



Timberland Bancorp, Inc.

March 5, 2009

Office of the Special Inspector General
Troubled Asset Relief Program
1500 Pennsylvania Avenue, N.W., Suite 1064
Washington D.C. 20220

Attn.: Neil M. Barofski, Special Inspector General

Re: TARP Inquiry

Dear Mr. Barofski:

You have requested certain information related to the sale of preferred stock to the U.S. Treasury in your letter to Timberland Bancorp, Inc. dated February 6, 2009. Our response follows:

1a. Our Anticipated Use of TARP Funds – Timberland Bancorp, Inc. (Company) elected to participate in the sale of preferred stock to the U.S. Treasury to strengthen its capital position in anticipation of an extended and severe economic slowdown and to participate in a program that healthy banks were encouraged to participate in by the Treasury. The consummation of the sale provided capital support and confidence to continue lending in spite of an economic climate more disruptive and uncertain than that of many previous decades. (b) Were the TARP Funds Segregated From Other Institutional Funds? – The Company received \$16.641 million in TARP funds of which \$6.0 million was invested as a capital injection into Timberland Bank (Bank) and \$10.641 million was retained by the Company for additional capital injections into the Bank, if necessary. The \$6.0 million capital injection into the Bank was not segregated from other funds owned, or loaned by the Bank. (c) Our Use of TARP capital to date – As noted, \$10.641 million was retained at the Company to support its capital position in light of the severely adverse economic climate in which we are now operating. The \$6 million capital injection into the Bank served to increase its capital position and to support its lending function. (d) Our Expected Use of TARP funds – We will continue to use the capital raised by the sale of preferred stock to support our capital position and to endeavor to continue supporting the credit needs of individuals and businesses in our communities. Without the receipt of such capital, lending initiatives would have been curtailed to increase the Bank's capital level during these uncertain economic times.

2. We plan to diligently monitor the capital level of the Company and of the Bank and continue to prudently originate business, mortgage and consumer loans to qualified applicants in the communities we serve. Capital will be injected by the Company into the Bank as deemed prudent to support the capital level and lending operations of the Bank. Capital from the sale of preferred stock was received by the Company on December 23, 2008. Timberland's lending volume for the two month period ended February 28, 2009 increased by 116% as compared to the two month period ended February 28, 2008. Timberland originated \$71.85 million in loans for the two month period ended February 28, 2009 as compared to \$33.20 million in the like period one year earlier. The noted period ended February 28, 2009 represented the first two full months after the sale of preferred stock to the U.S. Treasury. Presuming the increase was exclusively due to the securities sale would be a misstatement since much of the increase in loan volume was a function of the historically low interest rates available in 2009. Total loan originations in January 2009 also represented a \$6.6 million increase from the prior calendar month (December 2008). February 2009 originations increased to \$42.31 million, an increase of \$12.77 million from the total loans originated one month earlier (January 2009).

The Bank did not participate in the origination of sub-prime loans and has no such loans to manage or resolve. The Bank's loan committee is actively engaged in the review and monitoring of classified loans and has modified loan terms, as deemed prudent, to enable borrowers to better manage their loan obligations.

The Bank's compensation committee will meet in accordance with the time frames established in the guidance - within 120 days from the sale of the preferred securities and within 135 days after the first fiscal year end following the closing of the securities sale and will execute the appropriate certifications. We have been advised that these time frames are in the process of being revised. We will comply with the requirements specified in the revised guidance when it is issued. Attached are copies of the resolutions adopted by the Company's compensation committee in conjunction with the closing. Also attached is a copy of the SEO waiver submitted with the application for the Capital Purchase Program. (b) (4)

Timberland will comply with the provisions of the updated guidance when it is issued.

The primary positive effect of receiving TARP capital has been the continued willingness to lend due to a stronger capital base. The biggest negative has been the lack of clarity between companies receiving TARP funding to avoid failure and participants in the Capital Purchase Program (CPP). Treasury would significantly enhance the reputation of healthy community banks that participated in the CPP by clearly and forcefully reiterating the initial Treasury stance which specified CPP as being reserved for, and directed to, healthy community banks. The lack of clarity between general TARP funding and the CPP may lead to the use of TARP funding in community banks for liquidity rather than for extending credit as disgruntled depositors move deposits from

banks assumed to have been "bailed out" by the government. I encourage Treasury to support community banks by making the distinction clear. The majority of community banks did not engage in sub-prime lending and are not foreclosing on hordes of homeowners. We are continuing to meet the credit and savings needs of the businesses and the individuals in the communities we serve. Your public recognition of this fact would certainly improve the reputation of the healthy community banks in our Country.

I certify the accuracy of all statements, representations and supporting information provided (subject to the requirements and penalties set forth in Title 18, United States Code 1001).

If you wish specific additional information please contact me.

Thank you.

Cordially,

A handwritten signature in black ink, appearing to read "Michael R. Sand". The signature is written in a cursive style with a large, sweeping initial "M".

Michael R. Sand
President and CEO

Timberland Bancorp, Inc.

Resolutions of Compensation Committee

December 17, 2008

WHEREAS, the board of directors of Timberland Bancorp, Inc. (“Corporation”) has determined that it is in the best interests of the Corporation and its shareholders to participate in the Treasury TARP CPP program (“CPP”), under which the Corporation will issue preferred stock and a warrant to purchase Corporation common stock to the United States Treasury (“UST”) in return for cash; and

WHEREAS, the UST has accepted the Corporation’s CPP application and has informed the Corporation that the closing is scheduled for December 23, 2008; and

WHEREAS, in order for the Corporation to participate in the CPP, it must comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008 regarding executive compensation and corporate governance and the related UST interim final regulations published in the Federal Register on October 20, 2008 (the “Compensation Guidelines”); and

WHEREAS, the Corporation is required to deliver a certificate to the UST at the closing of the CPP transaction that it has complied with all the Compensation Guidelines; and

WHEREAS, the Corporation is required to deliver to the UST at the closing of the CPP transaction waivers of its senior executive officers subject to the Compensation Guidelines (“SEOs”) with respect to the changes in the Corporation’s compensation plans, policies and practices required by the Compensation Guidelines; and

WHEREAS, the board of directors of the Corporation has authorized and directed the Committee to take all the actions required under the Compensation Guidelines.

NOW, THEREFORE, BE IT

RESOLVED that, as long as UST holds securities of the Corporation acquired in the CPP, the Compensation Committee will be responsible for:

- Reviewing the Corporation’s compensation plans and policies with our senior risk officers in order to identify and eliminate any bonus plans or other incentive compensation for SEOs that encourage them to take unnecessary and excessive risks that threaten the value of the financial institution; and
- Meeting annually with our senior risk officers to discuss and review the relationship between the Corporation’s risk management policies and practices and the SEOs’ bonus and incentive compensation arrangements; and

- Certifying that the Committee has completed the annual review of the SEOs' bonus and incentive compensation arrangements in the Compensation Discussion and Analysis section included in the Corporation's annual meeting proxy statement; and
- Adopting appropriate provisions for the recovery by the Corporation or its subsidiaries of any bonus or incentive compensation paid to a SEO based on financial statements or performance metric criteria later determined to be materially inaccurate, including requiring SEOs to sign an agreement in this regard; and
- Prohibiting the Corporation or any subsidiary from making any golden parachute payment (as defined under the Compensation Guidelines) to any SEO, including requiring SEOs to sign an agreement to amend all applicable employment, severance, benefit or related agreements or plans in this regard; and
- Directing that all compensation to SEOs be subject to the special limits on deductibility for tax purposes under the Compensation Guidelines; and

RESOLVED, that based on its review with the senior risk officers of the Corporation of the bonus plans or other incentive compensation for SEOs of the Corporation and its subsidiaries, the Compensation Committee believes these bonus plans and other incentive compensation arrangements do not contain incentives that encourage SEOs to take unnecessary and excessive risks that threaten the value of the Corporation or its subsidiary financial institution; and

RESOLVED, that the Compensation Committee, acting on behalf of the Corporation, caused an agreement between the Corporation and each of its SEOs to be executed, in the form attached to these resolutions, providing for the recovery by the Corporation or its subsidiaries of any bonus or incentive compensation paid to a SEO based on financial statements or performance metric criteria later determined to be materially inaccurate and amending any compensation agreements or plans in order to prohibit any golden parachute payments (as defined under the Compensation Guidelines) to SEOs not permitted by the Compensation Guidelines as long as UST holds securities of the Corporation acquired in the CPP; and

RESOLVED, that the Compensation Committee, acting on behalf of the Corporation, has requested that each SEO execute the required form of waiver respecting his or her waiver of rights in connection with changes in his or her executive compensation that are required by the Compensation Guidelines, for delivery to the UST at the closing of the CPP; and

RESOLVED, that the Compensation Committee, acting on behalf of the Corporation, directs the officers and tax consultants of the Corporation and its subsidiaries to comply with the special tax rules for the deduction of the SEOs compensation, as long as UST holds an equity or debt position in the Corporation.


WAIVER

In consideration for the benefits I will receive as a result of my employer's participation in the United States Department of the Treasury's TARP Capital Purchase Program, I hereby voluntarily waive any claim against the United States or my employer for any changes to my compensation or benefits that are required to comply with the regulation issued by the Department of the Treasury as published in the Federal Register on October 20, 2008.

I acknowledge that this regulation may require modification of the compensation, bonus, incentive and other benefit plans, arrangements, policies and agreements (including so-called "golden parachute" agreements) that I have with my employer or in which I participate as they relate to the period the United States holds any equity or debt securities of my employer acquired through the TARP Capital Purchase Program.

This waiver includes all claims I may have under the laws of the United States or any state related to the requirements imposed by the aforementioned regulation, including without limitation a claim for any compensation or other payments I would otherwise receive, any challenge to the process by which this regulation was adopted and any tort or constitutional claim about the effect of these regulations on my employment relationship.

Date: December 23 2008



Michael R. Sand
President and Chief Executive Officer of
Timberland Bancorp, Inc. and
Timberland Bank