consideration to the weighted average dilutive effect of our 2003 Stock Option Plan shares and 2003 Management Recognition and Retention Plan shares. The following table is a reconciliation of basic and diluted EPS:

|  | <b>For the Three Months Ended June 30,</b> |                        |                      |                        |
|--|--|------------------------|----------------------|------------------------|
|  | <b>2007</b>                                |                        | <b>2006</b>          |                        |
|  | <b>Basic<br/>EPS</b>                       | <b>Diluted<br/>EPS</b> | <b>Basic<br/>EPS</b> | <b>Diluted<br/>EPS</b> |
| <i>(In thousands, except per share data)</i>                       |  |                        |                      |                        |
| Net income   | \$ 2,459                                   | \$ 2,459               | \$ 9,707             | \$ 9,707               |
| Total weighted average basic common shares outstanding             | 16,681                                     | 16,681                 | 16,463               | 16,463                 |
| <b>Effect of dilutive securities:</b>                              |  |                        |                      |                        |
| 2003 Stock Option Plan   |  | 473                    |                      | 577                    |
| 2003 Management Recognition and Retention Plan                     |  | 30                     |                      | 89                     |
| Total weighted average basic and diluted common shares outstanding | 16,681                                     | 17,184                 | 16,463               | 17,129                 |
| Net earnings per common share                                      | \$ 0.15                                    | \$ 0.14                | \$ 0.59              | \$ 0.57                |

| <i>(In thousands, except per share data)</i>                       | For the Six Months Ended June 30, |                |              |                |
|--|-----------------------------------|----------------|--------------|----------------|
|  | 2007                              |                | 2006         |                |
|  | Basic<br>EPS                      | Diluted<br>EPS | Basic<br>EPS | Diluted<br>EPS |
| Net income   | \$ 11,837                         | \$ 11,837      | \$ 18,909    | \$ 18,909      |
| Total weighted average basic common shares outstanding             | 16,640                            | 16,640         | 16,425       | 16,425         |
| <b>Effect of dilutive securities:</b>                              |                                   |                |              |                |
| 2003 Stock Option Plan   |                                   | 502            |              | 571            |
| 2003 Management Recognition and Retention Plan                     |                                   | 39             |              | 84             |
| Total weighted average basic and diluted common shares outstanding | 16,640                            | 17,181         | 16,425       | 17,080         |
| Net earnings per common share                                      | \$ 0.71                           | \$ 0.69        | \$ 1.15      | \$ 1.11        |

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**TierOne Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
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**Note 5 Stock-Based Benefit Plans**

**General.** We account for our stock-based benefit plans using SFAS No. 123(R), *Share-Based Payment* ( SFAS No. 123(R) ). SFAS No. 123(R) requires that compensation expense related to stock-based payment transactions be recognized in the financial statements and that expense be measured based on the fair value of the equity or liability instrument issued. SFAS No. 123(R) also requires that forfeitures be estimated over the vesting period of the instrument.

**Stock-Based Employee Compensation Expense.** Amounts recognized in the financial statements with respect to our Employee Stock Ownership Plan ( ESOP ) and stock-based employee compensation plans are presented in the following table:

| <i>(Dollars in thousands)</i>  | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|--|--------------------------------|----------|------------------------------|----------|
|  | 2007                           | 2006     | 2007                         | 2006     |
| <b>Stock-based employee compensation expense:</b>                        |                                |          |                              |          |
| Employee Stock Ownership Plan expense                                    | \$ 1,009                       | \$ 1,213 | \$ 2,055                     | \$ 2,379 |
| Management Recognition and Retention Plan expense                        | 726                            | 726      | 1,452                        | 1,452    |
| 2003 Stock Option Plan expense   | 420                            | 420      | 841                          | 841      |
| Amount of stock-based compensation expense,<br>before income tax benefit | \$ 2,155                       | \$ 2,359 | \$ 4,348                     | \$ 4,672 |
| Amount of related income tax benefit recognized                          | \$ 509                         | \$ 511   | \$ 1,013                     | \$ 1,015 |

**Employee Stock Ownership Plan.** Concurrent with the conversion from mutual to stock ownership, we established an ESOP for the benefit of our employees. The ESOP is a qualified pension plan under Internal Revenue Service guidelines that covers all full-time employees who have completed 1,000 hours of service. Upon formation, the ESOP purchased 1,806,006 shares of common stock issued in the initial public offering

with the proceeds of an \$18,060,060 loan from the Company.

We account for our ESOP in accordance with Statement of Position 93-6, *Employers Accounting for Employee Stock Ownership Plans*. Accordingly, expense is recognized based on the market value (average stock price) of shares scheduled to be released from the ESOP trust. The excess fair value of ESOP shares over cost is recorded as compensation expense but is not deductible for tax purposes. As shares are committed to be released from collateral, we report compensation expense equal to the average market price of the shares and the shares become outstanding for EPS computations. Our contributions and dividends on allocated and unallocated ESOP shares are used to pay down the loan. Accordingly, we have recorded the obligation with an offsetting amount of unearned compensation in stockholders' equity in the accompanying Consolidated Statements of Financial Condition.

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**TierOne Corporation and Subsidiaries**  
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(Unaudited)

|  | At or for the<br>Three Months Ended<br>June 30, |           | At or for the<br>Six Months Ended<br>June 30, |           |
|--|---|-----------|---|-----------|
|  | 2007  | 2006      | 2007  | 2006      |
| <i>(Dollars in thousands, except for share data)</i>           |   |           |   |           |
| Employee Stock Ownership Plan compensation expense             | \$ 1,009  | \$ 1,213  | \$ 2,055                                      | \$ 2,379  |
| Employee Stock Ownership Plan shares allocated to employees    | 639,627   | 489,127   | 639,627                                       | 489,127   |
| Employee Stock Ownership Plan shares unallocated               | 1,166,379                                       | 1,316,879 | 1,166,379                                     | 1,316,879 |
| Fair value of Employee Stock Ownership Plan unallocated shares | \$ 35,108                                       | \$ 44,471 | \$ 35,108                                     | \$ 44,471 |

**Management Recognition and Retention Plan.** We established the 2003 Management Recognition and Retention Plan ( MRRP ) which is a stock-based incentive plan. The shares awarded by the MRRP vest to participants at the rate of 20% per year. Compensation expense for this plan is being recorded over a 60-month period, using the straight-line amortization method adjusted for forfeitures, and is based on the market value of our stock as of the date the awards were made. Stockholders approved 903,003 shares to be granted under the MRRP and 100,653 shares are still available for future grants as of June 30, 2007. The following table summarizes shares of our common stock that were subject to award and have been granted pursuant to the MRRP as of June 30, 2007:

|   | At or for the Three and Six<br>Months Ended<br>June 30, |           |
|---|---|-----------|
|   | 2007  | 2006      |
| Nonvested shares outstanding at beginning of period | 328,940   | 489,160   |
| Shares granted                                      | --  | --        |
| Shares vested                                       | (152,720)   | (152,720) |
| Shares forfeited                                    | --  | --        |
| Nonvested shares outstanding at end of period       | 176,220   | 336,440   |

Compensation expense related to the MRRP totaled \$726,000 for the three months ended June 30, 2007 and 2006 and \$1.5 million for each of the six months ended June 30, 2007 and 2006. The weighted average grant date fair value of outstanding shares awarded by the MRRP was \$18.64 and \$18.38 at June 30, 2007 and 2006, respectively. As of June 30, 2007, we had \$2.7 million of total unrecognized employee compensation expense related to unvested MRRP shares which are expected to be recognized over a weighted average period of 1.1 years. We realized excess tax benefits related to MRRP shares of \$5,000 and \$13,000 during the three and six months ended June 30, 2007, respectively.

**TierOne Corporation and Subsidiaries**  
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**Stock Option Plan.** We established the 2003 Stock Option Plan ( SOP ) under which 2,257,508 shares of our common stock were reserved for the grant of stock options to directors, officers and employees. Stock options awarded under the SOP vest to participants at the rate of 20% per year. Compensation expense for this plan is being recorded over a 60-month period, using the straight-line amortization method adjusted for forfeitures, and is based on the fair value of our stock options as of the date the awards were made. The exercise price of the options is equal to the market price of the common stock on the grant date. Stockholders approved 2,257,508 stock options to be granted under the SOP and 359,758 of these stock options remain available for future grants as of June 30, 2007.

The fair value of each option was estimated on the date of the grant using the Black-Scholes model. The dividend yield was calculated based on the annual dividends paid and the 12-month average closing stock price at the time of the grant. Expected volatility was based on historical volatility of our stock price at the date of grant. We have utilized historical experience to determine the expected life of the stock options and to estimate future forfeitures. All inputs into the Black-Scholes model are estimates at the time of the grant. Actual results in the future could materially differ from these estimates; however, such results would not impact future reported net income.

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**Stock Option Activity.** The following table details stock options granted, exercised and forfeited during the three months ended June 30, 2007:

| <i>(Dollars in thousands, except per share data)</i> | Number of<br>Shares | Weighted<br>Average<br>Exercise Price | Weighted Average<br>Remaining<br>Contractual Term<br>(In Years) | Aggregate<br>Intrinsic<br>Value |
|--|---------------------|---------------------------------------|---|---------------------------------|
| Stock options outstanding at March 31, 2007          | 1,802,226           | \$ 17.92                              |   |                                 |
| Stock options granted                                | --                  | --                                    |   |                                 |
| Stock options exercised                              | (3,500)             | 17.83                                 |   |                                 |
| Stock options forfeited                              | (500)               | 17.83                                 |   |                                 |
| Stock options outstanding at June 30, 2007           | 1,798,226           | \$ 17.92                              | 5.8   | \$ 21,900                       |
| Stock options exercisable at June 30, 2007           | 1,410,676           | \$ 17.88                              | 5.8   | \$ 17,200                       |

The following table details stock options granted, exercised and forfeited during the six months ended June 30, 2007:

| <i>(Dollars in thousands, except per share data)</i> | Number of<br>Shares | Weighted<br>Average<br>Exercise Price | Weighted Average<br>Remaining<br>Contractual Term<br>(In Years) | Aggregate<br>Intrinsic<br>Value |
|--|---------------------|---------------------------------------|---|---------------------------------|
|--|---------------------|---------------------------------------|---|---------------------------------|

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| <i>(Dollars in thousands, except per share data)</i> | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (In Years) | Aggregate Intrinsic Value |
|--|------------------|---------------------------------|--|---------------------------|
| Stock options outstanding at December 31, 2006       | 1,818,626        | \$ 17.92                        |  |                           |
| Stock options granted                                | --               | --                              |  |                           |
| Stock options exercised                              | (19,900)         | 17.83                           |  |                           |
| Stock options forfeited                              | (500)            | 17.83                           |  |                           |
| Stock options outstanding at June 30, 2007           | 1,798,226        | \$ 17.92                        | 5.8  | \$ 21,900                 |
| Stock options exercisable at June 30, 2007           | 1,410,676        | \$ 17.88                        | 5.8  | \$ 17,200                 |

The following table details stock options granted, exercised and forfeited during the three months ended June 30, 2006:

| <i>(Dollars in thousands, except per share data)</i> | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (In Years) | Aggregate Intrinsic Value |
|--|------------------|---------------------------------|--|---------------------------|
| Stock options outstanding at March 31, 2006          | 1,858,250        | \$ 17.92                        |  |                           |
| Stock options granted                                | --               | --                              |  |                           |
| Stock options exercised                              | (7,900)          | 17.83                           |  |                           |
| Stock options forfeited                              | --               | --                              |  |                           |
| Stock options outstanding at June 30, 2006           | 1,850,350        | \$ 17.92                        | 6.8  | \$ 29,300                 |
| Stock options exercisable at June 30, 2006           | 1,088,250        | \$ 17.86                        | 6.8  | \$ 17,300                 |

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**TierOne Corporation and Subsidiaries**  
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The following table details stock options granted, exercised and forfeited during the six months ended June 30, 2006:

| <i>(Dollars in thousands, except per share data)</i> | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (In Years) | Aggregate Intrinsic Value |
|--|------------------|---------------------------------|--|---------------------------|
| Stock options outstanding at December 31, 2005       | 1,864,750        | \$ 17.92                        |  |                           |
| Stock options granted                                | --               | --                              |  |                           |
| Stock options exercised                              | (11,900)         | 18.60                           |  |                           |
| Stock options forfeited                              | (2,500)          | 17.83                           |  |                           |
| Stock options outstanding at June 30, 2006           | 1,850,350        | \$ 17.92                        | 6.8  | \$ 29,300                 |
| Stock options exercisable at June 30, 2006           | 1,088,250        | \$ 17.86                        | 6.8  | \$ 17,300                 |

The following table details the intrinsic value, cash received and tax benefit realized from the exercise of stock options during the three and six months ended June 30, 2007 and 2006:

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| <i>(Dollars in thousands)</i>   | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |        |
|---|--------------------------------|--------|------------------------------|--------|
|   | 2007                           | 2006   | 2007                         | 2006   |
| Intrinsic value (market value on the exercise date less the strike price) | \$ 27                          | \$ 126 | \$ 228                       | \$ 175 |
| Cash received from the exercise of stock options                          | 62                             | 141    | 355                          | 221    |
| Tax benefit realized from the exercise of stock options                   | 4                              | 35     | 50                           | 59     |

At June 30, 2007, there was \$1.4 million of total unrecognized compensation expense related to unvested stock options that will be expensed over a weighted average period of 0.9 years.

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**TierOne Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
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**Note 6 Goodwill and Other Intangible Assets**

**Goodwill.** Goodwill represents the excess price paid over the fair value of the tangible and intangible assets and liabilities acquired in connection with the acquisition of United Nebraska Financial Co. ( UNFC ) in 2004. There was no goodwill recorded in connection with our Marine Bank branch purchase in 2006. We evaluate goodwill for impairment annually in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*. There have been no changes in the carrying amount of goodwill during the six months ended June 30, 2007 due to impairment as we are not aware of any facts or circumstances that would indicate our carrying value exceeded fair value. The changes in the carrying amount of goodwill for the three and six months ended June 30, 2007 and 2006 are as follows:

| <i>(Dollars in thousands)</i>                            | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|--|--------------------------------|-----------|------------------------------|-----------|
|  | 2007                           | 2006      | 2007                         | 2006      |
| Balance at beginning of period                           | \$ 42,162                      | \$ 42,283 | \$ 42,228                    | \$ 42,283 |
| Adjustment due to adoption of FASB Interpretation No. 48 | --                             | --        | (66)                         | --        |
| Balance at end of period                                 | \$ 42,162                      | \$ 42,283 | \$ 42,162                    | \$ 42,283 |

**Other Intangible Assets.** Our only identifiable other intangible asset is the value of core deposits acquired as part of the UNFC and Marine Bank transactions. The core deposit intangible assets have been estimated to have nine- to ten-year lives. Core deposit intangible assets are amortized using an accelerated method of amortization which is recorded in other operating expense.

**Other Intangible Asset Activity.** The changes in the carrying amount of acquired intangible assets for the three and six months ended June 30, 2007 and 2006 are as follows:

| <i>(Dollars in thousands)</i> | Three Months Ended<br>June 30, |      | Six Months Ended<br>June 30, |      |
|-------------------------------|--------------------------------|------|------------------------------|------|
|                               | 2007                           | 2006 | 2007                         | 2006 |

|                                | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |           |
|--------------------------------|--------------------------------|----------|------------------------------|-----------|
|                                |                                |          |                              |           |
| Balance at beginning of period | \$ 7,967                       | \$ 9,600 | \$ 8,391                     | \$ 10,041 |
| Additions                      | --                             | 102      | --                           | 102       |
| Amortization expense           | (423)                          | (445)    | (847)                        | (886)     |
| Balance at end of period       | \$ 7,544                       | \$ 9,257 | \$ 7,544                     | \$ 9,257  |

**TierOne Corporation and Subsidiaries**  
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**Other Intangible Asset Estimated Amortization.** Estimated amortization expense related to our core deposit intangible assets for the year ending December 31, 2007 and five years thereafter are as follows:

*(Dollars in thousands)*

| Estimated Amortization Expense<br>For the Year Ending: |          |
|--|----------|
| December 31, 2007                                      | \$ 1,647 |
| December 31, 2008                                      | 1,513    |
| December 31, 2009                                      | 1,373    |
| December 31, 2010                                      | 1,222    |
| December 31, 2011                                      | 1,052    |
| December 31, 2012                                      | 850      |

**TierOne Corporation and Subsidiaries**  
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**Note 7 Investment and Mortgage-Backed Securities**

**Investment Security Composition.** The amortized cost, gross unrealized gains and losses and fair value of investment and mortgage-backed securities by major security category at June 30, 2007 and December 31, 2006 are as follows:

| <i>(Dollars in thousands)</i> | June 30, 2007    |        |
|-------------------------------|------------------|--------|
|                               | Gross Unrealized |        |
|                               | Gains            | Losses |

June 30, 2007

|   | June 30, 2007  |       |        |            |
|---|----------------|-------|--------|------------|
|   | Amortized Cost |       |        | Fair Value |
| <b>Held to maturity:</b>  |                |       |        |            |
| Municipal obligations   | \$ 80          | \$ -- | \$ --  | \$ 80      |
| <b>Available for sale:</b>  |                |       |        |            |
| Mortgage-backed securities  | 9,148          | 43    | 184    | 9,007      |
| U.S. Government securities and agency obligations                   | 110,657        | 19    | 400    | 110,276    |
| Corporate securities  | 4,940          | --    | 41     | 4,899      |
| Municipal obligations   | 14,740         | 10    | 90     | 14,660     |
| Agency equity securities  | 536            | 3     | 8      | 531        |
| Asset Management Fund - ARM Fund                                    | 6,000          | --    | 188    | 5,812      |
| Total investment and mortgage-backed securities, available for sale | \$ 146,021     | \$ 75 | \$ 911 | \$ 145,185 |

|   | December 31, 2006 |                  |          |            |
|---|-------------------|------------------|----------|------------|
|   | Amortized Cost    | Gross Unrealized |          | Fair Value |
|   |                   | Gains            | Losses   |            |
| <i>(Dollars in thousands)</i>                                       |                   |                  |          |            |
| <b>Held to maturity:</b>  |                   |                  |          |            |
| Municipal obligations   | \$ 90             | \$ --            | \$ --    | \$ 90      |
| <b>Available for sale:</b>  |                   |                  |          |            |
| Mortgage-backed securities  | 12,476            | 51               | 255      | 12,272     |
| U.S. Government securities and agency obligations                   | 78,201            | 4                | 636      | 77,569     |
| Corporate securities  | 5,245             | --               | 115      | 5,130      |
| Municipal obligations   | 15,970            | 19               | 61       | 15,928     |
| Agency equity securities  | 547               | --               | 10       | 537        |
| Asset Management Fund - ARM Fund                                    | 6,000             | --               | 164      | 5,836      |
| Total investment and mortgage-backed securities, available for sale | \$ 118,439        | \$ 74            | \$ 1,241 | \$ 117,272 |

We believe all unrealized losses as of June 30, 2007 to be market related, with no permanent sector or issuer credit concerns or impairments. We had 93 securities with unrealized losses totaling \$876,000 for 12 consecutive months or longer as of June 30, 2007. The unrealized losses are believed to be temporarily, not permanently, 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 June 30, 2007, we have the ability and intent to hold these securities until maturity.

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**Note 8 Loans Receivable**

*Loan Portfolio Composition.* Loans receivable at June 30, 2007 and December 31, 2006 are summarized in the following table:

| <i>(Dollars in thousands)</i>                          | <b>June 30, 2007</b> |                 | <b>December 31, 2006</b> |                 |
|--|----------------------|-----------------|--------------------------|-----------------|
|  | <b>Amount</b>        | <b>%</b>        | <b>Amount</b>            | <b>%</b>        |
| <b>Real estate loans:</b>                              |                      |                 |                          |                 |
| One-to-four family residential (1)                     | \$ 345,480           | 9.51 %          | \$ 339,080               | 9.21 %          |
| Second mortgage residential                            | 106,057              | 2.92            | 120,510                  | 3.27            |
| Multi-family residential                               | 123,634              | 3.40            | 148,922                  | 4.05            |
| Commercial real estate                                 | 381,580              | 10.50           | 396,620                  | 10.77           |
| Land and land development                              | 524,242              | 14.43           | 494,887                  | 13.44           |
| Residential construction                               | 657,602              | 18.09           | 780,991                  | 21.21           |
| Commercial construction                                | 577,080              | 15.88           | 491,997                  | 13.36           |
| Agriculture  | 85,746               | 2.36            | 68,459                   | 1.86            |
| <b>Total real estate loans</b>                         | <b>2,801,421</b>     | <b>77.09</b>    | <b>2,841,466</b>         | <b>77.17</b>    |
| Business   | 224,312              | 6.17            | 220,669                  | 5.99            |
| Agriculture - operating                                | 94,576               | 2.60            | 94,455                   | 2.56            |
| Warehouse mortgage lines of credit                     | 113,942              | 3.14            | 112,645                  | 3.06            |
| <b>Consumer loans:</b>                                 |                      |                 |                          |                 |
| Home equity  | 72,984               | 2.01            | 71,476                   | 1.94            |
| Home equity lines of credit                            | 122,698              | 3.37            | 130,071                  | 3.53            |
| Home improvement                                       | 50,048               | 1.38            | 55,513                   | 1.51            |
| Automobile   | 86,384               | 2.38            | 87,575                   | 2.38            |
| Other  | 67,550               | 1.86            | 68,365                   | 1.86            |
| <b>Total consumer loans</b>                            | <b>399,664</b>       | <b>11.00</b>    | <b>413,000</b>           | <b>11.22</b>    |
| <b>Total loans</b>                                     | <b>3,633,915</b>     | <b>100.00 %</b> | <b>3,682,235</b>         | <b>100.00 %</b> |
| Unamortized premiums, discounts and deferred loan fees | 7,977                |                 | 5,602                    |                 |
| Loans in process (2)                                   | (548,881)            |                 | (637,677)                |                 |
| <b>Net loans</b>                                       | <b>3,093,011</b>     |                 | <b>3,050,160</b>         |                 |
| Allowance for loan losses                              | (43,213)             |                 | (33,129)                 |                 |
| <b>Net loans after allowance for loan losses</b>       | <b>\$</b>            |                 | <b>\$</b>                |                 |