

Edgar Filing: Sound Financial Bancorp, Inc. - Form 10-K

Sound Financial Bancorp, Inc.
Form 10-K
March 31, 2015
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, 2014

OR

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

For the transition period from _____ to _____

COMMISSION FILE NUMBER 001-35633

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

Maryland 45-5188530
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

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 NO

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

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

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and

Edgar Filing: Sound Financial Bancorp, Inc. - Form 10-K

post such files). YES NO

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

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer 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 <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>	Smaller reporting Company <input checked="" type="checkbox"/>
(Do not check if smaller reporting Company)			

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of June 30, 2014, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$38.8 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 30, 2015, there were 2,528,451 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 2015 Annual Meeting of Shareholders.

PART I

Item 1. Business

Special Note Regarding Forward-Looking Statements

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

- changes in economic conditions, either nationally or in our market area;
- fluctuations in interest rates;
- the risks of lending and investing activities, including changes in the level and direction of loan delinquencies and write-offs and changes in estimates of the adequacy of our allowance for loan losses;
- the possibility of other-than-temporary impairments of securities held in our securities portfolio;
- our ability to access cost-effective funding;
- fluctuations in the demand for loans, the number of unsold homes, land and other properties, and fluctuations in real estate values and both residential and commercial and multifamily real estate market conditions in our market area;
- secondary market conditions for loans and our ability to sell loans in the secondary market;
- our ability to attract and retain deposits;
- our ability to successfully integrate any assets, liabilities, 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 including in particular, our recent acquisition of three branches from Columbia State Bank;
- 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;
- 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;

- computer systems on which we depend could fail or experience a security breach;
 - 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, 2014, Sound Financial Bancorp had total consolidated assets of \$495.2 million, net loans of \$426.0 million, deposits of \$407.8 million and stockholders' equity of \$50.6 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.

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, consumer and commercial business loans and construction and land 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, some of which we sell to Fannie Mae. We sell the majority of these loans with servicing retained to maintain the direct customer relationship and to continue providing strong customer service to our borrowers. 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, 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 0.21%, in King County approximately 0.15%, in Pierce County approximately 0.44% and in Snohomish County approximately 0.36%. In Clallam County and Jefferson County, we have approximately 13.67% and 4.04%, 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 Boeing, U.S. Joint Base Lewis-McChord, Navy Region Northwest, Microsoft, University of Washington, and Providence Health. Other significant employers include Costco, Nordstrom, Amazon.com, Inc., Starbucks, Alaska Air Group and Weyerhaeuser.

Weak economic conditions and ongoing strains in the financial and housing markets which began in 2008, generally started to improve in 2012 in portions of the United States, including our market area. While the effects during this period presented an unusually challenging environment for banks and their holding companies, including us, trends in housing prices and unemployment are generally improving. For the month of December 2014, the Seattle MSA reported an unemployment rate of 4.8%, as compared to the national average of 5.6%, 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 6.6% in 2014 from 2013. This compares favorably to the national average home price index increase in 2014 of 4.6%.

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 \$71,000. 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 2014 was \$391,000, a 5.1% increase from December 2013's median sale price of \$372,000.

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 western Puget Sound. It has approximately 811,000 residents and a median household income of approximately \$59,000. The Pierce County economy is diversified with the presence of military related government employment (Fort Lewis Army Base and McChord Air Force Base), transportation and shipping employment (Port of Tacoma), and aerospace related employment (Boeing). Based on information from the MLS, the median sale price in Pierce County in December 2014 was \$230,000, a 3.6% increase from December 2013's median sales price of \$222,000.

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 733,000 residents and a median household income of approximately \$68,000. 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, 2014 was \$300,000, a 1.4% increase from December 2013's median sales price of \$296,000.

Clallam County, with a population of approximately 71,000, 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 36,000 households and median household income of approximately \$46,000. 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 2014 was \$199,000, a 12.4% increase from 2013's median sales price of \$177,000.

4

Edgar Filing: Sound Financial Bancorp, Inc. - Form 10-K

Jefferson County, with a population of approximately 30,000, is the 27th largest county in the state of Washington. It is bordered by Clallam County and the Strait of Juan de Fuca to the north and the Hood Canal on the west and covers 2,200 square miles. The majority of the population of the county 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 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 2014 was \$147,000, a 3.3% decrease from 2013's median price of \$152,000.

There have been indications over the last several years that the U.S. job market, including the job market in our market area, is improving, however the unemployment rate in certain of our market areas remain relatively high.. According to the latest available information from the Bureau of Labor Statistics, King and Snohomish Counties reported an unemployment rate of 4.1% and 4.5%, respectively, as of December 2014, which are lower than the state and national unemployment rates of 6.3% and 5.6%, respectively. The unemployment rates for Clallam and Pierce Counties are above the state and national rates as of December 2014. The unemployment rate in Clallam County increased from 9.0% as of December 2013 to 9.3% as of December 2014, while the unemployment rate in Pierce County decreased from 7.3% as of December 2013 to 7.2% as of December 2014. The unemployment rate in Jefferson County increased from 8.4% as of December 2013 to 8.6% as of December 2014.

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,		2013		2012		2011		2010	
	2014									
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Real estate loans:										
One- to four-family	\$133,031	30.80 %	\$117,739	30.02 %	\$94,059	28.71 %	\$94,498	31.45 %	\$98,314	32.81 %
Home equity	34,675	8.03	35,155	8.96	35,364	10.80	39,656	13.20	44,829	14.96
Commercial and multifamily	168,952	39.12	157,516	40.17	133,620	40.79	106,016	35.28	93,053	31.05
Construction and land	46,279	10.72	44,300	11.30	25,458	7.77	17,805	5.93	16,650	5.56
Total real estate loans	382,937	88.67	354,710	90.45	288,501	88.07	257,975	85.85	252,846	84.37
Consumer loans:										
Manufactured homes	12,539	2.90	13,496	3.44	16,232	4.96	18,444	6.14	20,043	6.69
Other consumer	16,875	3.91	10,284	2.62	8,650	2.64	10,920	3.63	12,110	4.04
Total consumer loans	29,414	6.81	23,780	6.06	24,882	7.60	29,364	9.77	32,153	10.73
Commercial business loans	19,525	4.52	13,668	3.49	14,193	4.33	13,163	4.38	14,678	4.90

Edgar Filing: Sound Financial Bancorp, Inc. - Form 10-K

Total loans	431,876	100.00%	392,158	100.00%	327,576
-------------	---------	---------	---------	---------	---------