Sound Financial Bancorp, Inc.
Form 10-K
March 30, 2016
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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, 2015**

OR

o 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.)
2005 5th Avenue, Suite 200, 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 o 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 o 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 o

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 o

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 or a smaller reporting Company. See definition of large accelerated filer, and smaller reporting company in Rule 12b-2 of the Act.

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if smaller reporting Company)	Smaller reporting Company

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of June 30, 2015, the last business day of the registrant s most recently completed second fiscal quarter, was approximately $45.4 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 25, 2016, there were 2,481,389 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 2016 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, estimate forecasts, intends, plans, targets, potentially, probably, projects, outlook or similar expressions or future verbs such as may, will, should, would and could. Forward-looking statements include statements with respect to 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, customers, 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;
- 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;

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- 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;
- 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;
- the inability of key third-party providers to perform their obligations to us;
- 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 its predecessor, Sound Financial, Inc., a federal corporation, 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.

Sound Community Bank s deposits are insured up to applicable limits by the FDIC. At December 31, 2015, Sound Financial Bancorp had total consolidated assets of $540.8 million, net loans of $454.8 million, deposits of $440.0 million and stockholders equity of $54.5 million. The shares of Sound Financial Bancorp are traded on The NASDAQ Capital Market under the symbol SFBC. Our executive offices are located at 2005 5th Avenue, Suite 200, Seattle, Washington, 98121.

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Our principal business consists of attracting retail and commercial deposits from the general public 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, construction and land, consumer and commercial business loans. We offer a variety of secured and unsecured consumer loan products, including manufactured home loans, floating homes, automobile loans, boat loans and recreational vehicle loans. As part of our business, we focus on residential mortgage loan originations, the majority of which we sell to Fannie Mae. We sell loans which conform to the underwriting standards of Fannie Mae (conforming) with servicing retained to maintain the direct customer relationship and to continue providing strong customer service to our borrowers. We also originate loans which do not conform to the underwriting standards of Fannie Mae (non-conforming) loans to be held in our loan portfolio and for sale 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, manufactured home parks and construction and land development loans.

Market Area

We serve the Seattle Metropolitan Statistical Area (MSA), which includes the city of Seattle, King County, Snohomish County, and Pierce County within the Puget Sound region, and Clallam and Jefferson Counties on the North Olympic Peninsula of Washington. We serve these markets through our main office in Seattle, five branch offices, two of which are located in the Seattle MSA, two that are located in Clallam County and one that is located in Jefferson County, and a loan production office located in the Madison Park neighborhood of Seattle. Based on the most recent branch deposit data provided by the FDIC, our share of deposits in the Seattle-Tacoma-Bellevue MSA was approximately 0.18%, in King County approximately 0.10%, in Pierce County approximately 0.39% and in Snohomish County approximately 0.37%. In Clallam County and Jefferson County, we have approximately 15.59% and 3.63%, respectively, of the deposits in those markets. See – Competition.

Our market area includes a diverse population of management, professional and sales personnel, office employees, 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, Inc., Starbucks, Alaska Air Group and Weyerhaeuser.

Economic conditions have improved since the end of the economic recession, however, economic growth has been slow and uneven, presenting an unusually challenging environment for banks and their holding companies, including us. Property values, which began improving in 2013, have generally stabilized, although some properties collateralizing our loans are still valued lower than when the related loans were originated. Recent trends in housing prices and unemployment rates in our market areas generally reflect continuing improvement. For the month of December 2015, the Seattle MSA reported an unemployment rate of 5.0%, as compared to the national average of 4.8%, 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 10.0% in 2015 from 2014. This compares favorably to the national average home price index increase in 2015 of 5.4%.

King County has the largest population of any county in the state of Washington, covers approximately 2,100 square miles, and is located on the Puget Sound. It has approximately 2.0 million residents and a median household income of approximately $89,600. King County has a diversified economic base with many industries including shipping and

transportation (Port of Seattle, Paccar, Inc. and Expeditors International of Washington, Inc.), retail (Amazon.com, Inc., Starbucks Corp. and Nordstrom, Inc.) aerospace (the Boeing Company) and computer technology (Microsoft Corp.) and biotech industries. Based on information from the Northwest Multiple Listing Service (MLS), the median sales price in King County in December 2015 was $508,000, a 15.0% increase from December 2014 s median sale price of $442,000.

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. It has approximately 831,900 residents

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and a median household income of approximately $59,200. 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 sale price in Pierce County in December 2015 was $252,500 a 9.8% increase from December 2014 s median sales price of $230,000.

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 has approximately 757,600 residents and a median household income of approximately $69,400. 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 sales price in Snohomish County as of December 31, 2015 was $358,000, a 19.3% increase from December 2014 s median sales price of $300,000.

Clallam County, with a population of approximately 72,700, is ranked 18th among the counties 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 has approximately 35,800 households and median household income of approximately $47,000. 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 sales price in Clallam County in December 2015 was $229,000, a 15.1% increase from 2014 s median sales price of $199,000.

Jefferson County, with a population of approximately 30,200, 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 the 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. Port Ludlow ranks 16th of 522 ranked areas in the state of Washington and is the most affluent area of Jefferson County. The economy of Jefferson County is primarily based on tourism, agriculture, lumber, fish processing and ship repair and ship maintenance. Port Ludlow is a popular retirement community and is a well-known port of call for leisure craft sailing between Puget Sound and the San Juan Islands. Based on information from the MLS, the average home price in Jefferson County as of December 2015 was $150,000, a 2.0% increase from 2014 s median price of $147,000.

According to the latest available information from the Bureau of Labor Statistics, King and Snohomish Counties reported an unemployment rate of 4.5% and 5.0%, respectively, as of December 2015, as compared to the state and national unemployment rates of 5.8% and 4.8%, respectively. The unemployment rates for Clallam and Pierce Counties are above the state and national rates as of December 2015. The unemployment rate in Clallam County decreased from 9.3% as of December 2014 to 9.0% as of December 2015, while the unemployment rate in Pierce County decreased from 7.3% as of December 2014 to 7.2% as of December 2015. The unemployment rate in Jefferson County as of December 2015 of 8.6% remained unchanged from December 2014.

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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,									
	2015		2014		2013		2012		2011	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percen
eal estate ans:										
ne- to ur-family	$ 141,125	30.61 %	$ 133,031	30.80 %	$ 117,739	30.02 %	$ 94,059	28.71 %	$ 94,498	31.45
ome equity	31,573	6.85	34,675	8.03	35,155	8.96	35,364	10.80	39,656	13.20
ommercial d ultifamily	175,312	38.01	168,952	39.12	157,516	40.17	133,620	40.79	106,016	35.27
onstruction d land	57,043	12.37	46,279	10.72	44,300	11.30	25,458	7.77	17,805	5.93
otal real tate loans	405,053	87.84	382,937	88.67	354,710	90.45	288,501	88.07	257,975	85.85
onsumer ans:										
anufactured mes	13,798	2.99	12,539	2.90	13,496	3.44	16,232	4.96	18,444	6.14
oating omes	18,226	3.95	11,680	2.71	5,551	1.42	3,317	1.01	6,430	2.14
her nsumer	4,804	1.05	5,195	1.20	4,733	1.20	5,333	1.63	10,920	1.49
otal nsumer ans	36,828	7.99	29,414	6.81	23,780	6.06	24,882	7.60	29,364	9.77
ommercial isiness ans	19,295	4.18	19,525	4.52	13,668	3.49	14,193	4.33	13,163	4.38
otal loans	461,176	100.00 %	431,876	100.00 %	392,158	100.00 %	327,576	100.00 %	300,502	100.00
ess:										
eferred fees d discounts	1,707		1,516		1,232		832		406	
lowance r loan sses	4,636		4,387		4,177		4,248		4,455	
otal loans, t	$ 454,833		$ 425,973		$ 386,749		$ 322,496		$ 295,641	

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,									
	2015		2014		2013		2012		2011	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percen
ed-rate ns:										
al estate ns:										
e- to r-family	129,762	28.14 %	$ 118,083	27.34 %	$ 103,756	26.46 %	$ 79,020	24.12 %	$ 78,145	26.0
me equity	11,042	2.39	12,003	2.78	13,530	3.45	9,605	2.93	9,276	3.0
mmercial and tifamily	92,205	19.99	103,303	23.92	100,031	25.51	76,957	23.49	45,034	14.9
nstruction land	51,572	11.18	39,147	9.07	37,668	9.61	22,346	6.82	17,458	5.8
al real estate ns	284,581	61.71	272,536	63.11	254,985	65.03	187,928	57.36	149,913	49.8
nufactured nes	13,798	2.99	12,539	2.90	13,496	3.44	16,232	4.96	18,444	6.1
ating Homes	18,226	3.94	11,680	2.70	5,551	2.41	3,317	1.01	6,430	2.1
er consumer	4,082	0.89	4,447	1.04	3,944	1.41	4,450	1.36	3,300	1.1
mmercial iness	9,392	2.04	11,024	2.55	5,603	1.43	9,268	2.83	8,041	2.6
al fixed-rate ns	330,079	71.57	312,226	72.30	283,579	72.32	221,195	67.52	186,128	61.9
justable-rate ns:										
al estate ns:										
e- to r-family	11,363	2.46	14,948	3.46	13,983	3.57	15,039	4.59	16,353	5.4
me equity	20,531	4.45	22,672	5.25	21,625	5.51	25,759	7.86	30,380	10.1
mmercial and tifamily	83,107	18.02	65,649	15.20	57,485	14.66	56,663	17.30	60,982	20.2
nstruction land	5,471	1.19	7,132	1.65	6,632	1.69	3,112	0.95	347	0.1
al real estate ns	120,472	26.12	110,401	25.56	99,725	25.43	100,573	30.70	108,062	35.9
er consumer	722	0.16	746	0.17	789	0.20	883	0.27	1,190	0.4
mmercial iness	9,903	2.15	8,501	1.97	8,065	2.05	4,925	1.50	5,122	1.7
al ustable-rate	131,097	28.43	119,648	27.70	108,579	27.68	106,381	32.48	114,374	38.0

ns										
al loans	461,176	100.00 %	431,876	100.00 %	392,158	100.00 %	327,576	100.00 %	300,502	100.00
s:										
ferred fees discounts	1,707		1,516		1,232		832		406	
owance for n losses	4,636		4,387		4,177		4,248		4,455	
al loans, net	$ 454,833		$ 425,973		$ 386,749		$ 322,496		$ 295,641	

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The following table illustrates the contractual maturity of our construction, land and commercial business loans at December 31, 2015 (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, 2016, which have predetermined interest rates, is $21.2 million, while the total amount of loans due after such date, which have floating or adjustable interest rates, is $4.9 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
2016(2)	$ 42,978	5.57 %	$ 7,259	5.05 %	$ 50,237	5.49 %
2017 to 2020	10,088	6.31	6,331	4.93	16,419	5.78 %
2021 and following	3,977	6.85	5,705	5.37	9,682	5.98 %
Total(1)	$ 57,043	5.79 %	$ 19,295	5.10 %	$ 76,338	5.62 %

(1) Excludes deferred fees and discounts of $383,000.

(2) Includes demand loans, loans having no stated maturity and overdraft loans.

Lending Authority. Our President and Chief Executive Officer(CEO) may approve unsecured loans up to $1,000,000 and all types of secured loans up to 30% of our legal lending limit, or approximately $3.5 million as of December 31, 2015. 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 $1.7 million as of December 31, 2015. Any loans over the President and Chief Executive Officer s lending authority or loans otherwise outside our general underwriting guidelines must be approved by the Loan Committee. The Loan Committee consists of three independent directors, the CEO and the CCO. Lending authority is also granted to certain other lending staff at lower amounts, generally up to 7.5% of our legal lending limit for real estate secured loans and $50,000 for unsecured loans provided the loan has no policy exceptions.

Largest Borrowing Relationships. At December 31, 2015, the maximum amount under federal law that we could lend to any one borrower and the borrower s related entities was approximately $11.5 million. Our five largest relationships totaled $35.3 million in the aggregate, or 7.7% of our $461.2 million gross loan portfolio, at December 31, 2015. The largest relationship was for $9.6 million in loans to businesses with common ownership collateralized by residential construction properties. The second largest relationship consists of $6.8 million in loans collateralized by multifamily construction properties. The next three largest lending relationships at December 31, 2015, were: $6.7 million in loans to businesses with common ownership collateralized by multifamily real estate; a $6.2 million loan collateralized by one-to-four family real estate; and $6.1 million in loans to businesses with common ownership collateralized by multifamily construction properties. At December 31, 2015, we had five other lending relationships that exceeded $4.5 million. All of the loans in these relationships were performing in accordance with their repayment terms as of December 31, 2015.

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. Over the past two years, the majority of our one- to four-family loan originations were fixed rate.

Most of our loans are underwritten using secondary market generally-accepted underwriting guidelines, and are readily saleable to Fannie Mae or other private investors. A portion of the one- to four-family loans we originate are

retained in our portfolio while the majority are sold into the secondary market to Fannie Mae, with servicing retained for continued customer contact, relationship building and to increase noninterest income. We also originate a small portion of non-conforming loans 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 them in portfolio. Our pricing strategy for mortgage loans includes establishing interest rates that are competitive with other local financial institutions and consistent with

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our internal asset and liability management objectives. During the year ended December 31, 2015, we originated $107.4 million of one- to four-family fixed-rate mortgage loans and $4.8 million one- to four-family adjustable rate mortgage (ARM) loans. See - Loan Originations, Purchases, Sales, Repayments and Servicing. At December 31, 2015, one- to four-family residential mortgage loans (excluding loans held-for-sale) totaled $141.1 million, or 30.6%, of our gross loan portfolio, of which $129.8 million were fixed-rate loans and $11.4 million were ARM loans, compared to $133.0 million (excluding loans held-for-sale), or 30.8% of our gross loan portfolio as of December 31, 2014, of which $118.1 million were fixed-rate loans and $14.9 million were ARM loans.

Substantially all of the one- to four-family residential mortgage loans we retain in our portfolio consist of loans that are non-conforming because they 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., divorce, 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, not eligible to be purchased by Fannie Mae. At December 31, 2015, $72.8 million or 51.6% 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 generally require private mortgage insurance or other credit enhancement in order to reduce our exposure to 80% or we charge a higher interest rate. Properties securing our one- to four-family loans are generally appraised by independent fee appraisers who are selected in accordance with criteria approved by the Board of Directors. For loans that are less than $250,000, we may use the Home Value Estimator, an automated valuation model developed by Freddie Mac, in lieu of an appraisal. We typically 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 $258,000 at December 31, 2015.

Fixed-rate loans secured by one- to four-family residences have contractual maturities of up to 30 years; however, at December 31, 2015 we had $1.5 million of one- to four-family loans with an original contractual maturity of 40 years which were originated prior to 2009. All of these loans are fully amortizing, with payments due monthly. Our portfolio of fixed-rate loans also includes $13.4 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 criterion. In addition, we had $33.9 million of one- to four- family loans with a five-year call option at December 31, 2015. 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, $4.7 million of our ARM loans are to employees 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.

ARM loans generally pose different credit risks than fixed-rate loans, primarily because as interest rates rise, the borrower s payment rises, 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 continued to expand our fully amortizing ARM loans, by offering 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 market environment, however, the production of ARM loans has been substantially reduced because borrowers favor fixed rate mortgages.

Home Equity Lending. We originate home equity loans that consist of fixed-rate loans and variable-rate lines of credit. We typically originate home equity loans in amounts of up to 80% 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 plus a margin**.** Home equity lines of credit generally have up to a twelve-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 a twelve-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 drawn amount during the draw period. At December 31, 2015, home equity loans totaled $31.6 million, or 6.9% of our gross loan portfolio compared to $34.7 million, or 8.0% of our gross loan portfolio at December 31, 2014. Variable-rate home equity lines of credit at December 31, 2015 totaled $20.5 million, or 4.5% of our gross loan portfolio, compared to $22.7 million, or 5.3% of our gross loan portfolio as of December 31, 2014. At December 31, 2015, 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 80% of the appraised value of the subject property. These loans may have terms of up to 20 years and are fully amortizing. At December 31, 2015, fixed-rate home equity loans totaled $11.0 million, or 2.4% of our gross loan portfolio, compared to $12.0 million, or 2.8% of our gross loan portfolio as of December 31, 2014.

Commercial and Multifamily Real Estate Lending. We offer a variety of commercial and multifamily loans. Most of these loans are secured by commercial income producing properties, including retail centers, multifamily apartment buildings, warehouses, and office buildings located in our market area. At December 31, 2015, commercial and multifamily loans totaled $175.3 million, or 38.0% of our gross loan portfolio, compared to $169.0 million, or 39.1% of our gross loan portfolio as of December 31, 2014.

Loans secured by commercial and multifamily real estate are generally originated with a variable interest rate, fixed for a five to ten-year term and a 20- to 25-year amortization period. At the end of the initial term, there is a balloon payment 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 loans typically do not exceed 80% of the lower of cost or appraised value of the property securing the loan at origination.

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 coverage ratio of approximately 1.20 for originated loans secured by income producing commercial properties. If the borrower is other than an individual, we generally require the personal guaranty of the borrower. We also generally require an assignment of rents or leases 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 loans are performed by independent state certified licensed fee appraisers and approved by the Loan Committee. In order to monitor the adequacy of cash flows on

income-producing properties, the borrower is required to provide, at a minimum, annual financial information. From time to time we also acquire participation interests in commercial and multifamily loans originated by other financial institutions secured by properties located in our market area. On a case by case basis, we will consider loan participations where the collateral is located outside of our market area.

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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 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 loans are not fully amortizing and contain large 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 loan at December 31, 2015, totaled $4.0 million and is collateralized by a multifamily apartment building. At December 31, 2015 this loan was performing in accordance with its repayment terms.

The following table displays information on commercial and multifamily real estate loans by type at December 31, 2015 and 2014 (dollars in thousands):

	2015		2014	
	Amount	**Percent**	**Amount**	**Percent**
Multifamily residential	$ 62,419	35.60 %	$ 48,799	28.88 %
Warehouses	18,861	10.76	23,648	14.00
Office buildings	9,154	5.22	8,792	5.20
Mobile Home Parks	6,424	3.66	4,734	2.80
Gas station / Convenience store	10,636	6.07	9,688	5.73
Other non-owner occupied commercial real estate	28,275	16.16	46,555	27.56
Other owner-occupied commercial real estate	39,543	22.56	26,736	15.83
Total	$ 175,312	100.00 %	$ 168,952	100.00 %

Construction and Land Lending. We originate construction loans secured by single-family residences and commercial and multifamily real estate. We also originate land and lot loans, which are secured by raw land or developed lots on which the borrower intends to build a residence, and land acquisition and development loans. At December 31, 2015, our construction and land loans totaled $57.0 million, or 12.4% of our gross loan portfolio, compared to $46.3 million, or 10.7% of our gross loan portfolio at December 31, 2014. At December 31, 2015, unfunded construction loan commitments totaled $33.0 million.

Construction loans to individuals and contractors for the construction and acquisition of personal residences totaled $3.2 million, or 5.6% of our construction and land portfolio at December 31, 2015. We originate these loans whether or not the collateral property underlying the loan is under contract for sale. At December 31, 2015, construction loans to contractors for homes that were considered speculative totaled $33.9 million, or 59.4% of our construction and land portfolio.

The composition of, and location of underlying collateral securing, our construction and land loan portfolio, excluding loan commitments, at December 31, 2015 was as follows (in thousands):

	Olympic Peninsula	**Puget Sound**	**Other**	**Total**
Commercial and multifamily construction	$ —	$ 10,022	$ —	$ 10,022

Residential construction	785	2,381	—	3,166
Land and lot loans	4,465	2,912	563	7,940
Speculative residential construction	1,544	32,330	—	33,874
Commercial land developments	97	1,944	—	2,041
Total	$ 6,891	$ 49,589	$ 563	$ 57,043

Our residential construction loans generally provide for the payment of interest only during the construction phase, which is typically up to nine months. At the end of the construction phase, the construction loan generally either converts to a longer term mortgage loan or is paid off through a permanent loan from another lender.

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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 securing adequate private mortgage insurance or other form of credit enhancement to mitigate the higher loan to value.

At December 31, 2015, our largest residential construction loan commitment was for $2.0 million, $1.2 million of which had been disbursed. This loan was performing according to its terms. The average outstanding residential construction loan balance was approximately $539,450 at December 31, 2015. Before making a commitment to fund a residential construction loan, we require an appraisal of the subject property by an independent licensed 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. Typically, disbursements are made in monthly draws during the construction period. 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 (as applicable, 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. At December 31, 2015, lot and land loans totaled $7.9 million, or 13.9% of our construction and land portfolio.

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 any cash equity from the borrower if there is sufficient equity in the land being used as collateral. Development plans are required from developers prior to making the loan. Our loan officers are required to personally 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 three or five- year Des Moines Federal Home Loan Bank (FHLB) Rate 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 inspection by our approved inspectors warrant. 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.

We also offer commercial and multifamily construction loans. These loans are underwritten with terms similar to our permanent commercial real estate loans with special construction financing for up to 18 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, 2015, commercial and multifamily construction loans totaled $10.0 million, or 17.5% of our construction and land portfolio.

Construction financing is generally considered to involve a higher degree of credit risk than longer-term financing on improved, owner-occupied real estate. Construction and development lending contains the inherent difficulty in estimating both a property s value at completion of the project and the estimated cost (including interest) of the project. 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. If the estimate of construction cost proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the project. This type of

lending also typically involves higher loan amounts and is often concentrated with a small number of builders. 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. If the estimate of value upon completion proves to be inaccurate, we may be confronted at, or prior to, the maturity of the loan with a project value which is insufficient to assure full repayment. 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. Properties under construction are often difficult to sell and typically must be completed in order to be successfully sold which also complicates the process of working out problem construction loans. This may require us to advance additional funds and/or contract with another builder to complete construction. Furthermore, speculative construction loans to a builder are often associated with homes that are not pre-sold, and thus pose a greater potential risk than construction loans to individuals on their personal residences as there is the added risk associated with identifying an end-purchaser for the finished project. Loans on land under development or held for future construction 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 be significantly impacted by supply and demand. As a result, this type of lending often involves the disbursement of substantial funds with repayment dependent, on the success of the project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor themselves to repay principal and interest.

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, 2015, our consumer loans totaled $36.8 million, or 8.0% of our gross loan portfolio, compared to $29.4 million, or 6.8% of our gross loan portfolio at December 31, 2014.

We 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, 2015 was 8.0%, compared to 4.6% for one- to four-family mortgages, excluding loans held-for-sale. At December 31, 2015, these loans totaled $13.8 million, or 37.5% of our consumer loans and 3.0% of our gross 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 80% 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 have a higher probability of default, higher delinquency rates and greater servicing and collateral recovery costs 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 methodology. We attempt to work out delinquent loans with the borrower and, if that is not successful, any repossessed manufactured homes are repossessed and sold. At December 31, 2015, there were three nonperforming manufactured home loan totaling $62,000 and we held one manufactured home valued at $10,000 in the repossessed assets portfolio.

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 80% 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 shares is also unique compared to other types of lending

Sound Community Bank participates 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 processes and criteria. At December 31, 2015, floating home loans totaled $18.2 million, or 49.4% of our consumer loan portfolio and 4.0% of our gross loan portfolio.

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, 2015, totaled $4.8 million, or 13.0% of our consumer loan portfolio and 1.0%of our gross loan portfolio. Our automobile loan portfolio totaled $475,000 at December 31, 2015, or 1.3% of our consumer loan portfolio and 0.1% of our gross 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 auto loans, 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, 2015, unsecured consumer loans totaled $1.2 million and unfunded commitments on our unsecured consumer lines of credit totaled $1.4 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 customer base by increasing the number of customer relationships and providing cross-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.

Commercial Business Lending. At December 31, 2015, commercial business loans totaled $19.3 million, or 4.2% of our gross loan portfolio, compared to $19.5 million, or 4.5% of our gross loan portfolio at December 31, 2014. 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. Approximately $1.3 million of our commercial business loans at December 31, 2015 were unsecured. Our commercial business lending policy includes credit file documentation and 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 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.

Our commercial business loans are primarily made 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. Most often, this collateral is 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

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be illiquid and may fluctuate in value based on the specific type of business and equipment used. 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).

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 customer demand for loans in our market area. Over the past few years, we have continued to originate residential and consumer loans, and increased our emphasis on commercial and multifamily, 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 low interest rate environment prevailing 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 2015, 2014 and 2013, we sold commercial loan participations with other financial institutions in the amount of $6.9 million, $5.5 million and $2.7 million, respectively. We underwrite loan purchases and participations to the same standards as an internally-originated loan. We did not purchase any loan participations in 2015. In 2014 and 2013, we purchased commercial loan participations with other financial institutions in the amount of $166,000 and $5.3 million, respectively.

We do not actively engage in originating alt A loans, 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, 2015, we held $7.5 million of such loans in our loan portfolio, representing 1.62% of our gross 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 $107.4 million in one- to four- family loans originated in 2015, only $1.0 million, or 0.09%, were to borrowers with a credit score under 660. We obtain updated FICO scores on all of our borrowers periodically and based on the most recently updated score, $19.4 million, or 4.2% of our gross loan portfolio would be deemed subprime at December 31, 2015. Based on the FICO score as of December 31, 2015, our subprime portfolio included approximately $12.6 million in one- to four-family mortgage loans, $4.0 million in home equity loans, $2.2 million in manufactured home loans, $319,000 in construction and land loans, and $257,000 in other consumer loans or $19.4 million in the aggregate , representing 4.2% of our loan portfolio.

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

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 improve our interest rate risk. 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, 2015, we were servicing a $360.4 million portfolio of residential mortgage loans for Fannie Mae. No loans were repurchased from Fannie Mae in 2015 and two loans were repurchased from Fannie Mae totaling $453,000 in 2014.

We earned mortgage servicing income of $840,000, $509,000 and $457,000 for the years ended December 31, 2015, 2014 and 2013, 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.

These mortgage servicing rights are carried at fair value and had a value at December 31, 2015 of $3.2 million. See Note 6 to the Consolidated Financial Statements.

Sales of whole real estate loans can be beneficial to us since these sales generally 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 $72.6 million, $52.7 million and $108.9 million of one- to four- family loans

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during the years ended December 31, 2015, 2014 and 2013, 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 2015, 2014 and 2013 was $1.3 million, $624,000 and $967,000, respectively. In addition to loans sold to Fannie Mae on a servicing retained basis, we also sell certain loans to correspondent banks on a servicing released basis. In 2015, we sold $2.9 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):

	For the year ended December 31,		
	2015	**2014**	**2013**
Originations by type:			
Fixed-rate:			
One- to four-family	$ 107,440	$ 81,130	$ 118,217
Home equity	3,170	2,812	8,450
Commercial and multifamily	29,215	25,342	35,468
Construction and land	22,665	48,490	55,591
Manufactured homes	4,594	2,068	1,198
Other consumer	12,905	9,652	3,804
Commercial business	3,286	5,146	8,530
Total fixed-rate	183,275	174,640	231,258
Adjustable rate:			
One- to four-family	4,831	1,199	552
Home equity	1,881	3,550	294
Commercial and multifamily	35,136	25,789	14,524
Construction and land	2,609	8,228	1,478
Other consumer	133	264	280
Commercial business	3,266	4,193	5,226
Total adjustable-rate	47,856	43,223	22,354
Total loans originated	231,131	217,863	253,612
Purchases by type:			
Commercial and multifamily participations	—	—	983
Commercial business participations	—	166	4,325
Total loan participations purchased	—	166	5,308
Sales, repayments and participations sold:			
One- to four-family	72,622	52,696	108,870
Commercial and multifamily	6,858	5,445	2,676
Total loans sold and loan participations	79,480	58,141	111,546
Total principal repayments	122,351	119,774	79,479
Total reductions	201,831	177,915	191,025
Net increase	$ 29,300	$ 40,114	$ 62,587

The increase in originations in 2015 compared to 2014 was due to a modest decrease in interest rates which spurred the increase in one- to four-family origination and our increased emphasis on originating commercial and multifamily real estate loans in 2015 compared to 2014. One- to four- family home purchases continued to be strong in our market area due to the economic environment and the rate of unemployment in our markets although it has somewhat been hampered due to the lack of overall supply, especially in the Seattle area. Demand for multi-family and construction loans continued to be strong in our markets due to continued demand for new homes and apartments.

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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, and the borrower is contacted by phone within 30 days after the due date. Generally, a delinquency letter is also mailed to the borrower. All delinquent accounts are reviewed by a loan officer or branch manager who attempts to cure the delinquency by contacting the borrower once the loan is 30 days past due. If the account becomes 60 days delinquent and an acceptable repayment plan has not been agreed upon, we generally refer the account to legal counsel with instructions to prepare a notice of intent to foreclose. The notice of intent to foreclose allows the borrower up to 30 days to bring the account current. If foreclosed, typically we take title to the property and sell it directly through a real estate broker.

Delinquent consumer loans, as well as delinquent home equity loans and lines of credit, are handled in a similar manner to one-to four-family loans, except that appropriate action may be taken to collect any loan payment that is delinquent for more than 15 days. Once the loan is 90 days past due, it is classified as nonaccrual. Generally, credits are charged-off at 120 days past due, unless the Loss Mitigation Department provides support for continuing collection efforts. 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.

Delinquent loans are initially handled by the loan officer or branch manager in charge of the loan, who is responsible for contacting the borrower. The Loss Mitigation Department also works with the lenders to see that the necessary steps are taken to collect delinquent loans. In addition, management meets with all of the loan officers and reviews past due and classified loans, as well as other loans that management feels may present possible collection problems, which are reported to the board on a quarterly basis. If an acceptable workout of a delinquent loan cannot be agreed upon, we generally initiate foreclosure or repossession proceedings on any collateral securing the loan.

Delinquent Loans. The following table sets forth our loan delinquencies by type, by amount and by percentage of type at December 31, 2015 (dollars in thousands):

	Loans Delinquent For:											
	30-89 Days			**90 Days and Over**			**90+ Days and accruing**			**Total Delinquent Loans**		
	Number	**Amount**	**Percent of Loan Category**	**Number**	**Amount**	**Percent of Loan Category**	**Number**	**Amount**	**Percent of Loan Category**	**Number**	**Amount**	**Percent of Loan Category**
One- to four-family	17	$ 2,718	1.93 %	5	$ 881	0.62 %	1	$ 117	0.08 %	23	$ 3,716	2.63 %
Home equity	11	412	1.30	2	296	0.94				13	708	2.24
Commercial and Multifamily	1	203	0.12	—	—	—	—	—	—	—	203	0.12
Construction and land	1	65	0.11	—	—	—	—	—	—	1	65	0.11
Manufactured homes	6	130	0.94	—	—	—	—	—	—	6	130	0.94
	—	—	0.00	—	—	—	—	—	—	—	—	0.00

Floating Homes												
Other consumer	10	43	0.19	—	—	—	—	—	—	10	43	0.19
Commercial Business	2	162	0.84	—	—	—	—	—	—	—	162	0.84
Total	48	$ 3,733	0.81 %	7	$ 1,177	0.26 %	1	$ 117	0.03 %	53	$ 5,027	1.09 %

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. We had one accruing loan 90 days or more delinquent for the 2015 period reported totaling $117,000.

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	December 31,				
	2015	2014	2013	2012	2011
Nonperforming loans[1]:					
One- to four- family	$ 1,640	$ 1,512	$ 772	$ 1,143	$ 4,401
Home equity	428	386	222	717	873
Commercial and multifamily	—	1,639	820	1,347	1,219
Construction and land	—	81	—	471	80
Manufactured homes	62	195	106	29	—
Floating Homes					
Other consumer	—	29	1	8	64
Commercial business	—	—	—	197	—
Total nonperforming loans	$ 2,130	$ 3,842	$ 1,921	3,912	6,637
OREO and repossessed assets:					
One- to four-family	$ 159	$ 269	$ 1,086	$ 1,318	$ 478
Commercial and multifamily	600	—	—	1,073	2,225
Construction and land	—	—	—	—	—
Manufactured homes	10	54	92	112	118
Floating Homes					
Other consumer	—	—	—	—	—
Total OREO and repossessed assets	769	323	1,178	2,503	2,821
Total nonperforming assets	$ 2,899	$ 4,165	$ 3,099	$ 6,415	$ 9,458
Nonperforming assets as a percentage of total assets	0.54 %	0.84 %	0.70 %	1.68 %	2.78 %
Performing restructured loans:					
One- to four- family	$ 2,415	$ 2,619	$ 3,195	$ 3,198	$ 2,508
Home equity	232	679	704	356	812
Commercial and multifamily	1,966	1,317	761	776	785
Construction and land	91	99	106	100	—
Manufactured homes	255	279	496	602	—
Other consumer	—	1	9	19	4
Floating Homes					
Commercial business	114	123	133	564	26
Total performing restructured loans	$ 5,073	$ 5,117	$ 5,404	$ 5,615	$ 4,135

(1) Nonperforming loans include $971,000, $2.3 million, $1.0 million, $828,000 and $2.8 million in nonperforming troubled debt restructurings as of December 31, 2015, 2014, 2013, 2012 and 2011, respectively.

There were no nonperforming commercial and multifamily estate loans at December 31, 2015 compared to $1.6 million at December 31, 2014. Nonperforming one- to four- family loans increased $128,000 to $1.6 million at December 31, 2015 from $1.5 million at December 31, 2014. Our largest nonperforming loan at December 31, 2015 was a one-to-four- family loan totaling $324,000. The balance in nonperforming one- to four- family loans at December 31, 2015 consisted of 12 loans to different borrowers with an average loan balance of $137,000.

For the year ended December 31, 2015, gross interest income that would have been recorded had the nonaccrual loans been current in accordance with their original terms amounted to $104,000, all of which was excluded from interest income for the year ended December 31, 2015. See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations - Financial Condition at December 31, 2015 Compared to December 31, 2014 -- Delinquencies and Nonperforming Assets 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, 2015, we had $5.1 million of loans that were classified as performing TDRs and still on accrual. Included in nonperforming loans at December 31, 2015 and 2014 were troubled debt restructured loans of $971,000 and $2.3 million, respectively.

OREO and Repossessed Assets. OREO and repossessed assets include assets acquired in settlement of loans. At December 31, 2015, OREO and repossessed assets totaled $769,000. Our largest OREO property as of December 31, 2015 was a commercial real estate property which was acquired in 2014 as a part of the three branches purchased from another financial institution. It was originally classified as a fixed asset and was subsequently reclassified to OREO in 2015.

Other Loans of Concern. In addition to the nonperforming assets set forth in the table above, as of December 31, 2015, there were 14 loans totaling $3.3 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 majority of these loans have been considered individually in management s determination of our allowance for loan losses. The largest loans of concern at December 31, 2015, were a $1.3 million loan secured by residential property in King County, Washington and a $185,000 loan secured by residential property in Snohomish County, Washington. Other loans of concern included $271,000 in residential first mortgages, $293,000 in home equity loans, $43,000 in manufactured home loans, and $5,000 in other consumer loans. Loans of concern had specific loan loss reserves of $144,000 at December 31, 2015.

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, 2015, special mention assets totaled $2.9 million.

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, 2015, we had classified $3.7 million of our assets as substandard, of which $2.5 million represented a variety of outstanding loans, $449,000 represented non-agency mortgage backed securities, and the remaining balance OREO and repossessed assets. At that date, we had no assets classified as doubtful or loss. This total amount of classified assets represented 6.9% of our equity capital and 0.7% of our assets at December 31, 2015. Classified assets totaled $6.1 million, or 12.0% of our equity capital and 1.2% of our assets at December 31, 2014.

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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, home equity and consumer loans, 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 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, 2015, our allowance for loan losses was $4.6 million, or 1.01% of our total loan portfolio, compared to $4.4 million, or 1.02% of our total loan portfolio in 2014. Specific valuation reserves totaled $882,000 and $367,000 at December 31, 2015 and 2014, respectively.

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 of the Notes to Consolidated Financial Statements. The following table sets forth an analysis of our allowance for loan losses at the dates indicated (dollars in thousands):

	December 31,				
	2015	**2014**	**2013**	**2012**	**2011**
Balance at beginning of period	$ 4,387	$ 4,177	$ 4,248	$ 4,455	$ 4,436
Charge-offs:					
One-to four-family	21	127	560	2,740	834
Home equity	35	295	593	1,084	1,652
Commercial and multifamily		47	194	503	1,353
Construction and land	40		7	222	159
Manufactured homes	37	197	143	152	239
Floating Homes					
Other consumer	77	77	41	286	255
Commercial business		—	46	44	310
Total charge-offs	210	743	1,584	5,031	4,802
Recoveries:					
One-to four-family		64	—	4	11
Home equity	36	52	19	158	10
Commercial and multifamily		2	32	83	96
Construction and land		—	—	—	—
Manufactured homes	8	14	3	11	8
Floating Homes					
Other consumer	15	21	31	33	53
Commercial business		—	78	10	43

Total recoveries	59	153	163	299	221
Net charge-offs	151	590	1,421	4,732	4,581
Additions charged to operations	400	800	1,350	4,525	4,600
Balance at end of period	$ 4,636	$ 4,387	$ 4,177	$ 4,248	$ 4,455
Net charge-offs during the period as a percentage of average loans outstanding during the period	0.03 %	0.14 %	0.40 %	1.55 %	1.53 %
Net charge-offs during the period as a percentage of average nonperforming assets	5.26 %	18.65 %	41.16 %	35.15 %	48.04 %
Allowance as a percentage of nonperforming loans	217.65 %	114.19 %	217.44 %	110.88 %	67.12 %
Allowance as a percentage of total loans (end of period)	1.01 %	1.02 %	1.07 %	1.30 %	1.47 %

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Economic conditions have improved since the end of the economic recession, however, economic growth has been slow and uneven, presenting an unusually challenging environment for bank and their holding companies, including us. Property values, which began improving in 2013, have generally stabilized, although for some loans they are still lower than when many of the related loans were originated. Recent trends in housing prices and unemployment rates in our market areas are generally reflecting continuing improvement. The increase in our allowance for loan losses as a percentage of nonperforming loans ratio during 2015 was a result of a decrease in nonperforming loans during the last year. The allowance for loan losses as a percentage of nonperforming loans was 217.65% and 114.19% as of December 31, 2015 and 2014, respectively.

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

	December 31,									
	2015		2014		2013		2012		2011	
	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	$ 1,839	30.61 %	$ 1,442	30.80 %	$ 1,915	30.02 %	$ 1,417	28.71 %	$ 1,117	31.45 %
Home equity	607	6.85	601	8.03	781	8.96	997	10.80	1,426	13.20
Commercial and multifamily	921	38.01	1,244	39.12	300	40.17	492	40.79	969	35.27
Construction and land	382	12.37	399	10.72	318	11.30	217	7.77	105	5.93
Manufactured homes	301	2.99	193	2.90	209	3.44	260	4.96	290	6.14
Floating homes	149	3.95	116	2.71	59	1.42	56	1.01	125	2.14
Other consumer	39	1.04	51	1.20	50	1.20	90	1.63	88	1.49
Commercial business	157	4.18	108	4.52	102	3.49	218	4.33	254	4.38
Unallocated	241	—	233	—	443	—	501	—	81	—
Total	$ 4,636	100.00 %	$ 4,387	100.00 %	$ 4,177	100.00 %	$ 4,248	100.00 %	$ 4,455	100.00 %

Investment Activities

State 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 banks and savings institutions, 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 will be 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 will emphasize safer investments with the yield on those investments secondary to not taking unnecessary risk with the available funds. See Management s Discussion and Analysis of Financial Condition and Results of Operations – Asset/Liability Management.

At December 31, 2015, we owned $2.2 million FHLB stock. As a condition of membership at 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, 2015, our securities portfolio did not contain securities of any issuer with an aggregate book value in excess of 10% of our equity capital.

	December 31,					
	2015		2014		2013	
Securities available for sale	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Municipal bonds	$ 1,912	$ 2,096	$ 1,911	$ 2,083	$ 1,911	$ 1,931
Agency mortgage-backed securities	4,088	4,172	7,024	7,096	11,228	11,071
Non-agency mortgage-backed securities[1]	449	428	2,312	2,345	2,689	2,419
Total available for sale securities	6,449	6,696	11,247	11,524	15,828	15,421
FHLB stock	2,212	2,212	2,224	2,224	2,314	2,314
Total securities	$ 8,661	$ 8,908	$ 13,471	$ 13,748	$ 18,142	$ 17,735

(1) Our non-agency mortgage backed securities consist of one security purchased at a discount which had an unrealized loss of $21,000 as of December 31, 2015. This security has performed and paid principal and interest each month as contractually committed.

The composition and maturities of our investment securities portfolio at December 31, 2015, excluding FHLB stock, are as follows: Municipal bonds with an amortized cost of $1.9 million and a fair value of $2.1 million and a final maturity in five to ten years, federal agency mortgage-backed securities with an amortized cost of $4.1 million and a fair value of $4.2 million and a final maturity greater than ten years and one non-agency mortgage-backed security with an amortized cost of $449,000 and a fair value of $428,000 and a final maturity greater than ten years.

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, 2015, we recognized no non-cash OTTI charges on our investment securities. One agency security and one non-agency mortgage-backed security had unrealized losses but management determined the decline in value was not related to specific credit deterioration. We do not intend to sell this security and it is more likely than not that we will not be required to sell this securities 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 this security by selling it. If market conditions deteriorate and we determine our holdings of this security 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, 2015, approximately 3.8% of our deposits were from persons outside the State of Washington. As of December 31, 2015, core deposits, which we define as our non-time deposit accounts and time deposit accounts less than $250,000, represented approximately 85.7% of total deposits, compared to 86.9% and 87.0% as of December 31, 2014 and December 31, 2013, respectively. We primarily rely on competitive pricing policies, marketing and customer 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 have become more susceptible to short-term fluctuations in deposit flows as customers have become 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 has been 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):

	For the year ended December 31,		
	2015	**2014**	**2013**
Opening balance	$ 407,809	$ 348,339	$ 312,083
Net deposits	29,569	57,201	34,160
Interest credited	2,646	2,269	2,096
Ending balance	$ 440,024	$ 407,809	$ 348,339
Net increase	$ 32,215	$ 59,470	$ 36,256
Percent increase	7.9 %	17.1 %	11.6 %

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,					
	2015		**2014**		**2013**	
	Amount	**Percent of total**	**Amount**	**Percent of total**	**Amount**	**Percent of total**
Noninterest-bearing demand	$ 48,067	10.92 %	$ 41,773	10.24 %	$ 31,877	9.15 %
Interest-bearing demand	127,392	28.95	103,048	25.27	70,639	20.28
Savings	38,833	8.83	33,233	8.15	26,509	7.61
Money market	54,046	12.28	55,236	13.54	59,069	16.96
Escrow	2,806	0.64	2,580	0.63	2,717	0.78

Total non-maturity deposits	271,144	61.62	235,870	57.83	190,811	54.78
Certificates of deposit:						