Sound Financial Bancorp, Inc.
Form 10-K
March 27, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2017
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 001-35633

Sound Financial Bancorp, Inc.
(Exact Name of Registrant as Specified in its Charter)

Maryland	45-5188530
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2400 3rd Avenue, Suite 150, Seattle Washington	98121
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (206) 448-0884

Securities Registered Pursuant to Section 12(b) of the Act:
Common Stock, par value $.01 per share

Securities Registered Pursuant to Section 12(g) of the Act:
Title of each class
None

Indicate by checkmark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES NO

Indicate by checkmark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES NO

Indicate by checkmark 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 checkmark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES NO

Indicate by checkmark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definition of "large accelerated filer," accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of June 30, 2017, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $64.2 million. (The exclusion from such amount of the market value of the shares owned by any person shall not be deemed an admission by the registrant that such person is an affiliate of the registrant.)

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the latest practicable date: As of March 27, 2018, there were 2,524,346 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

PART III of Form 10-K – Portions of the Registrant's Proxy Statement for its 2018 Annual Meeting of Shareholders.
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PART I

Item 1. Business

Special Note Regarding Forward-Looking Statements

Certain matters discussed in this Form 10-K constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our financial condition, results of operations, plans, objectives, future performance or business. Forward-looking statements are not statements of historical fact, are based on certain assumptions and are generally identified by use of the words "believes," "expects," "anticipates," "estimates," "forecasts," "intends," "plans," "targets," "potentially," "probably," "projects," "outlook" or similar expressions or future or conditional verbs such as "may," "will," "should," "would" and "could." Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, assumptions and statements about, among other things, expectations of the business environment in which we operate, projections of future performance or financial items, perceived opportunities in the market, potential future credit experience, and statements regarding our mission and vision. These forward-looking statements are based upon current management expectations and may, therefore, involve risks and uncertainties. Our actual results, performance, or achievements may differ materially from those suggested, expressed, or implied by forward-looking statements as a result of a wide variety or range of factors including, but not limited to:

changes in economic conditions, either nationally or in our market area;
fluctuations in interest rates;
the risks of lending and investing activities, including changes in the level and direction of loan delinquencies and write-offs and changes in estimates of the adequacy of our allowance for loan losses;
the possibility of other-than-temporary impairments of securities held in our securities portfolio;
our ability to access cost-effective funding;
fluctuations in the demand for loans, the number of unsold homes, land and other properties, and fluctuations in real estate values and both residential and commercial and multifamily real estate market conditions in our market area;
secondary market conditions for loans and our ability to sell loans in the secondary market;
our ability to attract and retain deposits;
our ability to successfully integrate any assets, liabilities, clients, systems, and management personnel we may acquire into our operations and our ability to realize related revenue synergies and expected cost savings and other benefits within the anticipated time frames or at all;
legislative or regulatory changes such as the Dodd-Frank Wall Street Reform and Consumer Protection Act and its implementing regulations that adversely affect our business, as well as changes in regulatory policies and principles, or the interpretation of regulatory capital or other rules including changes related to Basel III;
monetary and fiscal policies of the Board of Governors of the Federal Reserve System ("Federal Reserve") and the U.S. Government and other governmental initiatives affecting the financial services industry;
results of examinations of Sound Financial Bancorp and Sound Community Bank by their regulators, including the possibility that the regulators may, among other things, require us to increase our allowance for loan losses or to write-down assets, change Sound Community Bank's regulatory capital position or affect our ability to borrow funds or maintain or increase deposits, which could adversely affect our liquidity and earnings;
increases in premiums for deposit insurance;
our ability to control operating costs and expenses;

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the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation;
difficulties in reducing risks associated with the loans on our balance sheet;
staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our workforce and potential associated charges;
our ability to keep pace with technological changes, including our ability to identify and address cyber-security risks such as data security breaches, "denial of service" attacks, "hacking" and identity theft, and other attacks on our information technology systems or on the third-party vendors who perform several of our critical processing functions;
inability of key third-party providers to perform their obligations to us;
our ability to retain key members of our senior management team;
costs and effects of litigation, including settlements and judgments;
our ability to implement our business strategies;
increased competitive pressures among financial services companies;
changes in consumer spending, borrowing and savings habits;
the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions;
our ability to pay dividends on our common stock;
adverse changes in the securities markets;
changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; and
other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services and the other risks described from time to time in this Form 10-K and our other filings with the U.S. Securities and Exchange Commission (the "SEC") .

We wish to advise readers not to place undue reliance on any forward-looking statements and that the factors listed above could materially affect our financial performance and could cause our actual results for future periods to differ materially from any such forward-looking statements expressed with respect to future periods and could negatively affect our stock price performance.

We do not undertake and specifically decline any obligation to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

General

References in this document to Sound Financial Bancorp or the Company refer to Sound Financial Bancorp, Inc. and references to the "Bank" refer to Sound Community Bank. References to "we," "us," and "our" means Sound Financial Bancorp and its wholly-owned subsidiary, Sound Community Bank, unless the context otherwise requires.

Sound Financial Bancorp, a Maryland corporation, is a bank holding company for its wholly owned subsidiary, Sound Community Bank. Substantially all of Sound Financial Bancorp's business is conducted through Sound Community Bank, a Washington state-chartered commercial bank. As a Washington commercial bank, the Bank's regulators are the Washington State Department of Financial Institutions ("WDFI") and the Federal Deposit Insurance Corporation ("FDIC"). The Federal Reserve is the primary federal regulator for Sound Financial Bancorp.

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Sound Community Bank's deposits are insured up to applicable limits by the FDIC. At December 31, 2017, Sound Financial Bancorp had total consolidated assets of $645.2 million, net loans of $543.4 million, deposits of $514.4 million and stockholders' equity of $65.2 million. The shares of Sound Financial Bancorp are traded on The NASDAQ Capital Market under the symbol "SFBC." Our executive offices are located at 2400 3rd Avenue, Suite 150, Seattle, Washington, 98121.

Our principal business consists of attracting retail and commercial deposits from the general public and local governments and investing those funds, along with borrowed funds, in loans secured by first and second mortgages on one- to four-family residences (including home equity loans and lines of credit), commercial and multifamily real estate, construction and land, consumer and commercial business loans. Our commercial business loans include unsecured lines of credit and secured term loans and lines of credit secured by inventory, equipment and accounts receivable. We also offer a variety of secured and unsecured consumer loan products, including manufactured home loans, floating home loans, automobile loans, boat loans and recreational vehicle loans. As part of our business, we focus on residential mortgage loan originations, many of which we sell to Fannie Mae and a portion of which we retain for our loan portfolio consistent with our asset/liability objectives. We sell loans which conform to the underwriting standards of Fannie Mae ("conforming") with servicing retained to maintain the direct client relationship and to generate noninterest income. Residential loans which do not conform to the underwriting standards of Fannie Mae ("non-conforming"), are either held in our loan portfolio or sold with servicing released. We originate and retain a significant amount of commercial real estate loans, including those secured by owner-occupied and nonowner-occupied commercial real estate, multifamily property, mobile home parks and construction and land development loans.

Market Area

We serve the Seattle Metropolitan Statistical Area ("MSA"), which includes King County (which includes the city of Seattle), Pierce County and Snohomish County within the Puget Sound region, and also serve Clallam and Jefferson Counties, on the North Olympic Peninsula of Washington. We serve these markets through our headquarters in Seattle, seven branch offices, four of which are located in the Seattle MSA, two that are located in Clallam County and one that is located in Jefferson County. We also have two loan production offices, one located in the Madison Park neighborhood of Seattle and one located in Sequim. Based on the most recent branch deposit data provided by the FDIC, our share of deposits was approximately 0.11% in King County, approximately 0.50% in Pierce County and in Snohomish County approximately 0.36%. In Clallam County and Jefferson County, we have approximately 16.1% and 6.5%, respectively, of the deposits in those markets. See "– Competition."

Our market area includes a diverse population of management, professional and sales personnel, office employees, health care workers, manufacturing and transportation workers, service industry workers and government employees, as well as retired and self-employed individuals. The population has a skilled work force with a wide range of education levels and ethnic backgrounds. Major employment sectors include information and communications technology, financial services, manufacturing, maritime, biotechnology, education, health and social services, retail trades, transportation and professional services. The largest employers headquartered in our market area include U.S. Joint Base Lewis-McChord, Navy Region Northwest, Microsoft, University of Washington, and Providence Health. Other significant employers include Costco, Boeing, Nordstrom, Amazon.com, Starbucks, Alaska Air Group and Weyerhaeuser.

Economic conditions in our markets continue to improve over the last year. Recent trends in housing prices and unemployment rates in our market areas reflect continuing improvement. For the month of December 2017, the Seattle MSA reported an unemployment rate of 3.8%, as compared to the national average of 4.1%, according to the latest available information from the Bureau of Labor Statistics. Home prices in our markets also improved over the past year. Based on information from Case-Shiller, the average home price in the Seattle MSA increased 12.7% in 2017 from 2016. This compares favorably to the national average home price index increase in 2017 of 6.2%.

King County has the largest population of any county in the state of Washington, covers approximately 2,100 square miles, and is located on Puget Sound. It had approximately 2.1 million residents and a median household income of approximately $85,000 at December 31, 2016. King County has a diversified economic base with many employers from various industries including shipping and transportation (Port of Seattle, Paccar, and Expeditors International of Washington), retail (Amazon.com, Starbucks and Nordstrom) aerospace (Boeing) and computer technology (Microsoft) and biotech industries. Based on information from the Northwest Multiple Listing Service ("MLS"), the median home sales price in King County in December 2017 was $635,000, a 15.5% increase from December 2016's median home sales price of $550,000.

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Pierce County has the second largest population of any county in the State of Washington, covers approximately 1,700 square miles and is located along the southwestern Puget Sound and borders southern King County. At December 31, 2016, it had approximately 845,000 residents and a median household income of approximately $61,000. The Pierce County economy is diversified with the presence of military related government employment (Fort Lewis Army Base and McChord Air Force Base), transportation and shipping employment (Port of Tacoma), and aerospace related employment (Boeing). Based on information from the MLS, the median home sales price in Pierce County in December 2017 was $320,000, a 12.2% increase from December 2016's median home sales price of $285,000.

Snohomish County has the third largest population of any county in the state of Washington, covers approximately 2,100 square miles and is located on Puget Sound touching the northern border of King County. It had approximately 773,000 residents and a median household income of approximately $78,000 at December 31, 2016. The economy of Snohomish County is diversified with the presence of military related government employment (Everett Homeport Naval Base), aerospace related employment (Boeing) and retail trade. Based on information from the MLS, the median home sales price in Snohomish County as of December 31, 2017 was $450,000, a 12.5% increase from December 2016's median home sales price of $400,000.

Clallam County, with a population of approximately 73,000, is ranked the 18th largest county in the state of Washington. It is bordered by the Pacific Ocean and the Strait of Juan de Fuca and covers 1,700 square miles, including the westernmost portion of the continental United States. It had a median household income of approximately $48,000 at December 31, 2016. The economy of Clallam County is primarily manufacturing and shipping. The Sequim Dungeness Valley continues to be a growing retirement location. Our offices are in Port Angeles and Sequim, the two largest cities in the county. Based on information from the MLS, the median home sales price in Clallam County in December 2017 was $295,000, an 18.9% increase from 2016's median home sales price of $248,000.

Jefferson County, with a population of approximately 31,000, is the 27th largest county in the state of Washington. It is bordered by Clallam County and the Strait of Juan de Fuca to the north and Hood Canal on the west and covers 2,200 square miles. The majority of the population lives in the northwestern portion of the county. Our office is located in Port Ludlow which is the third largest community in the county. The economy of Jefferson County is primarily based on tourism, agriculture, lumber, fish processing and ship repair and maintenance. Port Ludlow is a popular retirement community and is a popular port of call for leisure craft sailing between Puget Sound and the San Juan Islands. It had a median household income of approximately $55,000 at December 31, 2016. Based on information from the MLS, the average home sales price in Jefferson County as of December 2017 was $362,000, a 22.7% increase from 2016's median home sales price of $296,000.

According to the latest available information from the Bureau of Labor Statistics, King and Snohomish Counties reported an unemployment rate of 3.6% and 4.0%, respectively, as of December 2017, as compared to the state and national unemployment rates of 4.1% and 4.5%, respectively. The unemployment rates for Clallam, Pierce and Jefferson Counties were above the state and national rates as of December 2017. The unemployment rate in Clallam County decreased to 7.0% as of December 2017 from 8.1% as of December 2016, while the unemployment rate in Pierce County decreased to 5.4% as of December 2017 from 6.0% as of December 2016. The unemployment rate in Jefferson County decreased to 6.2% as of December 2017 from 7.4% as of December 2016.

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Lending Activities

The following table presents information concerning the composition of our loan portfolio, excluding loans held-for-sale, by the type of loan for the dates indicated (dollars in thousands):

	December 31,									
	2017		2016		2015		2014		2013	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Real estate loans:										
One- to four-family	$157,417	28.59 %	$152,386	30.37 %	$141,125	30.60 %	$133,031	30.80 %	$117,739	30.02 %
Home equity	28,379	5.16	27,771	5.53	31,573	6.85	34,675	8.03	35,155	8.96
Commercial and multifamily	211,269	38.38	181,004	36.07	175,312	38.01	168,952	39.12	157,516	40.17
Construction and land	61,482	11.17	70,915	14.13	57,043	12.37	46,279	10.72	44,300	11.30
Total real estate loans	458,547	83.30	432,076	86.10	405,053	87.83	382,937	88.67	354,710	90.45
Consumer loans:										
Manufactured homes	17,111	3.11	15,494	3.09	13,798	2.99	12,539	2.90	13,496	3.44
Floating homes	29,120	5.29	23,996	4.78	18,226	3.95	11,680	2.71	5,551	1.42
Other consumer [(1)]	4,902	0.89	3,932	0.78	4,804	1.05	5,195	1.20	4,733	1.20
Total consumer loans	51,133	9.29	43,422	8.65	36,828	7.99	29,414	6.81	23,780	6.06
Commercial business loans	40,829	7.41	26,331	5.25	19,295	4.18	19,525	4.52	13,668	3.49
Total loans	550,509	100.00%	501,829	100.00%	461,176	100.00%	431,876	100.00%	392,158	100.00%
Less:										
Deferred fees and discounts	1,914		1,828		1,707		1,516		1,232	
Allowance for loan losses	5,241		4,822		4,636		4,387		4,177	
Total loans, net	$543,354		$495,179		$454,833		$425,973		$386,749	

The following table shows the composition of our loan portfolio in dollar amounts and in percentages by fixed and adjustable rate loans for the dates indicated (dollars in thousands):

	December 31,									
	2017		2016		2015		2014		2013	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent

Fixed-rate loans:										
Real estate loans:										
One- to four-family	$117,590	21.36 %	$142,537	28.41 %	$129,762	28.14 %	$118,083	27.34 %	$103,756	26.46
Home equity	11,373	2.07	9,102	1.81	11,042	2.39	12,003	2.78	13,530	3.45
Commercial and multifamily	89,094	16.18	77,285	15.40	92,205	19.99	103,303	23.92	100,031	25.51
Construction and land	57,247	10.40	69,398	13.83	51,572	11.18	39,147	9.07	37,668	9.61
Total real estate loans	275,304	50.01	298,322	59.45	284,581	61.70	272,536	63.11	254,985	65.03
Manufactured homes	17,111	3.11	15,494	3.09	13,798	2.99	12,539	2.90	13,496	3.44
Floating homes	29,120	5.29	23,996	4.78	18,226	3.95	11,680	2.71	5,551	1.42
Other consumer	4,316	0.78	3,297	0.65	4,082	0.89	4,447	1.03	3,944	1.00
Commercial business	16,889	3.07	12,581	2.51	9,392	2.04	11,024	2.55	5,603	1.43
Total fixed-rate loans	342,740	62.26	353,690	70.48	330,079	71.57	312,226	72.30	283,579	72.32
Adjustable-rate loans:										
Real estate loans:										
One- to four-family	39,827	7.23	9,849	1.96	11,363	2.46	14,948	3.46	13,983	3.57
Home equity	17,007	3.09	18,669	3.72	20,531	4.45	22,672	5.25	21,625	5.51
Commercial and multifamily	122,175	22.19	103,719	20.67	83,107	18.02	65,649	15.20	57,485	14.66
Construction and land	4,235	0.77	1,517	0.30	5,471	1.19	7,132	1.65	6,632	1.69
Total real estate loans	183,244	33.29	133,754	26.65	120,472	26.12	110,401	25.56	99,725	25.43
Other consumer	585	0.11	635	0.13	722	0.16	746	0.17	789	0.20
Commercial business	23,940	4.35	13,750	2.74	9,903	2.15	8,501	1.97	8,065	2.05
Total adjustable-rate loans	207,769	37.74	148,139	29.52	131,097	28.43	119,648	27.70	108,579	27.68
Total loans	550,509	100.00%	501,829	100.00%	461,176	100.00%	431,874	100.00%	392,158	100.00
Less:										
Deferred fees and discounts	1,914		1,828		1,707		1,516		1,232	
Allowance for loan losses	5,241		4,822		4,636		4,387		4,177	

Total loans, net	$543,354	$495,179	$454,833	$425,971	$386,749

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The following table illustrates the contractual maturity of our construction and land and commercial business loans at December 31, 2017 (dollars in thousands). Loans that have adjustable or renegotiable interest rates are shown as maturing in the period during which the contract is due. The total amount of loans due after December 31, 2018, which have predetermined interest rates, is $26.8 million, while the total amount of loans due after such date, which have floating or adjustable interest rates, is $12.2 million. The table does not reflect the effects of possible prepayments or enforcement of due-on-sale clauses.

	Construction and Land			Commercial Business			Total [(1)]		
	Amount	Weighted Average Rate		Amount	Weighted Average Rate		Amount	Weighted Average Rate	
2018 [(1)]	$49,410	5.46	%	$13,924	4.97	%	$63,334	5.35	%
2019 to 2022	7,727	6.51		19,221	5.06		26,948	5.48	
2023 and following	4,345	6.28		7,684	5.40		12,029	5.71	
Total[(2)]	$61,482	5.65	%	$40,829	5.09	%	$102,311	5.43	%

(1) Includes demand loans, loans having no stated maturity and overdraft loans.
(2) Excludes deferred fees of $435,000.

Lending Authority. Our President and Chief Executive Officer ("CEO") may approve unsecured loans up to $1.0 million and all types of secured loans up to 30% of our legal lending limit, or approximately $4.0 million as of December 31, 2017. Our Executive Vice President and Chief Credit Officer ("CCO") may approve unsecured loans up to $400,000 and secured loans up to 15% of our legal lending limit, or approximately $2.0 million as of December 31, 2017. Any loans over the CEO's lending authority or loans significantly outside our general underwriting guidelines must be approved by the Loan Committee consisting of four independent directors, the CEO and the CCO. Lending authority is also granted to certain other lending staff at lower amounts. The Business Banking Team Leader has lending authority of up to 7.5% of our legal lending limit for real estate and other secured loans, and $50,000 for unsecured loans. The Residential Lending Team Leader has lending authority up to 7.5% of our legal lending limit for real estate and other secured loans, and $5,000 for unsecured loans.

Largest Borrowing Relationships. At December 31, 2017, the maximum amount under federal law that we could lend to any one borrower and the borrower's related entities was approximately $13.5 million. Our five largest relationships totaled $49.1 million in the aggregate, or 8.9% of our $550.5 million total loan portfolio, at December 31, 2017. At December 31, 2017, the largest lending relationship totaled $11.5 million consisting of two loans to businesses with common ownership, collateralized by an assignment of promissory notes and two loans to a related individual collateralized by a primary residence. The second and third largest relationships consisted of a $10.5 million business line of credit loan participation to a third party loan originator secured by an assignment of promissory notes from their borrowers for residential loans and a $10.0 million business line of credit loan participation to a third party loan originator secured by an assignment of promissory notes from their borrowers for construction projects. The next two largest lending relationships at December 31, 2017, consisted of four loans totaling $9.3 million to businesses with common ownership collateralized by multifamily real estate and four loans totaling $7.8 million, consisting of a commercial business loan collateralized by multifamily real estate, a residential real estate loan and a line of credit to a related individual collateralized by one- to-four family real estate and an unsecured line of credit provided to the same individual. At December 31, 2017, we had ten other lending relationships that exceeded $5.0 million. All of the foregoing loans were performing in accordance with their repayment terms as of December 31, 2017.

One- to Four-Family Real Estate Lending. One of our primary lending activities is the origination of loans secured by first mortgages on one- to four-family residences, substantially all of which are secured by property located in our geographic lending area. We originate both fixed-rate and adjustable-rate loans. During 2017, our fixed rate, one- to four-family loan originations decreased $64.2 million, or 46.6% to $73.6 million compared to $137.8 million in 2016. In 2017, the Bank identified demand in the marketplace for one- to four-family, residential adjustable rate mortgages, especially jumbo loans (loans above conforming Fannie Mae limits). As a result, our adjustable rate one- to four-family, residential loan originations increased $31.2 million, or 627.0% to $36.1 million compared to $5.0 million in 2016. In 2017, the average loan amount was $657,000 for adjustable rate, one- to four-family mortgages.

Most of our loans are underwritten using generally-accepted secondary market underwriting guidelines. A portion of the one- to four-family loans we originate are retained in our portfolio and the remaining loans are sold into the secondary market to Fannie Mae or other private investors. Loans that are sold into the secondary market to Fannie Mae are sold with the servicing retained to maintain the client relationship and to generate noninterest income. We also originate a small portion of government guaranteed and jumbo loans over $424,100 for sale servicing released to certain correspondent purchasers. The sale of mortgage loans provides a source of non-interest income through the gain on sale, reduces our interest rate risk, provides a stream of servicing income, enhances liquidity and enables us to originate more loans at our current capital level than if we held the loans in our loan portfolio. Our pricing strategy for mortgage loans includes establishing interest rates that are competitive with other financial institutions and consistent with our internal asset and liability management objectives. During the year ended December 31, 2017, we originated $73.6 million of one- to four-family fixed-rate mortgage loans and $36.1 million one- to four-family adjustable rate mortgage ("ARM") loans. See "- Loan Originations, Purchases, Sales, Repayments and Servicing." At December 31, 2017, one- to four-family residential mortgage loans (excluding loans held-for-sale) totaled $157.4 million, or 28.6%, of our gross loan portfolio, of which $117.6 million were fixed-rate loans and $39.8 million were ARM loans, compared to $152.4 million (excluding loans held-for-sale), or 30.4% of our gross loan portfolio as of December 31, 2016, of which $142.5 million were fixed-rate loans and $9.8 million were ARM loans.

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Substantially all of the one- to four-family residential mortgage loans we retain in our portfolio consist of loans that do not satisfy acreage limits, income, credit, conforming loan limits (i.e., jumbo mortgages) or various other requirements imposed by Fannie Mae. Some of these loans are also originated to meet the needs of borrowers who cannot otherwise satisfy Fannie Mae credit requirements because of personal and financial reasons (i.e., bankruptcy, length of time employed, etc.), and other aspects, which do not conform to Fannie Mae's guidelines. Such borrowers may have higher debt-to-income ratios, or the loans are secured by unique properties in rural markets for which there are no sales of comparable properties to support the value according to secondary market requirements. We may require additional collateral or lower loan-to-value ratios to reduce the risk of these loans. We believe that these loans satisfy the needs of borrowers in our market area. As a result, subject to market conditions, we intend to continue to originate these types of loans. We also retain jumbo loans which exceed the conforming loan limits and therefore, are not eligible to be purchased by Fannie Mae. At December 31, 2017, $95.1 million or 60.4% of our one- to four-family loan portfolio consisted of jumbo loans.

We generally underwrite our one- to four-family loans based on the applicant's employment and credit history and the appraised value of the subject property. We generally lend up to 80% of the lesser of the appraised value or purchase price for one- to four-family first mortgage loans and non-owner occupied first mortgage loans. For first mortgage loans with a loan-to-value ratio in excess of 80%, we may require private mortgage insurance or other credit enhancement to help mitigate the risk. Properties securing our one- to four-family loans are typically appraised by independent fee appraisers who are selected in accordance with criteria approved by the Loan Committee. For loans that are less than $250,000, we may use an automated valuation model, in lieu of an appraisal. We require title insurance policies on all first mortgage real estate loans originated. Homeowners, liability, fire and, if required, flood insurance policies are also required for one-to four-family loans. Our real estate loans generally contain a "due on sale" clause allowing us to declare the unpaid principal balance due and payable upon the sale of the security property. The average balance of our one- to four-family residential loans was approximately $291,000 at December 31, 2017.

Fixed-rate loans secured by one- to four-family residences have contractual maturities of up to 30 years. All of these loans are fully amortizing, with payments due monthly. Our portfolio of fixed-rate loans also includes $9.2 million of loans with an initial seven year term and a 30-year amortization period with a borrower refinancing option at a fixed rate at the end of the initial term as long as the loan has met certain performance criteria. In addition, we had $34.3 million one- to four- family loans with a five-year call option at December 31, 2017. Prior to 2012, we originated for portfolio five and seven year balloon reset loans (which are loans that are originated with a fixed interest rate for the initial five or seven years, and thereafter incur one interest rate change based on current market interest rates in which the new rate remains in effect for the remainder of the loan term) based on a 30-year amortization period.

ARM loans are offered with annual adjustments and life-time rate caps that vary based on the product, generally with a maximum annual rate change of 2.0% and a maximum overall rate change of 6.0%. We generally use the rate on one-year Treasury Bills to re-price our ARM loans, however, $4.0 million of our ARM loans are to employees and directors that re-price annually based on a margin of 1% over our average 12 month cost of funds. As a consequence of using caps, the interest rates on ARM loans may not be as rate sensitive as our cost of funds. Furthermore, because loan indexes may not respond perfectly to changes in market interest rates, upward adjustments on loans may occur more slowly than increases in our cost of interest-bearing liabilities, especially during periods of rapidly increasing interest rates. Because of these characteristics, future yields on ARM loans may not be sufficient to offset increases in our cost of funds.

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ARM loans generally pose different credit risks than fixed-rate loans, primarily because as interest rates rise, the borrower's payment increases, which increases the potential for default. The majority of these loans have been originated within the past several years, when rates were historically low. We continue to offer our fully amortizing ARM loans with a fixed interest rate for the first one, three, five or seven years, followed by a periodic adjustable interest rate for the remaining term. Given the recent increase in market rates over the past year, the origination of ARM loans has increased significantly as borrowers are beginning to favor ARM loans over fixed-rate mortgages.

In 2016, in order to enable individuals to secure the purchase of a new residence before selling their existing residence, we commenced a loan program designed to allow borrowers to access the equity in their current residence to apply towards the purchase of a new residence. The loan or loans to purchase the new residence are generally originated in an amount in excess of $1.0 million and secured by the borrowers existing and/or new residences, with a maximum combined LTV of up to 80%. These loans provide for repayment upon the earlier of the sale of the current residence or the loan maturity date, which is typically up to 12 months. Upon the sale of the borrower's current residence, we may refinance the new residence using our traditional jumbo mortgage loan underwriting guidelines. During 2017, we originated $15.6 million of loans under this program compared to $20.9 million in 2016. At December 31, 2017, we had $15.6 million of these interest only residential loans in our one- to four-family residential mortgage loan portfolio.

The primary focus of our underwriting guidelines for interest only residential loans is on the value of the collateral rather than the ability of the borrower to repay the loan. As a result, this type of lending exposes us to an increased risk of loss due to the larger loan balance and our inability to sell them to Fannie Mae, similar to the risks associated with jumbo one- to four-family residential loans. In addition, a decline in residential real estate values resulting from a downturn in the Washington housing market may reduce the value of the real estate collateral securing these types of loans and increase our risk of loss if borrowers default on their loans.

Home Equity Lending. We originate home equity loans that consist of fixed-rate fully amortizing loans and variable-rate lines of credit. We typically originate home equity loans in amounts of up to 90% of the value of the collateral, minus any senior liens on the property; however, prior to 2010 we originated home equity loans in amounts of up to 100% of the value of the collateral, minus any senior liens on the property. Home equity lines of credit are typically originated for up to $250,000 with an adjustable rate of interest, based on the one-year Treasury Bill rate or the Wall Street Journal Prime rate, plus a margin. Home equity lines of credit generally have a three, five or 12 year draw period, during which time the funds may be paid down and redrawn up to the committed amount. Once the draw period has lapsed, the payment is amortized over either a 12, 19 or 21 year period based on the loan balance at that time. We charge a $50 annual fee on each home equity line of credit and require monthly interest-only payments on the entire amount drawn during the draw period. At December 31, 2017, home equity loans totaled $28.4 million, or 5.2% of our total loan portfolio compared to $27.8 million, or 5.5% of our total loan portfolio at December 31, 2016. Variable-rate home equity lines of credit at December 31, 2017 totaled $17.0 million, or 3.1% of our total loan portfolio, compared to $18.7 million, or 3.7% of our total loan portfolio as of December 31, 2016. At December 31, 2017, unfunded commitments on home equity lines of credit totaled $12.0 million.

Our fixed-rate home equity loans are generally originated in amounts, together with the amount of the existing first mortgage, of up to 90% of the appraised value of the subject property. These loans may have terms of up to 15 years and are fully amortizing. At December 31, 2017, fixed-rate home equity loans totaled $11.4 million, or 2.1% of our gross loan portfolio, compared to $9.1 million, or 1.8% of our total loan portfolio as of December 31, 2016.

Commercial and Multifamily Real Estate Lending. We offer a variety of commercial and multifamily real estate loans. Most of these loans are secured by owner-occupied and non-owner-occupied commercial income producing properties, multifamily apartment buildings, warehouses, office buildings, gas station/convenience stores and mobile home parks located in our market area. At December 31, 2017, commercial and multifamily real estate loans totaled $211.3 million, or 38.4% of our total loan portfolio, compared to $181.0 million, or 36.1% of our total loan portfolio as of December 31, 2016.

Loans secured by commercial and multifamily real estate are generally originated with a variable interest rate, fixed for a three to ten-year term and a 20- to 25-year amortization period. At the end of the initial term, the balance is due in full or the loan re-prices based on an independent index plus a margin of 1% to 4% for another five years. Loan-to-value ratios on our commercial and multifamily real estate loans typically do not exceed 80% of the lower of cost or appraised value of the property securing the loan at origination.

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Loans secured by commercial and multifamily real estate are generally underwritten based on the net operating income of the property, quality and location of the real estate, the credit history and financial strength of the borrower and the quality of management involved with the property. The net operating income, which is the income derived from the operation of the property less all operating expenses, must be sufficient to cover the payments related to the outstanding debt plus an additional coverage requirement. We generally impose a minimum debt service coverage ratio of 1.20 for originated loans secured by income producing commercial properties. If the borrower is other than an individual, we typically require the personal guaranty of the principal owners of the borrowing entity. We also generally require an assignment of rents in order to be assured that the cash flow from the project will be used to repay the debt. Appraisals on properties securing commercial and multifamily real estate loans are performed by independent state certified licensed fee appraisers. In order to monitor the adequacy of cash flows on income-producing properties, the borrower is required to provide annual financial information. From time to time we also acquire participation interests in commercial and multifamily real estate loans originated by other financial institutions secured by properties located in our market area.

Historically, loans secured by commercial and multifamily properties generally involve different credit risks than one-to four-family properties. These loans typically involve larger balances to single borrowers or groups of related borrowers. Because payments on loans secured by commercial and multifamily properties are often dependent on the successful operation or management of the properties, repayment of these loans may be subject to adverse conditions in the real estate market or the economy. If the cash flow from the project is reduced, or if leases are not obtained or renewed, the borrower's ability to repay the loan may be impaired. Commercial and multifamily real estate loans also expose a lender to greater credit risk than loans secured by one-to four-family because the collateral securing these loans typically cannot be sold as easily as one-to four-family. In addition, most of our commercial and multifamily real estate loans are not fully amortizing and include balloon payments upon maturity. Balloon payments may require the borrower to either sell or refinance the underlying property in order to make the payment, which may increase the risk of default or non-payment. The largest single commercial and multifamily real estate loan at December 31, 2017, totaled $5.7 million and is collateralized by an office building. At December 31, 2017, this loan was performing in accordance with its repayment terms.

The following table provides information on commercial and multifamily real estate loans by type at December 31, 2017 and 2016 (dollars in thousands):

	2017		2016	
	Amount	Percent	Amount	Percent
Multifamily residential	$62,879	29.76 %	$56,797	31.38 %
Owner-occupied commercial real estate retail	7,273	3.44	8,070	4.46
Owner-occupied commercial real estate office buildings	21,189	10.03	17,863	9.87
Owner-occupied commercial real estate other (1)	20,972	9.94	21,498	11.88
Non Owner-occupied commercial real estate retail	10,248	4.85	13,891	7.67
Non Owner-occupied commercial real estate office buildings	11,732	5.55	12,203	6.74
Non owner occupied commercial real estate other (1)	40,908	19.36	12,669	7.00
Warehouses	17,678	8.37	18,485	10.21
Gas station/Convenience store	9,469	4.48	11,476	6.34
Mobile Home Parks	8,921	4.22	8,052	4.45
Total	$211,269	100.00%	$181,004	100.00%

(1) Other commercial real estate loans includes schools, churches, storage facilities, restaurants, etc.

Construction and Land Lending. We originate construction loans secured by single-family residences and commercial and multifamily real estate. We also originate land acquisition and development loans, which are secured by raw land or developed lots on which the borrower intends to build a residence. At December 31, 2017, our construction and land loans totaled $61.5 million, or 11.2% of our total loan portfolio, compared to $70.9 million, or 14.1% of our total loan portfolio at December 31, 2016. At December 31, 2017, unfunded construction loan commitments totaled $39.4 million.

Construction loans to individuals and contractors for the construction of personal residences, including speculative residential construction, totaled $32.3 million, or 52.6%, of our construction and land portfolio at December 31, 2017. In addition to custom home construction loans to individuals, we originate loans that are termed "speculative" which are those loans where the builder does not have, at the time of loan origination, a signed contract with a buyer for the home or lot who has a commitment for permanent financing with either us or another lender. At December 31, 2017, construction loans to contractors for homes that were considered speculative totaled $26.4 million, or 42.9%, of our construction and land portfolio.

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The composition of, and location of underlying collateral securing, our construction and land loan portfolio, excluding loan commitments, at December 31, 2017 was as follows (in thousands):

	Puget Sound	Olympic Peninsula	Other	Total
Commercial and multifamily construction	$18,134	$ 332	$1,073	$19,539
Speculative residential construction	26,368	—	22	26,390
Land acquisition and development and lot loans	—	240	—	240
Residential lot loans	3,300	4,976	1,112	9,388
Residential construction	4,607	1,205	113	5,925
Total	$52,409	$ 6,753	$2,320	$61,482

Our residential construction loans generally provide for the payment of interest only during the construction phase, which is typically twelve to eighteen months. At the end of the construction phase, the construction loan generally either converts to a longer term mortgage loan or is paid off with a permanent loan from another lender. Residential construction loans are made up to the lesser of a maximum loan-to-value ratio of 100% of cost or 80% of appraised value at completion; however, we generally do not originate construction loans which exceed these limits without some form of credit enhancement to mitigate the higher loan to value.

At December 31, 2017, our largest residential construction loan commitment was for $3.2 million, $1.8 million of which had been disbursed. This loan was performing according to its repayment terms at December 31, 2017. The average outstanding residential construction loan balance was approximately $539,000 at December 31, 2017. Before making a commitment to fund a construction loan, we require an appraisal of the subject property by an independent approved appraiser. During the construction phase, we make periodic inspections of the construction site and loan proceeds are disbursed directly to the contractors or borrowers as construction progresses. Loan proceeds are disbursed after inspection based on the percentage of completion method. We also require general liability, builder's risk hazard insurance, title insurance, and flood insurance, for properties located in or to be built in a designated flood hazard area, on all construction loans.

We also originate developed lot and raw land loans to individuals intending to construct a residence in the future on the property. We will generally originate these loans in an amount up to 75% of the lower of the purchase price or appraisal. These lot and land loans are secured by a first lien on the property and have a fixed rate of interest with a maximum amortization of 20 years.

We make land acquisition and development loans to experienced builders or residential lot developers in our market area. The maximum loan-to-value limit applicable to these loans is generally 75% of the appraised market value upon completion of the project. We may not require cash equity from the borrower if there is sufficient equity in the land being used as collateral. Development plans are required prior to making the loan. Our loan officers visit the proposed site of the development and the sites of competing developments. We require that developers maintain adequate insurance coverage. Land acquisition and development loans generally are originated with a loan term up to 24 months, have adjustable rates of interest based on the Wall Street Journal Prime Rate or the three or five- year rate charged by the Federal Home Loan Bank of Des Moines ("FHLB") and require interest only payment during the term of the loan. Land acquisition and development loan proceeds are disbursed periodically in increments as construction progresses and as an inspection by our approved inspector warrants. We also require these loans to be paid on an accelerated basis as the lots are sold, so that we are repaid before all the lots are sold. At December 31, 2017, land acquisition and development and lot loans totaled $240,000, or 0.4% of our construction and land portfolio all of which were lot loans.

We also offer commercial and multifamily construction loans. These loans are underwritten as interest only with financing typically up to 24 months under terms similar to our residential construction loans. Commercial and multifamily construction loans are made up to the lesser of a maximum loan-to-value ratio of 100% of cost or 80% of appraised value at completion. Most of our commercial and multifamily construction loans provide for disbursement of loan funds during the construction period and conversion to a permanent loan when the construction is complete, and either tenant lease-up provisions or prescribed debt service coverage ratios are met. At December 31, 2017, commercial and multifamily construction loans totaled $19.5 million, or 31.8% of our construction and land portfolio, compared to $30.0 million, or 42.3% of our construction and land portfolio at December 31, 2016. The three largest commercial and multifamily construction loans at December 31, 2017 included a $6.7 million multifamily residential building, a $4.8 million multifamily residential building and a $1.8 million residential development project, all located in Seattle, Washington.

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Our construction and land development loans are based upon estimates of costs in relation to values associated with the completed project. Construction and land development lending involves additional risks when compared with permanent residential lending because funds are advanced upon the collateral for the project based on an estimate of costs that will produce a future value at completion. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the completed project and the effects of governmental regulation on real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the completed project loan-to-value ratio. Changes in the demand, such as for new housing and higher than anticipated building costs may cause actual results to vary significantly from those estimated. For these reasons, this type of lending also typically involves higher loan principal amounts and is often concentrated with a small number of builders. These loans often involve the disbursement of funds with repayment substantially dependent on the success of the ultimate project and the ability of the borrower to sell or lease the property or obtain permanent take-out financing, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of a completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of construction of the project and may incur a loss. Because construction loans require active monitoring of the building process, including cost comparisons and on-site inspections, these loans are more difficult and costly to monitor. Increases in market rates of interest may have a more pronounced effect on construction loans by rapidly increasing the end-purchasers' borrowing costs, thereby reducing the overall demand for the project. In addition, during the term of some of our construction loans, an interest reserve is created at origination and is added to the principal of the loan through the construction phase. Properties under construction may be difficult to sell and typically must be completed in order to be successfully sold which also complicates the process of resolving problem construction loans. This may require us to advance additional funds and/or contract with another builder to complete construction. Furthermore, in the case of speculative construction loans, there is the added risk associated with identifying an end-purchaser for the finished project. Land loans also pose additional risk because of the lack of income being produced by the property and the potential illiquid nature of the collateral. These risks can also be significantly impacted by supply and demand conditions.

Commercial Business Lending. At December 31, 2017, commercial business loans totaled $40.8 million, or 7.4% of our total loan portfolio, compared to $26.3 million, or 5.3% of our total loan portfolio at December 31, 2016. Substantially all of our commercial business loans have been to borrowers in our market area. Our commercial business lending activities encompass loans with a variety of purposes and security, including loans to finance commercial vehicles and equipment and loans secured by accounts receivable and/or inventory. Approximately $1.6 million of our commercial business loans at December 31, 2017 were unsecured. Our commercial business lending policy includes an analysis of the borrower's background, capacity to repay the loan, the adequacy of the borrower's capital and collateral, as well as an evaluation of other conditions affecting the borrower. Analysis of the borrower's past, present and future cash flows is also an important aspect of our credit analysis. We generally require personal guarantees on both our secured and unsecured commercial business loans. Nonetheless, commercial business loans are believed to carry higher credit risk than residential mortgage and commercial real estate loans.

Our interest rates on commercial business loans are dependent on the type of loan. Our secured commercial business loans typically have a loan to value ratio of up to 80% and are term loans ranging from three to seven years. Secured commercial business term loans generally have a fixed rated based on the commensurate FHLB amortizing rate or prime rate as reported in the West Coast edition of the Wall Street Journal plus 1% to 3%. In addition, we typically charge loan fees of 1% to 2% of the principal amount at origination, depending on the credit quality and account relationships of the borrower. Business lines of credit are usually adjustable-rate and are based on the prime rate plus 1% to 3%, and are generally originated with both a floor and ceiling to the interest rate. Our business lines of credit generally have terms ranging from 12 months to 24 months and provide for interest-only monthly payments during the term.

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Our commercial business loans are primarily based on the cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The borrowers' cash flow may be unpredictable, and collateral securing these loans may fluctuate in value. This collateral may consist of accounts receivable, inventory, equipment or real estate. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. Other collateral securing loans may depreciate over time, may be difficult to appraise, may be illiquid and may fluctuate in value based on the specific type of business and equipment. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself which, in turn, is often dependent in part upon general economic conditions.

Consumer Lending. We offer a variety of secured and unsecured consumer loans, including new and used manufactured homes, floating homes, automobiles, boats and recreational vehicle loans, and loans secured by deposit accounts. We also offer unsecured consumer loans. We originate our consumer loans primarily in our market area. All of our consumer loans are originated on a direct basis. At December 31, 2017, our consumer loans totaled $51.1 million, or 9.3% of our total loan portfolio, compared to $43.4 million, or 8.7% of our total loan portfolio at December 31, 2016.

We typically originate new and used manufactured home loans to borrowers who intend to use the home as a primary residence. The yields on these loans are higher than that on our other residential lending products and the portfolio has performed reasonably well with an acceptable level of risk and loss in exchange for the higher yield. Our weighted-average yield on manufactured home loans at December 31, 2017 was 8.11%, compared to 4.61% for one- to four-family mortgages, excluding loans held-for-sale. At December 31, 2017, these loans totaled $17.1 million, or 33.5% of our consumer loans and 3.1% of our total loan portfolio. For used manufactured homes, loans are generally made up to 90% of the lesser of the appraised value or purchase price up to $200,000, and with terms typically up to 20 years. On new manufactured homes, loans are generally made up to 90% of the lesser of the appraised value or purchase price up to $200,000, and with terms typically up to 20 years. We generally charge a 1% fee at origination. We underwrite these loans based on our review of creditworthiness of the borrower, including credit scores, and the value of the collateral, for which we hold a security interest under Washington law.

Manufactured home loans are higher risk than loans secured by residential real property, though this risk is reduced if the owner also owns the land on which the home is located. A small portion of our manufactured home loans involve properties on which we also have financed the land for the owner. The primary risk in manufactured home loans is the difficulty in obtaining adequate value for the collateral due to the cost and limited ability to move the collateral. These loans tend to be made to retired individuals and first-time homebuyers. First-time homebuyers of manufactured homes tend to be a higher credit risk than first-time homebuyers of single-family residences, due to more limited financial resources. As a result, these loans may have a higher probability of default and higher delinquency rates than single-family residential loans and other types of consumer loans. We take into account this additional risk as a component of our allowance for loan losses. We attempt to work out delinquent loans with the borrower and, if that is not successful, any past due manufactured homes are repossessed and sold. At December 31, 2017, there were eight nonperforming manufactured home loans totaling $206,000 and we held one manufactured home valued at $10,000 as a repossessed asset.

We originate floating home, houseboat and house barge loans typically located on cooperative or condominium moorages. Terms vary from five to 20 years and have a fixed rate of interest. We lend up to 90% of the lesser of the appraised value or purchase price. The primary risk in floating home loans is the unique nature of the collateral and the challenges of relocating such collateral to a location other than where such housing is permitted. The process for securing the deed and/or the condominium or cooperative dock is also unique compared to other types of lending we participate in. As a result, these loans may have higher collateral recovery costs than for one- to four-family mortgage loans and other types of consumer loans. We take into account these additional risks as a part of our underwriting criteria. At December 31, 2017, floating home loans totaled $29.1 million, or 56.9% of our consumer loan portfolio and 5.3% of our total loan portfolio.

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The balance of our consumer loans include loans secured by new and used automobiles, new and used boats, motorcycles and recreational vehicles, loans secured by deposits and unsecured consumer loans, all of which, at December 31, 2017, totaled $4.9 million, or 9.6% of our consumer loan portfolio and 0.9% of our total loan portfolio. Our automobile loan portfolio totaled $570,000 at December 31, 2017, or 1.1% of our consumer loan portfolio and 0.1% of our total loan portfolio. Automobile loans may be written for a term up to 72 months and have fixed rates of interest. Loan-to-value ratios are up to 100% of the lesser of the purchase price or the National Automobile Dealers Association value for used automobiles, including tax, licenses, title and mechanical breakdown and gap insurance.

Loans secured by boats, motorcycles and recreational vehicles typically have terms from five to 20 years depending on the collateral and loan-to-value ratios up to 90%. These loans may be made with fixed or adjustable interest rates. Our unsecured consumer loans have either a fixed rate of interest generally for a maximum term of 48 months, or are revolving lines of credit of generally up to $25,000. At December 31, 2017, unsecured consumer loans totaled $1.1 million and unfunded commitments on our unsecured consumer lines of credit totaled $1.0 million. At that date, the average outstanding balance on these lines was less than $1,000.

Consumer loans (other than our manufactured and floating homes) generally have shorter terms to maturity, which reduces our exposure to changes in interest rates. In addition, management believes that offering consumer loan products helps to expand and create stronger ties to our existing client base by increasing the number of client relationships and providing additional marketing opportunities.

Consumer loans generally entail greater risk than do one- to four-family residential mortgage loans, particularly in the case of consumer loans that are secured by rapidly depreciable assets, such as manufactured homes, automobiles, boats and recreational vehicles. In these cases, any repossessed collateral for a defaulted loan may not provide an adequate source of repayment of the outstanding loan balance. As a result, consumer loan collections are dependent on the borrower's continuing financial stability and, thus, are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy.

Loan Originations, Purchases, Sales, Repayments and Servicing

We originate both fixed-rate and adjustable-rate loans. Our ability to originate loans, however, is dependent upon client demand for loans in our market area. Over the past several years, we have continued to originate residential and consumer loans, and increased our emphasis on commercial and multifamily real estate, construction and land, and commercial business lending. Demand is affected by competition and the interest rate environment. During the past few years, we, like many other financial institutions, have experienced significant prepayments on loans due to the prevailing low interest rate environment in the United States. In periods of economic uncertainty, the ability of financial institutions, including us, to originate large dollar volumes of real estate loans may be substantially reduced or restricted, with a resultant decrease in interest income. If a proposed loan exceeds our internal lending limits, we may originate the loan on a participation basis with another financial institution. From time to time, we also participate with other financial institutions on loans they originate. In 2017, 2016 and 2015, we sold commercial loan participations to other financial institutions in the amount of $3.1 million, $3.0 million and $6.9 million, respectively. We underwrite loan purchases and participations to the same standards as an internally-originated loan. We purchased two commercial business loan participations from other financial institutions in 2017 totaling $15.5 million as compared to $2.7 million in 2016.

We do not engage in originating negative amortization, option adjustable rate or subprime loans and have no established program to originate or purchase these loans. We do offer interest-only one- to four- family loans to well-qualified borrowers and at December 31, 2017, we held $16.9 million of such loans in our loan portfolio, representing 3.1% of our total loan portfolio. Subprime loans are defined as loans that at the time of loan origination had a FICO credit score of less than 660. Of the $109.7 million in one- to four- family loans originated in 2017, only $4.9 million, or 4.5%, were to borrowers with a credit score under 660.

In addition to interest earned on loans and loan origination fees, we receive fees for loan commitments, late payments and other miscellaneous services.

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We also sell whole one-to four-family loans without recourse to Fannie Mae, subject to a provision for repurchase upon breach of representation, warranty or covenant. These loans are fixed-rate mortgages, which primarily are sold to reduce our interest rate risk and generate noninterest income. These loans are generally sold for cash in amounts equal to the unpaid principal amount of the loans determined using present value yields to the buyer. These sales allow for a servicing fee on loans when the servicing is retained by us. Most one- to four-family loans are sold with servicing retained. At December 31, 2017, we were servicing a $392.6 million portfolio of residential mortgage loans for Fannie Mae. We repurchased one loan from Fannie Mae in 2017 totaling $135,000. We did not repurchase any loans from Fannie Mae in 2016.

We earned mortgage servicing income of $566,000, $907,000 and $1.1 million for the years ended December 31, 2017, 2016 and 2015, respectively. In November 2009, we acquired a $340.1 million loan servicing portfolio from Leader Financial Services. These loans are 100% owned by Fannie Mae and are subserviced under an agreement with a third party loan servicer who performs all servicing including payment processing, reporting and collections. In October 2015, we acquired a $45.9 million loans servicing portfolio from Seattle Bank. These loans are 100% owned by Fannie Mae and are serviced by us. These mortgage servicing rights are carried at fair value and had a value at December 31, 2017 of $3.4 million. See Note 6 in the Notes to Consolidated Financial Statements contained in Item 8 of this report on Form 10-K.

Sales of whole real estate loans are beneficial to us since these sales may generate income at the time of sale, produce future servicing income on loans where servicing is retained, provide funds for additional lending, and increase liquidity. We sold $52.0 million, $85.1 million and $72.6 million of conforming one- to four- family loans during the years ended December 31, 2017, 2016 and 2015, respectively. Gains, losses and transfer fees on sales of one-to four-family loans and participations are recognized at the time of the sale. Our net gain on sales of residential loans for all of 2017, 2016 and 2015 was $1.1 million, $1.4 million and $1.3 million, respectively. In addition to loans sold to Fannie Mae on a servicing retained basis, we also sell nonconforming residential loans to correspondent banks on a servicing released basis. In 2017, we sold $4.3 million of loans servicing released.

The following table shows our loan origination, sale and repayment activities, including loans held-for-sale, for the periods indicated (in thousands):

	Year Ended December 31,		
	2017	2016	2015
Originations by type:			
Fixed-rate:			
One- to four-family	$73,560	$137,760	$107,440
Home equity	4,538	1,733	3,170
Commercial and multifamily	34,438	20,561	29,215
Construction and land	49,771	31,610	22,665
Manufactured homes	5,106	5,006	4,594
Floating homes	7,409	12,694	11,496
Other consumer	2,360	630	1,409
Commercial business	10,440	6,365	3,286
Total fixed-rate	$187,622	$216,359	$183,275
Adjustable rate:			
One- to four-family	36,130	4,970	4,831
Home equity	5,832	2,067	1,881
Commercial and multifamily	33,155	37,256	35,136
Construction and land	6,094	629	2,609
Other consumer	86	81	133
Commercial business	7,527	2,131	3,266

Total adjustable-rate	$88,824	$47,134	$47,856
Total loans originated	$276,446	$263,493	$231,131
Purchases by type:			
Commercial business participations	15,450	2,694	—
Total loan participations purchased	$15,450	$2,694	$—
Sales, repayments and participations sold:			
One- to four-family	51,959	85,092	72,622
Commercial and multifamily	3,136	3,042	6,858
Total loans sold and loan participations	55,095	88,134	79,480
Total principal repayments	188,121	137,400	122,351
Total reductions	243,216	225,534	201,831
Net increase	$48,680	$40,653	$29,300

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The increase in originations in 2017 compared to 2016 was primarily due to the relatively strong economy in our market area and increased sales efforts by our loan officers. One- to four-family fixed rate, residential loan originations decreased as compared to prior years while one- to four-family adjustable rate, residential loan originations increased significantly compared to prior years. During 2017, the Bank identified demand in the marketplace for one- to-four family adjustable rate, residential mortgages, especially those above the Fannie Mae conforming limits. Commercial business loan originations increased significantly in 2017 as compared to 2016 as a result of our emphasis on this business segment and the continued demand in our local market. Demand for construction loans for new homes and apartments continued to be strong as our markets experienced appreciation in residential market prices and a declining supply of homes for sale because of strong demand. Increased commercial and multifamily construction loan originations in 2017 compared to 2016 were due to an emphasis on producing these types of loans in our markets.

Asset Quality

When a borrower fails to make a required payment on a one-to four-family loan, we attempt to cure the delinquency by contacting the borrower. In the case of loans secured by a one-to four-family property, a late notice typically is sent 15 days after the due date. Generally, a pre-foreclosure loss mitigation letter is also mailed to the borrower 30 days after the due date. All delinquent accounts are reviewed by a loan officer or branch manager who attempts to cure the delinquency by contacting the borrower. If the account becomes 120 days delinquent and an acceptable foreclosure alternative has not been agreed upon, we generally refer the account to legal counsel with instructions to prepare a notice of default. The notice of default begins the foreclosure process. If foreclosure is completed, typically we take title to the property and sell it directly through a real estate broker.

Delinquent consumer loans are handled in a similar manner to one-to four-family loans. Our procedures for repossession and sale of consumer collateral are subject to various requirements under the applicable consumer protection laws as well as other applicable laws and the determination by us that it would be beneficial from a cost basis.

Once a loan is 90 days past due, it is classified as nonaccrual. Generally, delinquent consumer loans are charged-off at 120 days past due, unless we have a reasonable basis justifying continuing collection efforts.

Delinquent Loans. The following table sets forth our loan delinquencies by type, by amount and by percentage of type at December 31, 2017 (dollars in thousands):

	Loans Delinquent For:								
	30-89 Days			90 Days and Over			Total Delinquent Loans		
	Number	Amount	Percent of Loan Category	Number	Amount	Percent of Loan Category	Number	Amount	Percent of Loan Category
One- to four- family	21	$ 3,911	2.48 %	6	$ 727	0.46 %	27	$ 4,638	2.94 %
Home equity	10	526	1.85	7	633	2.23	17	1,159	4.08
Commercial and Multifamily	1	313	0.15	—	—	—	1	313	0.15
Construction and land	1	51	0.08	2	92	0.15	3	143	0.23
Manufactured homes	7	235	1.37	7	197	1.15	14	432	2.52
Other consumer	8	15	0.31	—	—	—	8	15	0.31
Commercial Business	4	400	0.98	—	—	—	4	400	0.98
Total	52	$ 5,451	0.99 %	22	$ 1,649	0.30 %	74	$ 7,100	1.29 %

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Nonperforming Assets. The table below sets forth the amounts and categories of nonperforming assets in our loan portfolio (in thousands). Loans are placed on nonaccrual status when the collection of principal and/or interest become doubtful or when the loan is more than 90 days past due. OREO and repossessed assets include assets acquired in settlement of loans.

	December 31,				
	2017	2016	2015	2014	2013
Nonperforming loans [1]:					
One- to four-family	$837	$2,216	$1,640	$1,512	$772
Home equity	722	553	428	386	222
Commercial and multifamily	201	218	—	1,639	820
Construction and land	92	—	—	81	—
Manufactured homes	206	120	62	195	106
Other consumer	8	—	—	29	1
Commercial business	217	242	—	—	—
Total nonperforming loans	$2,283	$3,349	$2,130	$3,842	$1,921
OREO and repossessed assets:					
One- to four-family	$—	$562	$159	$269	$1,086
Commercial and multifamily	600	600	600	—	—
Manufactured homes	10	10	10	54	92
Total OREO and repossessed assets	$610	$1,172	$769	$323	$1,178
Total nonperforming assets	$2,893	$4,521	$2,899	$4,165	$3,099
Nonperforming assets as a percentage of total assets	0.45 %	0.77 %	0.54 %	0.84 %	0.70 %
Performing restructured loans:					
One- to four- family	$2,876	$1,977	$2,415	$2,619	$3,195
Home equity	158	144	232	679	704
Commercial and multifamily	—	361	1,966	1,317	761
Construction and land	49	83	91	99	106
Manufactured homes	150	160	255	279	496
Other consumer	36	40	—	1	9
Commercial business	—	—	114	123	133
Total performing restructured loans	$3,269	$2,765	$5,073	$5,117	$5,404

(1) Nonperforming loans include $445,000, $683,000, $971,000, $2.3 million and $1.0 million in nonperforming troubled debt restructurings as of December 31, 2017, 2016, 2015, 2014 and 2013, respectively. We had no accruing loan 90 days or more delinquent for the periods reported.

Nonperforming loans decreased $1.1 million to $2.3 million at December 31, 2017 from $3.3 million at December 31, 2016 due primarily to a $1.4 million decrease in the one-to-four- family loan category. Our largest nonperforming loan at December 31, 2017 was a $201,000 owner-occupied commercial real estate loan. Nonperforming one- to four-family loans at December 31, 2017 consisted of eight loans to different borrowers with an average loan balance of $105,000. There were nine home equity loans, eight manufactured home loans, three commercial business loans, two construction and land loans, one commercial real estate loan, and one consumer loan classified as nonperforming at December 31, 2017.

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For the year ended December 31, 2017, gross interest income that would have been recorded had the nonaccrual loans been current in accordance with their original terms amounted to $33,000, all of which was excluded from interest income for the year ended December 31, 2017. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Financial Condition at December 31, 2017 Compared to December 31, 2016 -- Delinquencies and Nonperforming Assets" contained in Item 7 of this report on Form 10-K for more information on troubled assets.

Troubled Debt Restructured Loans. Troubled debt restructurings ("TDRs"), which are accounted for under Accounting Codification Standard ("ASC") 310-40, are loans which have renegotiated loan terms to assist borrowers who are unable to meet the original terms of their loans. Such modifications to loan terms may include a lower interest rate, a reduction in principal, or a longer term to maturity. All TDRs are initially classified as impaired regardless of whether the loan was performing at the time it was restructured. Once a troubled debt restructuring has performed according to its modified terms for six months and the collection of principal and interest under the revised terms is deemed probable, we remove the TDR from nonperforming status. At December 31, 2017, we had $3.3 million of loans that were classified as performing TDRs and still on accrual. Included in nonperforming loans at December 31, 2017 and 2016 were troubled debt restructured loans of $445,000 and $683,000, respectively.

OREO and Repossessed Assets. OREO and repossessed assets include assets acquired in settlement of loans. At December 31, 2017, OREO and repossessed assets totaled $610,000. Our OREO at December 31, 2017, consisted of a former bank branch property located in Port Angeles, Washington which was acquired in 2015 as a part of three branches purchased from another financial institution with a balance of $600,000 and a manufactured home located in Seattle, Washington, with a balance of $10,000. The former bank branch property originally was classified as a fixed asset and was subsequently reclassified to OREO in 2016. It is currently leased to a local not-for-profit organization at a below market rate.

Other Loans of Concern. In addition to the nonperforming assets set forth in the table above, as of December 31, 2017, there were 34 loans totaling $5.2 million with respect to which known information about the possible credit problems of the borrowers have caused management to have doubts as to the ability of the borrowers to comply with present loan repayment terms and which may result in the future inclusion of such items in the nonperforming asset categories. The largest loans of concern at December 31, 2017, were a $1.4 million loan secured by one- to four-family residential real estate located in King County, Washington, and a $751,000 loan secured by an owner-occupied office building in King County, Washington. Additional other loans of concern included, $746,000 of commercial and multifamily real estate loans, $784,000 in commercial business loans, $1.4 million in residential mortgages, and $186,000 in consumer loans.

Classified Assets. Federal regulations provide for the classification of lower quality loans and other assets (such as OREO and repossessed assets), debt and equity securities considered, as "substandard," "doubtful" or "loss." An asset is considered "substandard" if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. "Substandard" assets include those characterized by the "distinct possibility" that the insured institution will sustain "some loss" if the deficiencies are not corrected. Assets classified as "doubtful" have all of the weaknesses in those classified "substandard," with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions and values, "highly questionable and improbable." Assets classified as "loss" are those considered "uncollectible" and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

When we classify problem assets as either substandard or doubtful, we may establish a specific allowance in an amount we deem prudent to address specific impairments. General allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been specifically allocated to particular problem assets. When an insured institution classifies problem assets as a loss, it is required to charge off those assets in the period in which they are deemed uncollectible. Our determination as to the classification of our assets and the amount of our valuation allowances is subject to review by the FDIC and, since our conversion to a Washington chartered commercial bank, the WDFI, which can order the establishment of additional loss allowances. Assets which do not currently expose us to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated as special mention. At December 31, 2017, special mention assets totaled $1.3 million.

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We regularly review the problem assets in our portfolio to determine whether any assets require classification in accordance with applicable regulations. On the basis of management's review of our assets, at December 31, 2017, we had classified $6.8 million of our assets as substandard, of which $6.2 million represented a variety of outstanding loans and $610,000 represented the balance of our OREO and repossessed assets. At that date, we had no assets classified as doubtful or loss. This total amount of classified assets represented 10.4% of our equity capital and 1.1% of our assets at December 31, 2017. Classified assets totaled $6.6 million, or 11.0% of our equity capital and 1.1% of our assets at December 31, 2016.

Allowance for Loan Losses. We maintain an allowance for loan losses to absorb probable loan losses in the loan portfolio. The allowance is based on ongoing, monthly assessments of the estimated probable incurred losses in the loan portfolio. In evaluating the level of the allowance for loan losses, management considers the types of loans and the amount of loans in the loan portfolio, peer group information, historical loss experience, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. Large groups of smaller balance homogeneous loans, such as one-to four-family, small commercial and multifamily real estate, home equity and consumer loans, including floating homes and manufactured homes, are evaluated in the aggregate using historical loss factors and peer group data adjusted for current economic conditions. More complex loans, such as commercial and multifamily real estate loans and commercial business loans are evaluated individually for impairment, primarily through the evaluation of the borrower's net operating income and available cash flow and their possible impact on collateral values.

At December 31, 2017, our allowance for loan losses was $5.2 million, or 0.96% of our total loan portfolio, compared to $4.8 million, or 0.96% of our total loan portfolio in 2016. Specific valuation reserves totaled $896,000 and $863,000 at December 31, 2017 and 2016, respectively.

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Assessing the allowance for loan losses is inherently subjective as it requires making material estimates, including the amount and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. In the opinion of management, the allowance, when taken as a whole, properly reflects estimated probable loan losses inherent in our loan portfolio. See Notes 1 and 5 in the Notes to Consolidated Financial Statements contained in Item 8 of this report on Form 10-K. The following table sets forth an analysis of our allowance for loan losses at the dates indicated (dollars in thousands):

	December 31,				
	2017	2016	2015	2014	2013
Balance at beginning of period	$4,822	$4,636	$4,387	$4,177	$4,248
Charge-offs:					
One- to four-family	—	72	21	127	560
Home equity	89	15	35	295	593
Commercial and multifamily	24	314	—	47	194
Construction and land	—	—	40	—	7
Manufactured homes	12	—	37	197	143
Other consumer	18	42	77	77	41
Commercial business	—	29	—	—	46
Total charge-offs	143	472	210	743	1,584
Recoveries:					
One- to four-family	—	47	—	64	—
Home equity	33	78	36	52	19
Commercial and multifamily	1	—	—	2	32
Construction and land	—	18	—	—	—
Manufactured homes	8	8	8	14	3
Other consumer	20	53	15	21	31
Commercial business	—	—	—	—	78
Total recoveries	62	204	59	153	163
Net charge-offs	81	268	151	590	1,421
Additions charged to operations	500	454	400	800	1,350
Balance at end of period	$5,241	$4,822	$4,636	$4,387	$4,177
Net charge-offs during the period as a percentage of average loans outstanding during the period	0.02 %	0.06 %	0.03 %	0.14 %	0.40 %
Net charge-offs during the period as a percentage of average nonperforming assets	2.12 %	6.27 %	5.26 %	18.65 %	41.16 %
Allowance as a percentage of nonperforming loans	229.57%	143.98%	217.65%	114.19%	217.44%
Allowance as a percentage of total loans (end of period)	0.96 %	0.96 %	1.01 %	1.02 %	1.07 %

Economic conditions have been favorable in our market areas. Housing prices have experienced double-digit growth throughout 2017, with historically low inventory levels. Unemployment rates in many of our market areas remain low as the job market is competitive. The increase in our allowance for loan losses as a percentage of nonperforming loans during 2017 was a result of a decrease in nonperforming loans during the last year due primarily to the reduction of $1.4 million in nonperforming one-to-four- family loans during the year. The allowance for loan losses as a percentage of nonperforming loans was 229.57% and 143.98% as of December 31, 2017 and 2016, respectively. The unallocated portion of our allowance for loan losses has increased over the past few years as we have experienced a decrease in the amount of loan losses, charge-offs, and impaired loans relative to prior periods.

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The distribution of our allowance for losses on loans at the dates indicated is summarized as follows (dollars in thousands):

	December 31, 2017		2016		2015		2014		2013	
	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans
Allocated at end of period to:										
One- to four-family	$1,241	28.59 %	$1,542	30.37 %	$1,839	30.60 %	$1,442	30.80 %	$1,915	30.02 %
Home equity	282	5.16	378	5.53	607	6.85	601	8.03	781	8.96
Commercial and multifamily	1,250	38.38	1,144	36.07	921	38.01	1,244	39.12	300	40.17
Construction and land	375	11.17	459	14.13	382	12.37	399	10.72	318	11.30
Manufactured homes	344	3.11	168	3.09	301	2.99	193	2.90	209	3.44
Floating homes	169	5.29	132	4.78	102	3.95	90	2.70	59	1.42
Other consumer	77	0.89	112	0.78	86	1.05	77	1.21	50	1.20
Commercial business	367	7.41	175	5.25	157	4.18	108	4.52	102	3.49
Unallocated	1,136	—	712	—	241	—	233	—	443	—
Total	$5,241	100.00 %	$4,822	100.00 %	$4,636	100.00 %	$4,387	100.00 %	$4,177	100.00 %

Investment Activities

State chartered commercial banks have the authority to invest in various types of liquid assets, including United States Treasury obligations, securities of various federal agencies, including callable agency securities, certain certificates of deposit of insured commercial banks and savings banks, certain bankers' acceptances, repurchase agreements and federal funds. Subject to various restrictions, state commercial banks may also invest their assets in investment grade commercial paper and corporate debt securities and mutual funds whose assets conform to the investments that the institution is otherwise authorized to make directly. See "- How We Are Regulated – Sound Community Bank" for a discussion of additional restrictions on our investment activities.

Our Chief Executive Officer and Chief Financial Officer have the responsibility for the management of our investment portfolio, subject to the direction and guidance of the Board of Directors. These officers consider various factors when making decisions, including the marketability, maturity and tax consequences of the proposed investment. The maturity structure of investments will be affected by various market conditions, including the current and anticipated slope of the yield curve, the level of interest rates, the trend of new deposit inflows, and the anticipated demand for funds via deposit withdrawals and loan originations and purchases.

The general objectives of our investment portfolio are to provide liquidity when loan demand is high, to assist in maintaining earnings when loan demand is low and to maximize earnings while satisfactorily managing risk, including credit risk, reinvestment risk, liquidity risk and interest rate risk. Our investment quality emphasizes safer investments with the yield on those investments secondary to not taking unnecessary risk with the available funds. See "Quantitative and Qualitative Disclosures About Market Risk" for additional information about our interest rate risk management contained in Item 7A. of this report on Form 10-K.

At December 31, 2017, we owned $3.1 million of stock issued by the FHLB. As a condition of membership in the FHLB, we are required to purchase and hold a certain amount of FHLB stock.

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The following table sets forth the composition of our securities portfolio and other investments at the dates indicated. At December 31, 2017, our securities portfolio did not contain securities of any issuer with an aggregate book value in excess of 10% of our equity capital. See Note 4 in the Notes to Consolidated Financial Statements contained in Item 8 of this report on Form 10-K.

	December 31,					
	2017		2016		2015	
	Amortized	Fair	Amortized	Fair	Amortized	Fair
Securities available-for-sale	Cost	Value	Cost	Value	Cost	Value
Municipal bonds	$3,240	$3,369	$3,262	$3,353	$1,912	$2,096
Agency mortgage-backed securities	2,030	2,066	2,858	2,904	4,088	4,172
Non-agency mortgage-backed securities	—	—	362	347	449	428
Total available for sale securities	5,270	5,435	6,482	6,604	6,449	6,696
FHLB stock	3,065	3,065	2,840	2,840	2,212	2,212
Total securities	$8,335	$8,500	$9,322	$9,444	$8,661	$8,908

We review investment securities on an ongoing basis for the presence of other-than-temporary impairment ("OTTI") taking into consideration current market conditions, fair value in relationship to cost, extent and nature of the change in fair value, issuer rating changes and trends, whether we intend to sell a security or if it is likely that we will be required to sell the security before recovery of our amortized cost basis of the investment, which may be maturity, and other factors. For debt securities, if we intend to sell the security or it is likely that we will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If we do not intend to sell the security and it is not more likely than not that we will be required to sell the security but we do not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected.

Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and the fair value, is recognized as a charge to other comprehensive income. Impairment losses related to all other factors are presented as separate categories within other comprehensive income.

During the year ended December 31, 2017, we did not recognize any non-cash OTTI charges on our investment securities. Three agency securities had unrealized losses although management determined the decline in value was not related to specific credit deterioration. We do not intend to sell these securities and it is more likely than not that we will not be required to sell either security before anticipated recovery of the remaining amortized cost basis. We closely monitor our investment securities for changes in credit risk. The current market environment significantly limits our ability to mitigate our exposure to valuation changes in these securities by selling them. If market conditions deteriorate and we determine our holdings of these or other investment securities are OTTI, our future earnings, shareholders' equity, regulatory capital and continuing operations could be materially adversely affected.

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Sources of Funds

General. Our sources of funds are primarily deposits (including deposits from public entities), borrowings, payments of principal and interest on loans and investments and funds provided from operations.

Deposits. We offer a variety of deposit accounts to both consumers and businesses having a wide range of interest rates and terms. Our deposits consist of savings accounts, money market deposit accounts, NOW accounts, demand accounts and certificates of deposit. We solicit deposits primarily in our market area; however, at December 31, 2017, approximately 3.0% of our deposits were from persons outside the State of Washington. As of December 31, 2017, core deposits, which we define as our non-time deposit accounts and time deposit accounts less than $250,000, represented approximately 90.8% of total deposits, compared to 88.0% and 85.7% as of December 31, 2016 and December 31, 2015, respectively. We primarily rely on competitive pricing policies, marketing and client service to attract and retain these deposits and we expect to continue these practices in the future.

The flow of deposits is influenced significantly by general economic conditions, changes in money market and prevailing interest rates and competition. The variety of deposit accounts we offer has allowed us to be competitive in obtaining funds and to respond with flexibility to changes in consumer demand. We are more susceptible to short-term fluctuations in deposit flows as clients are more interest rate sensitive. We manage the pricing of our deposits in keeping with our asset/liability management, liquidity and profitability objectives, subject to competitive factors. Based on our experience, we believe that our deposits are relatively stable sources of funds. Despite this stability, our ability to attract and maintain these deposits and the rates paid on them is and will continue to be significantly affected by market conditions.

The following table sets forth our deposit flows during the periods indicated (dollars in thousands):

	Year Ended December 31,		
	2017	2016	2015
Opening balance	$467,731	$440,024	$407,809
Net deposits	43,648	24,999	29,569
Interest credited	3,021	2,708	2,646
Ending balance	$514,400	$467,731	$440,024
Net increase	$46,669	$27,707	$32,215
Percent increase	10.0 %	6.3 %	7.9 %

The following table sets forth the dollar amount of deposits in the various types of deposit programs offered by us at the dates indicated (dollars in thousands):

	December 31,					
	2017		2016		2015	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
Noninterest-bearing demand	$69,094	13.43 %	$60,566	12.94 %	$48,067	10.92 %
Interest-bearing demand	173,413	33.71	150,327	32.14	127,392	28.95
Savings	49,450	9.61	44,879	9.60	38,833	8.83
Money market	54,860	10.66	49,042	10.49	54,046	12.28
Escrow	3,029	0.59	3,175	0.68	2,806	0.64
Total non-maturity deposits	349,846	68.01	307,989	65.85	271,144	61.62
Certificates of deposit:						
1.99% or below	154,102	29.96	152,294	32.56	155,409	35.32
2.00 - 3.99%	10,452	2.03	7,448	1.59	13,471	3.06
Total certificates of deposit	164,554	31.99	159,742	34.15	168,880	38.38
Total deposits	$514,400	100.00%	$467,731	100.00%	$440,024	100.00%

Interest-bearing demand accounts increased compared to 2016 as a result of our acquisition of the University Place branch in 2017 and our continued marketing emphasis on our rewards checking product as well our competitively priced interest-bearing demand account. This product is priced and marketed similarly to a money market account however, it does not have the monthly withdrawal and outgoing transfer restrictions like savings and money market accounts. The increase in noninterest-bearing demand accounts was primarily a result of our continued emphasis on attracting relatively low-cost core deposit accounts, in particular from small businesses. The increase in certificate accounts over the past year was also due to the acquisition of the University Place branch which offset a decrease in public funds certificates

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We are a public funds depository and as of December 31, 2017, we had $30.0 million in public funds compared to $39.7 million in public funds at December 31, 2016. These funds consisted of $29.6 million in certificates of deposit, $194,000 in money market accounts and $134,000 in checking accounts at December 31, 2017. These accounts must be 50% collateralized if the amount on deposit exceeds FDIC insurance of $250,000. We use letters of credit from the FHLB as collateral for these funds.

The following table shows rate and maturity information for our certificates of deposit at December 31, 2017 (dollars in thousands):

	0.00-1.99%	2.00-3.99%	Total	Percent of Total
Certificate accounts maturing in quarter ending:				
March 30, 2018	$11,496	$75	$11,571	7.03 %
June 30, 2018	18,742	—	18,742	11.39
September 30, 2018	16,784	—	16,784	10.20
December 31, 2018	19,663	—	19,663	11.95
March 30, 2019	39,383	—	39,383	23.93
June 30, 2019	16,354	—	16,354	9.94
September 30, 2019	1,882	4,621	6,503	3.95
December 31, 2019	2,156	3,760	5,916	3.60
March 30, 2020	2,948	—	2,948	1.79
June 30, 2020	1,295	—	1,295	0.79
September 30, 2020	2,444	—	2,444	1.49
December 31, 2020	1,139	—	1,139	0.69
Thereafter	19,816	1,996	21,812	13.25
Total	$154,102	$10,452	$164,554	100.00%
Percent of total	93.65 %	6.35 %	100.00 %	

The following table indicates the amount of our certificates of deposit and other deposits by time remaining until maturity as of December 31, 2017 (in thousands):

	Maturity 3 months or less	Over 3 to 6 months	Over 6 to 12 months	Over 12 months	Total
Certificates of deposit less than $100,000	$6,993	$8,215	$13,308	$32,085	$60,601
Certificates of deposit of $100,000 or more	4,577	10,526	23,138	65,712	103,953
Total certificates of deposit	$11,570	$18,741	$36,446	$97,797	$164,554

Borrowings. Although deposits are our primary source of funds, we may utilize borrowings as a cost-effective source of funds when they can be invested at a positive interest rate spread, for additional capacity to fund loan demand, or to meet our asset/liability management goals. Our borrowings currently consist of advances from the FHLB. See Note 10 in the Notes to Consolidated Financial Statements contained in Item 8 of this report on Form 10-K.

We are a member of and obtain advances from the FHLB, which is part of the Federal Home Loan Bank System. The eleven regional Federal Home Loan Banks provide a central credit facility for their member institutions. These advances are provided upon the security of certain of our mortgage loans and mortgage-backed securities. These advances may be made pursuant to several different credit programs, each of which has its own interest rate, range of maturities and call features, and all long-term advances are required to provide funds for residential home financing. We have entered into a loan agreement with the FHLB pursuant to which Sound Community Bank may borrow up to approximately 35% of total assets, secured by a blanket pledge on a portion of our residential mortgage portfolio including one- to four family first and second mortgage loans, and commercial and multifamily real estate loans. Based on eligible collateral, the total amount available under this agreement as of December 31, 2017 was $217.6 million. At the same date, we had $59.0 million in FHLB advances outstanding with maturities between zero and one year. We also had outstanding letters of credit from the FHLB with a notional amount of $14.5 million at December 31, 2017. We plan to rely in part on FHLB advances to fund asset and loan growth. We also use short-term advances to meet short term liquidity needs. We are required to own stock in the FHLB based on the amount of our advances.

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From time to time, we also may borrow from the Federal Reserve Bank of San Francisco's "discount window" for overnight liquidity needs, although we have not borrowed from the discount window in recent years.

The following table sets forth the maximum balance and average balance of borrowings for the periods indicated (dollars in thousands):

	Year Ended December 31,		
	2017	2016	2015
Maximum balance:			
FHLB advances	$61,500	$59,846	$44,988
Average balances:			
FHLB advances	$29,791	$36,609	$24,626
Weighted average interest rate:			
FHLB advances	1.16 %	0.58 %	0.43 %

The following table sets forth certain information about our borrowings at the dates indicated (dollars in thousands):

	As of December 31,		
	2017	2016	2015
FHLB advances	$59,000	$54,792	$40,435
Weighted-average interest rate:			
FHLB advances	1.63 %	0.82 %	0.39 %

Subsidiary and Other Activities

Sound Financial Bancorp has one subsidiary, Sound Community Bank.

Competition

We face competition in attracting deposits and originating loans. Competition in originating real estate loans comes primarily from commercial banks, credit unions, life insurance companies and mortgage brokers. Commercial banks, credit unions and finance companies provide vigorous competition in consumer lending. Commercial business competition is primarily from local commercial banks, but credit unions also compete for this business. We compete by consistently delivering high-quality, personal service to our clients which results in a high level of client satisfaction.

Our market area has a high concentration of financial institutions, many of which are branches of large money center and regional banks that have resulted from the consolidation of the banking industry in Washington and other western states. These include such large national lenders as US Bank, JP Morgan Chase, Wells Fargo, Bank of America, Key Bank and others in our market area that have greater resources than we do.

We attract our deposits through our branch offices and web site. Competition for those deposits is principally from savings banks, commercial banks and credit unions, as well as mutual funds and other alternative investments. We compete for these deposits by offering superior service, online and mobile access and a variety of deposit accounts at competitive rates. Based on the most recent data provided by the FDIC, there are approximately 45 other commercial banks and savings banks operating in the Seattle MSA, which includes King, Snohomish and Pierce Counties. Based on the most recent branch deposit data provided by the FDIC, our share of deposits in the Seattle MSA is approximately 0.2%. The five largest financial institutions in that area have 72.1% of those deposits. In Clallam County there are nine other commercial banks and savings banks. Our share of deposits in Clallam County was the second highest in the county at approximately 16.1%, with the five largest institutions in that county having 76.3% of the deposits. In Jefferson County there are six other commercial banks and savings banks. Our share of deposits in Jefferson County is approximately 6.49%, while the five largest institutions in that county have 81.88% of those deposits.

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How We Are Regulated

General. On December 28, 2012, Sound Community Bank converted from a federally chartered savings bank to a Washington state-chartered commercial bank. As a Washington commercial bank, Sound Community Bank's regulators are the WDFI and the FDIC, rather than the OCC. The Federal Reserve is the primary federal regulator for Sound Financial Bancorp. A brief description of certain laws and regulations that are applicable to Sound Financial Bancorp and Sound Community Bank is set forth below. This description of these laws and regulations, as well as descriptions of laws and regulations contained elsewhere herein, does not purport to be complete and is qualified in its entirety by reference to the applicable laws and regulations. Legislation is introduced from time to time in the United States Congress or the Washington State Legislature that may affect the operations of Sound Financial Bancorp and Sound Community Bank. In addition, the regulations governing us may be amended from time to time. Any such legislation or regulatory changes in the future could adversely affect our operations and financial condition.

The WDFI and FDIC have extensive enforcement authority over Sound Community Bank. The Federal Reserve has the same type of authority over Sound Financial Bancorp. This enforcement authority includes, among other things, the ability to assess civil money penalties, issue cease-and-desist orders and removal orders and initiate injunctive actions. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with the regulators.

Regulatory Reform. On July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The Dodd-Frank Act imposed various restrictions and an expanded framework of regulatory oversight for financial institutions, including depository institutions. The following discussion summarizes significant aspects of the Dodd-Frank Act that affect us.

The following aspects of the Dodd-Frank Act are related to our operations:

The Consumer Financial Protection Bureau (the "CFPB"), an independent consumer compliance regulatory agency, was established within the Federal Reserve. The CFPB is empowered to exercise broad regulatory, supervisory and enforcement authority over financial institutions with total assets over $10 billion with respect to both new and existing consumer financial protection laws. Smaller financial institutions, like Sound Community Bank, are subject to supervision and enforcement by their primary federal banking regulator with respect to federal consumer financial protection laws and regulations. The CFPB also has authority to promulgate new consumer financial protection regulations and amend existing consumer financial protection regulations.

The Federal Reserve must require depository institution holding companies to serve as a source of strength for their depository institution subsidiaries.

The prohibition on payment of interest on demand deposits was repealed.

Deposit insurance increased to $250,000.

The deposit insurance assessment base for FDIC insurance is the depository institution's average consolidated total assets less average tangible equity during the assessment period.

The minimum reserve ratio of the Deposit Insurance Fund ("DIF") increased to 1.35 percent of estimated annual insured deposits or the comparable percentage of the assessment base; however, the FDIC is directed to "offset the effect" of the increased reserve ratio for insured depository institutions with total consolidated assets of less than $10 billion. Pursuant to the Dodd-Frank Act, the FDIC issued a rule setting a designated reserve ratio at 2.0% of insured deposits.

Tier 1 capital treatment for "hybrid" capital items like trust preferred securities was eliminated subject to various grandfathering and transition rules. The federal banking agencies have promulgated rules on regulatory capital for both depository institutions and their holding companies, including leverage capital and risk-based capital measures at least as stringent as those applicable to Sound Community Bank under the prompt corrective action regulations. See "-Capital Rules"

A separate, non-binding shareholder vote is required regarding golden parachutes for named executive officers when a shareholder vote takes place on mergers, acquisitions, dispositions or other transactions that would trigger the parachute payments.
Securities exchanges are required to prohibit brokers from using their own discretion to vote shares not beneficially owned by them for certain "significant" matters, which include votes on the election of directors, executive compensation matters, and any other matter determined to be significant.
Stock exchanges, not including the OTC Bulletin Board, are prohibited from listing the securities of any issuer that does not have a policy providing for (i) disclosure of its policy on incentive compensation that is based on financial information required to be reported under the securities laws, and (ii) the recovery from current or former executive officers, following an accounting restatement triggered by material noncompliance with securities law reporting requirements, of any incentive compensation paid erroneously during the three-year period preceding the date on which the restatement was required that exceeds the amount that would have been paid on the basis of the restated financial information.

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Regulation of Sound Community Bank

General. Sound Community Bank, as a state-chartered commercial bank, is subject to applicable provisions of Washington law and to regulations and examinations of the WDFI. As an insured institution, it also is subject to examination and regulation by the FDIC, which insures the deposits of Sound Community Bank to the maximum permitted by law. During these state or federal regulatory examinations, the examiners may require Sound Community Bank to provide for higher general or specific loan loss reserves, which can impact our capital and earnings. This regulation of Sound Community Bank is intended for the protection of depositors and the Deposit Insurance Fund of the FDIC and not for the purpose of protecting shareholders of Sound Community Bank or Sound Financial Bancorp. Sound Community Bank is required to maintain minimum levels of regulatory capital and is subject to certain limitations on the payment of dividends to Sound Financial Bancorp. See "- Capital Rules" and "-Limitations on Dividends and Other Capital Distributions."

Regulation by the WDFI and the FDIC. State law and regulations govern Sound Community Bank's ability to take deposits and pay interest, to make loans on or invest in residential and other real estate, to make other loans, to invest in securities, to offer various banking services to its clients, and to establish branch offices. As a state commercial bank, Sound Community Bank must pay semi-annual assessments, examination costs and certain other charges to the WDFI.

Washington law generally provides the same powers for Washington commercial banks as federally and other-state chartered savings banks with branches in Washington. Washington law allows Washington commercial banks to charge the maximum interest rates on loans and other extensions of credit to Washington residents which are allowable for a national bank in another state if higher than Washington limits. In addition, the WDFI may approve applications by Washington commercial banks to engage in an otherwise unauthorized activity, if it determines that the activity is closely related to banking, and Sound Community Bank is otherwise qualified under the statute.

Federal law generally limits the activities and equity investments of Sound Community Bank to those that are permissible for national banks, unless approved by the FDIC. Our relationship with our depositors and borrowers is regulated to a great extent by federal laws and regulations, especially with respect to disclosure requirements.

The FDIC has adopted regulatory guidelines establishing safety and soundness standards on such matters as loan underwriting and documentation, asset quality, earnings standards, internal controls and information systems, audit systems, interest rate risk exposure and compensation and other benefits. If the FDIC determines that Sound Community Bank fails to meet any standard prescribed by these guidelines, it may require Sound Community Bank to submit an acceptable plan to achieve compliance with the standard.

Among these safety and soundness standards are FDIC regulations that require Sound Community Bank to adopt and maintain written policies that establish appropriate limits and standards for real estate loans. These standards, which must be consistent with safe and sound banking practices, establish loan portfolio diversification standards, prudent underwriting standards (including loan-to-value ratio limits) that are clear and measurable, loan administration procedures, and documentation, approval and reporting requirements. Sound Community Bank is obligated to monitor conditions in its real estate markets to ensure that its standards continue to be appropriate for current market conditions. Sound Community Bank's board of directors is required to review and approve Sound Community Bank's standards at least annually. The FDIC has published guidelines for compliance with these regulations, including supervisory limitations on loan-to-value ratios for different categories of real estate loans. Under the guidelines, the aggregate level of all loans in excess of the supervisory loan-to-value ratios should not exceed an aggregate limit of 100% of total capital, and within the aggregate limit, the total of all loans for commercial, agricultural, multifamily or other non-one-to-four-family residential properties should not exceed 30% of total capital.

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Loans in excess of the supervisory loan-to-value ratio limitations must be identified in Sound Community Bank's records and reported at least quarterly to Sound Community Bank's Board of Directors. Sound Community Bank is in compliance with the records and reporting requirements. As of December 31, 2017, Sound Community Bank's aggregate loans in excess of the supervisory loan-to-value ratios were $8.1 million.

The FDIC and the WDFI must approve any merger transaction involving Sound Community Bank as the acquirer, including an assumption of deposits from another depository institution. The FDIC generally is authorized to approve interstate merger transactions without regard to whether the transaction is prohibited by the law of any state. Interstate acquisitions of branches are permitted only if the law of the state in which the branch is located permits such acquisitions. Interstate mergers and branch acquisitions are also be subject to the nationwide and statewide insured deposit concentration amounts described below. The Dodd-Frank Act permits de novo interstate branching for banks.

Insurance of Accounts. The DIF of the FDIC insures deposit accounts in Sound Community Bank up to $250,000 per separately insured depositor.

The FDIC assesses deposit insurance premiums quarterly on each FDIC-insured institution applied to its deposit base, which is their average consolidated total assets minus its Tier 1 capital. No institution may pay a dividend if it is in default on its federal deposit insurance assessment.

Effective July 1, 2016, the FDIC commenced calculating assessments for small institutions so that assessment rates for small institutions (those with assets of less than $10 billion) are based on an institution's weighted average CAMELS component ratings and certain financial ratios. Assessment rates range from 3 to 16 basis points for institutions with CAMELS composite ratings of 1 or 2, 6 to 30 basis points for those with CAMELS composite ratings of 3, and 16 to 30 basis points for those with CAMELS composite ratings of 4 or 5, subject to certain adjustments. Assessment rates are expected to decrease in the future as the reserve ratio increases in specified increments to the 1.35% ratio required by the Dodd-Frank Act.

As required by the Dodd Frank Act, the FDIC has adopted a rule to offset the effect of the increase in the minimum reserve ratio of the DIF on small institutions by imposing a surcharge on institutions with assets of $10 billion or more commencing on July 1, 2016 and ending when the reserve ratio reaches 1.35%. This surcharge period is expected to end by December 31, 2018. Small institutions will receive credits for the portions of their regular assessments that contributed to growth in the reserve ratio between 1.15% and 1.35%. Subject to certain limitations, the credits will apply to reduce regular assessments until exhausted

Transactions with Related Parties. Transactions between Sound Community Bank and its affiliates are required to be on terms as favorable to Sound Community Bank as transactions with non-affiliates, and certain of these transactions, such as loans to an affiliate, are restricted to a percentage of Sound Community Bank's capital and require eligible collateral in specified amounts. Sound Financial Bancorp is an affiliate of Sound Community Bank.

The Sarbanes-Oxley Act of 2002 generally prohibits loans by Sound Financial Bancorp to its executive officers and directors. However, the law contains a specific exception for loans by a depository institution to its executive officers and directors in compliance with federal banking laws. Under such laws, Sound Community Bank's authority to extend credit to executive officers, directors and 10% shareholders ("insiders"), as well as entities such persons control, is limited. The laws limit both the individual and aggregate amount of loans that Sound Community Bank may make to insiders based, in part, on Sound Community Bank's capital level and requires that certain board approval procedures be followed. Such loans are required to be made on terms substantially the same as those offered to unaffiliated borrowers and must not involve more than the normal risk of repayment. There is an exception for loans made pursuant to a benefit or compensation program that is widely available to all employees of the institution and does not give preference to insiders over other employees. Loans to executive officers are subject to additional limitations based on the type of loan involved.

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Capital Rules. Effective January 1, 2015 (with some provisions transitioned into full effectiveness over several years), Sound Financial Bancorp and Sound Community Bank are subject to the capital regulations adopted by the Federal Reserve and the FDIC pursuant to the Dodd-Frank Act. Under these capital regulations, the minimum capital ratios are: (1) a common equity Tier 1 ("CET1") capital ratio of 4.5% of risk-weighted assets; (2) a Tier 1 capital ratio of 6.0% of risk-weighted assets; (3) a total capital ratio of 8.0% of risk-weighted assets, and (4) a leverage ratio (the ratio of Tier 1 capital to average total adjusted assets) of 4.0%. CET1 generally consists of common stock, retained earnings, accumulated other comprehensive income ("AOCI") unless an institution elects to exclude AOCI from regulatory capital, as discussed below, and certain minority interests, all subject to applicable regulatory adjustments and deductions. Tier 1 capital generally includes CET1 and noncumulative perpetual preferred stock, less most intangible assets, subject to certain adjustments. Total capital consists of Tier 1 and Tier 2 Capital. Tier 2 capital, which is limited to 100 percent of Tier 1 capital, includes such items as qualifying general loan loss reserves, cumulative perpetual preferred stock, mandatory convertible debt, term subordinated debt and limited life preferred stock; however, the amount of term subordinated debt and intermediate term preferred stock that may be included in Tier 2 capital is limited to 50 percent of Tier 1 capital. Risk-weighted assets are determined under the capital regulations, which assign risk-weights to all assets and to certain off-balance sheet items.

These regulations include the phasing-out of certain instruments as qualifying capital. Mortgage servicing and deferred tax assets over designated percentages of CET1 are deducted from capital. In addition, Tier 1 capital includes AOCI, which includes all unrealized gains and losses on available for sale debt and equity securities, unless an institution elects to opt out of such inclusion, if eligible to do so. We have elected to permanently opt-out of the inclusion of AOCI in our capital calculations.

The capital regulations include a 150% risk weight for certain high volatility commercial real estate acquisition, development and construction loans and for non-residential mortgage loans that are 90 days past due or otherwise in nonaccrual status; a 20% risk weight for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable; and a 250% risk weight for mortgage servicing and deferred tax assets that are not deducted from capital.

In addition to the minimum CET1, Tier 1 and total capital ratios, Sound Financial Bancorp and Sound Community Bank must maintain a capital conservation buffer consisting of additional CET1 capital greater than 2.5% of risk-weighted assets above the required minimum levels in order to avoid limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses. The capital conservation buffer requirement began to phase in on January 1, 2016, when a buffer greater than 0.625% of risk-weighted assets was required, which amount increases each year until the buffer requirement is fully implemented on January 1, 2019.

Under the FDIC's prompt corrective action standards, in order to be considered well-capitalized, a bank must have a ratio of CET1 capital to risk-weighted assets of at least 6.5%, a ratio of Tier 1 capital to risk-weighted assets of at least 8%, a ratio of total capital to risk-weighted assets of at least 10%, and a leverage ratio of at least 5%, and the bank must not be subject to a regulatory capital requirement imposed on it as an individual bank. In order to be considered adequately capitalized, a bank must have the minimum capital ratios described above. Institutions with lower capital ratios are assigned to lower capital categories. Based on safety and soundness concerns, the FDIC may assign an institution to a lower capital category than would originally apply based on its capital ratios. The FDIC is also authorized to require Sound Community Bank to maintain additional amounts of capital in connection with concentrations of assets, interest rate risk, and certain other items. The FDIC has not imposed such a requirement on Sound Community Bank.

An institution that is not well capitalized is subject to certain restrictions on brokered deposits and interest rates on deposits. An institution that is not at least adequately capitalized is subject to numerous additional restrictions, and a guaranty by its holding company is required. An institution with a ratio of tangible equity to total assets of 2.0% or less is subject to appointment of the FDIC as receiver if its capital level does not improve in timely fashion. When the

FDIC as receiver liquidates an institution, the claims of depositors and the FDIC as their successor have priority over other unsecured claims against the institution.

As of December 31, 2017, Sound Financial Bancorp and Sound Community Bank are well capitalized under applicable regulations and both meet the capital conservation buffer requirement.

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Volcker Rule Regulations. Regulations were adopted by the federal banking agencies to implement the provisions of the Dodd Frank Act commonly referred to as the Volcker Rule. The regulations contain prohibitions and restrictions on the ability of banks and their holding companies and the affiliates to engage in proprietary trading and to hold certain interests in, or to have certain relationships with, various types of investment funds, including hedge funds and private equity funds, and certain other investments, including certain collateralized mortgage obligations, collateralized debt obligations, collateralized loan obligations and others.

Community Reinvestment and Consumer Protection Laws. In connection with its lending and other activities, Sound Community Bank is subject to a number of federal laws designed to protect clients and promote lending to various sectors of the economy and population. These include, among others, the Equal Credit Opportunity Act, the Truth-in-Lending Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, and the Community Reinvestment Act ("CRA"). Among other things, these laws:

require lenders to disclose credit terms in meaningful and consistent ways;
prohibit discrimination against an applicant in a credit transaction;
prohibit discrimination in housing-related lending activities;
require certain lenders to collect and report applicant and borrower data regarding home loans;
require lenders to provide borrowers with information regarding the nature and cost of real estate settlements;
prohibit certain lending practices and limit escrow account amounts with respect to real estate loan transactions;
require financial institutions to implement identity theft prevention programs and measures to protect the confidentiality of consumer financial information; and
prescribe possible penalties for violations of the requirements of consumer protection statutes and regulations.

The CFPB has authority to amend existing consumer protection regulations and implement new regulations, and is charged with examining the compliance of financial institutions with assets in excess of $10 billion with these rules. Sound Community Bank's compliance with consumer protection rules is examined by the WDFI and the FDIC since it does not meet this $10 billion asset level threshold.

In addition, federal regulations limit the ability of banks and other financial institutions to disclose nonpublic consumer information to non-affiliated third parties. The regulations require disclosure of privacy policies and allow consumers to prevent certain personal information from being shared with non-affiliated parties.

The CRA requires the appropriate federal banking agency to assess the bank's record in meeting the credit needs of the communities served by the bank, including low and moderate income neighborhoods. The FDIC examines Sound Community Bank for compliance with its CRA obligations. Under the CRA, institutions are assigned a rating of "outstanding," "satisfactory," "needs to improve," or "substantial non-compliance" and the appropriate federal banking agency is to take this rating into account in the evaluation of certain applications of the institution, such as an application relating to a merger or the establishment of a branch. An unsatisfactory rating may be the basis for the denial of such an application. The CRA also requires that all institutions make public disclos