



**FIRST DEFIANCE
FINANCIAL CORP.**

Neil M. Barofsky
Office of the Inspector General
Troubled Asset Relief Program
1500 Pennsylvania Ave., N.W., Suite 1064
Washington, D.C. 20220

March 6, 2009

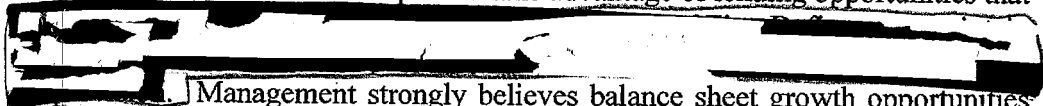
Dear Mr. Barofsky:

At your request, First Defiance Financial Corp. (FDEF) provides the following information related to our participation in the Capital Purchase Program (CPP) developed under the Troubled Asset Relief Program (TARP) of the U.S. Treasury as established by The Emergency Economic Stabilization Act of 2008 (EESA). Through this program, we applied for and received \$37 million in exchange for issuing the required number of preferred shares of FDEF stock and warrants.

(1)(a) Consistent with the intended uses set out in our application to participate in the CPP, we have used the funds to replace debt with equity by paying down the \$20 million balance on FDEF's line of credit with LaSalle/ Bank of America and infused the balance into our bank subsidiary, First Federal Bank of the Midwest (FFB) as common equity. The reduction of the line of credit replaced a non-qualifying funding facility with Tier 1 capital and also increased the liquidity of the company by eliminating short term debt.

This will enable FDEF to pursue the following strategies:

- Accelerate FDEF's organic growth rate in existing markets. Participation in the CPP has provided increased capital to take advantage of lending opportunities that

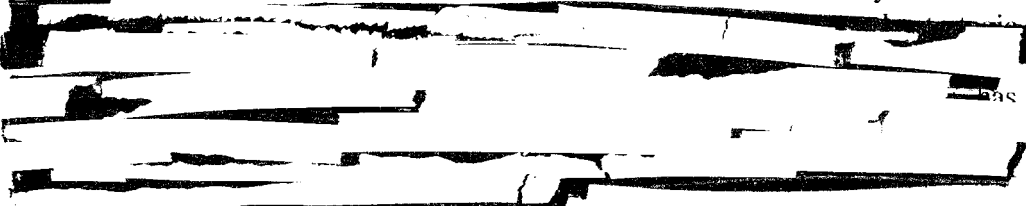


Management strongly believes balance sheet growth opportunities for core deposits and loans, across a range of business lines, exist in the bank's current geographic footprint. This will promote economic growth in the Bank's market area.

- FDEF will be better positioned and has determined to more aggressively expand its participation in FHA programs.
- The enhanced capital position of FDEF and First Federal Bank will provide greater flexibility to develop work-out plans for selected housing related problem assets. Value can be maximized in certain instances by working with customers

b(8)

to allow continued occupancy, rather than implementing an aggressive foreclosure policy. The benefits of this strategy to the customer and the community are clear.

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- Strengthening our capital position in this economic climate is viewed as a prudent decision as we continue to face the uncertainties of today's financial markets and was a major factor in our decision to participate in the CPP. The future impact of Other Than Temporary Impairment, additional loan provision expense, goodwill impairment, as well as other challenges that banks face today all could have a negative impact on a bank's capital levels.

(1)(b) The funds received through the CPP are not segregated from other funds at the institution. This capital is not the direct source of funding for loans. It provides us with a higher level of capital that is enabling us to make loans that we would have otherwise declined because of possible constraints on regulatory capital levels. The addition of the CPP funds raised our total risk based capital level from 12.04% at September 30, 2008 up to 13.02% at the bank level as of December 31, 2008. For every \$0.12 of additional capital we can support \$1.00 in new lending.

(1)(c) With the additional capital provided by the CPP, FDEF through FFB has made \$53,593,369 in new commercial loans, primarily to small businesses, since receiving the funds in early December. In addition to the new loans, we have also been able to renew or refinance \$117,710,609 in loans to existing commercial customers, in many cases relieving financial pressure on these entities due to the current economic conditions. With the additional capital it has also allowed us to modify or enter into forbearance agreements with several of these customers where we reduced interest rates and/or allowed interest only payments on loans totaling \$25,469,102. With our residential mortgage customers we have been able to do modifications, repayment plans, deeds in lieu and forbearance agreements to help sold and non-sold mortgage customers. We have been able to help nearly all the customers who have requested assistance. Since we received the CPP funds we have assisted 14 customers through this program and currently are in the process of working with 41 others. As a result, we have very few owner-occupied residential mortgage loans that are going through foreclosure. We are in the process of expanding this outreach program through participation in the administration's recently announced Making Home Affordable Program. This level of additional lending and the loan modifications or forbearances would not have been possible without the additional capital.


(1d) It is our intention to continue to make loans to credit worthy applicants, both commercial and retail. We will also continue to work with both commercial and retail customers to modify loan terms, as warranted, to ease financial pressure. As mentioned above, capital levels need to be carefully monitored in this economic

environment, but the additional capital from the CPP is allowing us to continue making loans and to work with our customers to work through their financial challenges.

(2) Prior to participating in the CPP, we did an extensive review of all the executive compensation guidelines involved with the program. Employment agreements with four executives were amended to assure compliance with the golden parachute guidelines. The Chief Risk Officer at FDEF reviewed all incentive compensation programs and certified to our board of directors that they did not incur undue risk to FDEF. No new plans were put in place to offset any of these changes. However, FDEF is currently reviewing the additional restrictions that were added through the enactment of the stimulus bill on February 17, 2009, after the CPP agreement was entered into.

FDEF considers this a complete response to the inquiry by the Special Inspector General and the undersigned certifies that the information provided herein is accurate.

Sincerely,



William J. Small
Chairman, President, and CEO
First Defiance Financial Corp.