Sound Financial Bancorp, Inc.
Form 10-K
April 01, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2012

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 (State or other jurisdiction of incorporation or organization)	45-5188530 (I.R.S. Employer Identification No.)
2005 5th Avenue, Suite 200, Seattle Washington (Address of principal executive offices)	98121 (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 [X]

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 [X]

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 [X] NO [ ]

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

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 [ ]	Accelerated filer [ ]	Non-accelerated filer [ ] (Do not check if smaller reporting Company)	Smaller reporting Company [X]

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of June 30, 2012, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $8.9 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 29, 2013, there were 2,587,544 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 2013 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,” “outloo expressions or future or conditional verbs such as “may,” “will,” “should,” “would” and “could.” Forward-looking stateme 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,;
- 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;

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- 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.

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.

General

Sound Financial Bancorp, a Maryland corporation, is a full stock holding company for its wholly owned subsidiary, Sound Community Bank (hereinafter sometimes referred to as the "Bank"). On August 22, 2012, Sound Financial Bancorp completed a public offering and share exchange as part of the Bank's conversion from the mutual holding company structure and the elimination of Sound Financial, Inc. and Sound Community MHC (the "Conversion"). Please see Note 3 of the Notes to Consolidated Financial Statements under Item 8 of this report for more information. All share and per share information in this report for periods prior to the Conversion has been adjusted to reflect the 0.87423:1 exchange ratio on publicly traded shares.

Substantially all of Sound Financial Bancorp's business is conducted through Sound Community Bank, which until December 28, 2102, was a federal savings bank subject to extensive regulation by the Office of the Comptroller of the Currency ("OCC"). During October 2012, the Bank filed an application to convert from a federally chartered savings bank to a Washington state-chartered commercial bank. The charter change was completed on December 28, 2012. 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 will remain as the primary federal regulator for the Company. The charter change primarily was undertaken to reduce regulatory examination costs and to move oversight of the Bank to the WDFI, which is focused on local community banks and financial institutions.

Sound Community Bank's deposits are insured up to applicable limits by the FDIC. At December 31, 2012, Sound Financial Bancorp had total consolidated assets of $381.0 million, net loans of $322.5 million, deposits of $312.1 million and stockholders' equity of $43.5 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.

Our principal business consists of attracting retail 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, to a lesser extent, construction and land loans. We offer a wide variety of secured and unsecured consumer loan products, including manufactured home loans, automobile loans, boat loans and recreational vehicle loans. As part of our business, we focus on residential mortgage loan originations, many of which we sell to Fannie Mae. We sell these loans with servicing retained to maintain the direct customer relationship and promote our emphasis on strong customer service.

Our operating revenues are derived principally from earnings on interest earning assets, service charges and fees, and gains on the sale of loans. Our primary sources of funds are deposits, Federal Home Loan Bank ("FHLB") advances and other borrowings, and payments received on loans and securities. We offer a variety of deposit accounts that provide a wide range of interest rates and terms, generally including savings, money market, term certificate and demand accounts.

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Market Area

We serve the Puget Sound region in western Washington, including the Seattle Metropolitan Statistical Area ("MSA"), and Clallam County, Washington through our main office in Seattle and four branch offices, two of which are located in the Seattle MSA and two that are located in Clallam County, west of Puget Sound. Our main office is located in Seattle in King County, while the Tacoma branch is located in Pierce County, the Mountlake Terrace branch is located in Snohomish County and the Sequim and Port Angeles branches are located in Clallam County. Based on the most recent branch deposit data provided by the FDIC, our share of deposits in the Seattle MSA was approximately 0.1%. In Clallam County we have approximately 12.2% of the deposits in that market. 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, Microsoft, Costco, Nordstrom, Amazon.com, Starbucks, University of Washington 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 2012, the Seattle MSA reported an unemployment rate of 6.2%, as compared to the national average of 7.8%, 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 8.2% in 2012 from 2011. This compares favorably to the national average home price index increase in 2012 of 6.8%.

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 1.9 million residents and a median household income of approximately $68,000. 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 Washington Center for Real Estate Research ("WCRER"), the average home price in King County as of September 30, 2012 was $379,900, an 8.5% increase from September 30, 2011 and a 2.6% decrease from September 30, 2010.

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 795,000 residents and a median household income of approximately $57,000. 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 WCRER the average home price in Pierce County in September 2012 was $204,600, a 14.1% increase from 2011 and a 9.1% decrease from September 30, 2010.

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 713,000 residents and a median household income of approximately $64,000. 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 WCRER, the average home price in

Snohomish County as of September 30, 2012 was $274,000, a 14.1% increase from 2011 and a 0.4% decrease from September 30, 2010.

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 $42,000. 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 WCRER the average home price in Clallam County as of September 30, 2012 was $208,300, a 17.6% increase from 2011 and a 6.0% increase from September 30, 2010.

There have been indications over the past year that the U.S. job market, including the job market in our market area, is improving. Economic conditions in general appear to be stabilizing, as the unemployment rates in our four county market area and the state of Washington have decreased since December 31, 2011, which was consistent with the nation as a whole. According to the latest available information from the Bureau of Labor Statistics, King and Snohomish Counties reported an unemployment rate of 6.1% and 6.7%, respectively, as of December 2012, which are lower than the state and national unemployment rates of 7.5% and 7.8%, respectively. The unemployment rates for Clallam and Pierce Counties are above the state and national rates as of December 2012. The unemployment rate in Clallam County decreased from 10.5% as of December 2011 to 9.9% as of December 2012, while the unemployment rate in Pierce County decreased from 9.3% as of December 2011 to 8.5% as of December 2012.

Lending Activities

The following table presents information concerning the composition of our loan portfolio, including loans held for sale by the type of loan for the dates indicated:

	December 31,									
	2012		2011		2010		2009		2008	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Real estate loans:										
One- to four-family	$95,784	29.09 %	$96,305	31.86 %	$99,215	33.01 %	$107,318	36.63 %	$90,863	34.33 %
Home equity	35,364	10.74	39,656	13.12	44,829	14.91	50,445	17.22	54,557	20.61
Commercial and multifamily	133,620	40.58	106,016	35.07	93,053	30.96	72,035	24.58	48,730	18.41
Construction and land	25,458	7.72	17,805	5.89	16,650	5.54	10,000	3.41	12,220	4.62
Total real estate loans	290,226	88.13	259,782	85.93	253,747	84.42	239,798	81.84	206,370	77.97
Consumer loans:										
Manufactured homes	16,232	4.93	18,444	6.10	20,043	6.67	21,473	7.33	22,723	8.58
Other consumer	8,650	2.63	10,920	3.61	12,110	4.03	13,945	4.76	17,951	6.78
	24,882	7.56	29,364	9.71	32,153	10.70	35,418	12.09	40,674	15.37

Total consumer loans										
Commercial business loans	14,193	4.31	13,163	4.35	14,678	4.88	17,800	6.07	17,668	6.67
Total loans	329,301	100.00%	302,309	100.00%	300,578	100.00%	293,016	100.00%	264,712	100.00%
Less:										
Deferred fees and discounts	832		406		431		334		43	
Loans held for sale	1,725		1,807		901		2,857		956	
Allowance for loan losses	4,248		4,455		4,436		3,468		1,306	
Total loans, net	$322,496		$295,641		$294,810		$286,357		$262,407	

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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:

	December 31,									
	2012		2011		2010		2009		2008	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percen
Fixed- rate loans:	(Dollars in thousands)									
Real estate loans:										
One- to four-family(1)	$80,745	24.52 %	$79,952	26.45 %	$80,831	26.89 %	$88,201	30.10 %	$72,439	27.37
Home equity	9,605	2.92	9,276	3.07	10,294	3.42	12,009	4.10	15,613	5.90
Commercial and multifamily	76,957	23.37	45,034	14.90	40,491	13.47	27,373	9.34	26,035	9.84
Construction and land	22,346	6.79	17,458	5.77	10,907	3.63	9,453	3.23	10,323	3.90
Total real estate loans	189,653	57.59	151,720	50.19	142,523	47.41	137,036	46.77	124,410	47.01
Manufactured homes	16,232	4.93	18,444	6.10	20,043	6.67	21,473	7.33	22,723	8.58
Other consumer	7,767	2.36	9,730	3.22	10,772	3.58	12,372	4.22	16,248	6.14
Commercial business	9,268	2.81	8,041	2.66	8,293	2.76	11,157	3.80	7,551	2.85
Total fixed-rate loans	222,920	67.69	187,935	62.17	181,631	60.43	182,038	62.13	170,932	64.58
Adjustable- rate loans:										
Real estate loans:										
One- to four-family	15,039	4.57	16,353	5.41	18,384	6.11	19,117	6.52	18,424	6.96
Home equity	25,759	7.82	30,380	10.05	34,535	11.49	38,436	13.12	38,944	14.71
Commercial and multifamily	56,663	17.21	60,982	20.17	52,562	17.49	44,662	15.24	22,695	8.57
Construction and land	3,112	0.95	347	0.11	5,743	1.91	547	0.19	1,897	0.72
Total real estate loans	100,573	30.54	108,062	35.75	111,224	37.00	102,762	35.07	81,960	30.96
Other consumer	883	0.27	1,190	0.39	1,338	0.45	1,573	0.54	1,703	0.64
Commercial business	5,539	1.50	5,122	1.69	6,385	2.12	6,643	2.27	10,117	3.82
Total adjustable-rate loans	106,381	32.31	114,374	37.83	118,947	39.57	110,978	37.87	93,780	35.42

Total loans	329,301	100.00%	302,309	100.00%	300,578	100.00%	293,016	100.00%	$264,712	100.0
Less:										
Deferred fees and discounts	832		406		431		334		43	
Loans held for sale	1,725		1,807		901		2,857		956	
Allowance for loan losses	4,248		4,455		4,436		3,468		1,306	
Total loans, net	$322,496		$295,641		$294,810		$286,357		$262,407	

(1) Includes 30-year loans with a one-time rate adjustment five to seven years after origination, which at December 31, 2012, totaled $25.8 million, or 31.97% of our fixed-rate one-to-four-family mortgages.

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The following table illustrates the contractual maturity of our loan portfolio at December 31, 2012. Mortgages 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, 2013, which have predetermined interest rates, is $203.6 million, while the total amount of loans due after such date, which have floating or adjustable interest rates, is $102.3 million. The table does not reflect the effects of possible prepayments or enforcement of due-on-sale clauses.

	Real Estate Mortgage												
	One- to Four- Family		Home Equity Loans		Commercial and Multifamily		Construction and Land		Manufactured Homes		Other Consumer		C
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	A
	(Dollars in thousands)												
2013(2)	$6,631	4.47%	$363	5.66%	$2,766	5.56%	$10,902	5.45%	$18	7.72%	$401	5.11%	$3
2014	2,572	6.65	117	5.69	4,192	5.10	3,015	5.88	209	7.46	770	6.40	2
2015	5,324	5.42	562	5.73	7,574	5.66	3,186	5.12	205	7.18	406	6.00	6
2016	5,318	6.63	1,649	5.11	796	6.67	1,606	5.76	157	7.80	732	6.12	1
2017 to 2019	6,926	5.09	14,246	5.06	19,632	6.12	2,072	6.49	1,902	8.03	1,309	6.40	2
2020 to 2023	5,708	4.83	13,389	6.13	85,359	5.32	2,260	7.14	5,129	9.14	1,302	6.66	1
2024 to 2027	10,610	4.50	910	6.62	4,886	4.66	1,510	7.12	6,183	7.68	1,102	6.53	1
2018 and following	52,695	4.70	4,128	6.37	8,415	6.28	907	6.81	2,429	7.32	2,628	9.51	6
Total	$95,784	4.90%	$35,364	5.68%	$133,620	5.50%	$25,458	5.86%	$16,232	8.12%	$8,650	7.30%	$1

(1) Excludes deferred fees and discounts of $832,000.

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

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Lending Authority. Our President and Chief Executive Officer may approve unsecured loans up to $500,000 and all types of secured loans up to $1.5 million. Our Executive Vice President and Chief Credit Officer may approve secured loans up to $750,000 and unsecured loans up to $250,000. 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 Board Loan Committee.

Largest Borrowing Relationships. At December 31, 2012, the maximum amount under federal law that we could lend to any one borrower and the borrower's related entities was approximately $6.5 million. Our five largest relationships totaled $19.2 million in the aggregate, or 5.9% of our $326.7 million gross loan portfolio, at December 31, 2012. The largest relationship consists of a $4.5 million line of credit to a business collateralized by the borrower's accounts receivable, inventory and equipment. The total credit facility to this borrower is $15.0 million and there are two other participating financial institutions. The next four largest lending relationships at December 31, 2012, were: $4.0 million in loans to commonly owned businesses collateralized by commercial real estate; a $3.9 million loan collateralized by multifamily real estate; a $3.5 million construction line of credit to a business secured by multifamily real estate; and a $3.3 million loan collateralized by commercial real estate. At December 31, 2012, we had one other lending relationship that exceeded $3.0 million. All of the loans in these lending relationships were performing in accordance with their repayment terms as of December 31, 2012.

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 overwhelming majority of our one- to four-family loan originations were fixed rate.

Most of our loans are written using 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 non-interest income. 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. We are currently selling all our conforming fixed-rate loans, on a servicing retained basis. Our pricing strategy for mortgage loans includes establishing interest rates that are competitive with other local financial institutions and consistent with our internal asset and liability management objectives. During the year ended December 31, 2012, we originated $107.2 million of one- to four-family fixed-rate mortgage loans and no one- to four-family adjustable rate mortgage ("ARM") loans. See "- Loan Originations, Purchases, Sales, Repayments and Servicing." At December 31, 2012, one- to four-family residential mortgage loans (including $1.7 million of loans held for sale) totaled $95.8 million, or 29.1%, of our gross loan portfolio, of which $80.7 million were fixed-rate loans and $15.1 million were ARM loans, compared to $96.3 million (including $1.8 million of loans held for sale), or 31.9% of our gross loan portfolio as of December 31, 2011, of which $80.0 million were fixed-rate loans and $16.3 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 a need for borrowers in our market area. As a result, subject to market conditions, we intend to continue to originate these types of 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. At December 31, 2012, we had $7.9 million of 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 in order to reduce our exposure to 80% or 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 an automated valuation model developed by Freddie Mac, called the Home Value Estimator, in lieu of an appraisal. We generally 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 size of our one- to four-family residential loans was approximately $210,000 at December 31, 2012.

Fixed-rate loans secured by one- to four-family residences have contractual maturities of up to 30 years; however, at December 31, 2012 we had $1.7 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 $25.6 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, 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, $7.8 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, 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 intend to expand our fully amortizing ARM loans, by offering ARM loans having 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 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 outstanding home equity line of credit and require monthly interest-only payments on the entire drawn amount during the draw period. At December 31, 2012, home equity loans totaled $35.4 million, or 10.7% of our gross loan portfolio compared to 39.7 million, or 13.1% of our gross loan portfolio at December 31, 2011. Home equity lines of credit at December 31, 2012 totaled $25.8 million, or 7.8% of our gross loan portfolio, compared to $30.3 million, or 10.1% of our gross loan portfolio as of December 31, 2011. At December 31, 2012, unfunded commitments on home equity lines of credit totaled $13.4 million.

Our fixed-rate home equity loans are originated in amounts, together with the amount of the existing first mortgage, of up to 90% of the appraised value of the subject property. These loans may have terms of up to 20 years and are fully amortizing. At December 31, 2012, fixed-rate home equity loans totaled $9.6 million, or 2.9% of our gross loan portfolio, compared to $9.3 million, or 3.1% of our gross loan portfolio as of December 31, 2011.

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, 2012, commercial and multifamily loans totaled $133.6 million, or 40.6% of our gross loan portfolio, compared to $106.0 million, or 35.1% of our gross loan portfolio as of December 31, 2011.

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 Board 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. At December 31, 2012, we held $3.2 million in commercial and multifamily loan participations secured by property located in Renton, WA, Gresham, OR and Billings, MT.

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. Our largest single commercial and multifamily borrowing relationship at December 31, 2012, totaled $4.0 million and is collateralized by four commercial real estate notes. At December 31, 2012, these loans were performing in accordance with its repayment terms.

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The following table displays information on commercial and multifamily loans by type at December 31, 2012 and 2011:

	2012		2011	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Multifamily residential	$43,048	32.22 %	$39,233	37.01 %
Warehouses	21,925	16.41	14,113	13.31
Office buildings	9,456	7.08	8,491	8.01
Mobile Home Parks	6,427	4.81	1,605	1.51
Gas station / Convenience store	5,827	4.36	7,918	7.47
Other non-owner occupied commercial real estate	31,358	23.47	18,230	17.20
Other owner-occupied commercial real estate	15,579	11.65	16,426	15.49
Total	$133,620	100.00 %	$106,016	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, 2012, our construction and land loans totaled $25.5 million, or 7.7% of our gross loan portfolio, compared to $17.8 million, or 5.9% of our gross loan portfolio at December 31, 2011. At December 31, 2012, unfunded construction loan commitments totaled $13.7 million.

Construction loans to individuals and contractors for the construction and acquisition of personal residences totaled $8.2 million, or 32.4% of our construction and land portfolio at December 31, 2012. We originate these loans whether or not the collateral property underlying the loan is under contract for sale. At December 31, 2012, construction loans to contractors for homes that were not pre-sold totaled $4.7 million.

The composition of, and location of underlying collateral securing, our construction and land loan portfolio including loan commitments at December 31, 2012 was as follows:

Type	Olympic Peninsula	Puget Sound	Other	Total
		(In thousands)		
Commercial and multifamily construction	$-	$5,882	$-	$5,882
Residential construction	323	3,155	61	3,539
Land and lot loans	6,456	1,834	3,049	11,339
Speculative residential construction	-	2,806	1,892	4,698
Total	$6,779	$13,677	$5,002	$25,458

The composition of, and location of underlying collateral securing, our construction and land loan portfolio including loan commitments at December 31, 2011 was as follows:

Type	Olympic Peninsula	Puget Sound	Other	Total
		(In thousands)		
Commercial and multifamily construction	$-	$584	$66	$650
Residential construction	2,359	3,035	-	5,394
Land and lot loans	7,072	1,849	956	9,877
Speculative residential construction	130	1,754	-	1,884
Total	$9,561	$7,222	$1,022	$17,805

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. 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, 2012, our largest residential construction loan commitment was for $3.0 million, of which $2.4 million had been disbursed. This loan was performing according to its repayment terms. The average outstanding residential construction loan balance was approximately $391,000 at December 31, 2012. 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 or to be built in a designated flood hazard area) on all construction loans.

We also originate developed lot and land loans to individuals intending to construct in the future a residence 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, 2012, lot and land loans totaled $11.3 million, or 44.5% 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 do 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 and require interest only payment during the term of the loan. 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. At December 31, 2012, we had $1.6 million in land acquisition and development loans. At December 31, 2012 our largest land acquisition and development loan consisted of a $909,000 loan, secured by single family residential lots located in our market area. At December 31, 2012, this loan was performing in accordance with its repayment terms.

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 12 months under terms similar to our residential construction loans. At December 31, 2012, commercial and multifamily construction loans totaled $5.9 million, or 23.1% of our construction and land portfolio.

Construction and land financing is generally considered to involve a higher degree of credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost (including interest) of construction and other assumptions. If the estimate of construction costs is inaccurate, we may be required to advance funds beyond the amount originally committed in order to protect the value of the property and may have to hold the property for an indeterminate period of time. Additionally, if the estimate of value is inaccurate, we may be confronted with a project that, when completed, has a value that is insufficient to generate full payment. Land loans also pose additional risk because of the lack of income being produced by the property and the potential illiquid nature of the collateral. The value of the lots securing our loans may be affected by the success of the development in which they are located. As a result, construction loans and land loans often involve the disbursement of funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property or refinance the indebtedness, rather than the ability of the borrower or guarantor to repay principal and interest. The nature of these loans is also such that they are generally more difficult to monitor. In addition, 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.

Consumer Lending. We offer a variety of secured consumer loans, including new and used manufactured homes, floating homes, automobiles, boats and recreational vehicle loans, and loans secured by savings deposits. 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.

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, 2012 was 8.1%, compared to 5.0% for one- to four-family mortgages, excluding loans held for sale. At December 31, 2012, these loans totaled $16.2 million, or 65.2% of our consumer loans and 4.9% of our gross loan portfolio. For used manufactured homes, loans are generally made for 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 for 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 additional 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, 2012, there was one nonperforming manufactured home loan for $29,000 and we held five manufactured homes valued at $112,000 in our other real estate owned (“OREO”) and repossessed assets portfolio.

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We make loans on new and used automobiles. Our automobile loan portfolio totaled $1.3 million at December 31, 2012, or 5.2% of our consumer loan portfolio and 0.4% of our gross loan portfolio. Automobile loans may be written for a term of up to 84 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. We follow our internal underwriting guidelines in evaluating automobile loans, including credit scoring, verification of employment, reviewing debt to income ratios and valuation of the underlying collateral.

Our consumer loans also include loans secured by new and used boats, floating homes, motorcycles and recreational vehicles, loans secured by deposits and unsecured consumer loans, all of which, at December 31, 2012, totaled $5.8 million or 23.4% of our consumer loan portfolio and 1.8% of our gross loan portfolio. Loans secured by boats, floating homes, motorcycles and recreational vehicles typically have terms from five to thirty 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 $50,000. At December 31, 2012, unfunded commitments on our unsecured consumer lines of credit totaled $2.2 million, and 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, 2012, commercial business loans totaled $14.2 million, or 4.3% of our gross loan portfolio, compared to $13.2 million, or 4.4% of our gross loan portfolio at December 31, 2011. 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 $989,000 of our commercial business loans at December 31, 2012 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 lending. 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 FHLB amortizing rate. 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 as reported in the West Coast edition of the Wall Street Journal plus 1% to 3%, and are generally originated with both a floor and ceiling to the interest rate. Our business lines of credit have terms ranging from 12 months to 24 months and provide for interest-only monthly payments during the term.

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Our commercial business loans are primarily 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 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. As a result, from time to time we will purchase whole loans or enter into loan participations with other financial institutions. In, 2012 and 2011, we engaged in commercial loan participations with another financial institution in the amount of $4.5 million and $3.4 million, respectively and purchased no whole loans during these years. We underwrite loan purchases and participations to the same standards as an internally-originated loan.

We do not actively engage in originating "alt A" loans, interest-only, option adjustable rate or subprime loans and have no established program to originate or purchase these loans. Through our normal lending practices, we held in our loan portfolio at December 31, 2012, $4.1 million of interest only loans, representing 1.3% of our total loan portfolio, and $18.8 million in loans identified as subprime at the time loan origination, representing 5.7% of our total loan portfolio, and no alt A or option adjustable rate loans. Subprime loans are defined by bank regulators as loans that at the time of loan origination had a FICO credit score of less than 660. At the time of loan origination or modification, our subprime borrowers had an average FICO score of 631. We obtain updated FICO scores on all our borrowers semi-annually and based on this updated score, at December 31 2012, $12.6 million or 3.8% of our total loan portfolio would be deemed subprime. As of December 31, 2012, our subprime portfolio, based on the FICO score at the time of loan origination or modification, included approximately $11.1 million in one- to four-family mortgage loans (of which $3.0 million were adjustable rate), $5.1 million in home equity loans (of which $4.2 million were adjustable rate), $2.2 million in manufactured home loans (none of which were adjustable rate) and $435,000 in other types of consumer loans (of which $158,000 were adjustable rate). Approximately 72.6% of these subprime loans were originated prior to 2009, and these loans are managed in the ordinary course of business. We do not believe subprime lending to be a material part of our business.

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 sold by us are sold with servicing retained. There were three loans repurchased from Fannie Mae totaling $440,000 in 2012 and none repurchased in 2011. We earned mortgage servicing income of $550,000 and $418,000, respectively, for the years ended December 31, 2012 and 2011. 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. At December 31, 2012, we were servicing a $365.7 million portfolio of residential mortgage loans for Fannie Mae. These mortgage servicing rights are carried at fair value and had a value at December 31, 2012 of $2.3 million. See Note 7 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 other investments, and increase liquidity. We sold $95.1 million and $53.7 million of loans during the years ended December 31, 2012 and 2011, 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 2012 and 2011 was $2.1 million and $501,000, respectively.

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

	For the year ended December 31,		
	2012	2011	2010
Originations by type:		(In thousands)	
Fixed-rate:			
One- to four-family	$143,189	$66,883	$73,366
Home equity	4,130	2,715	1,790
Commercial and multifamily	50,202	18,356	18,298
Construction and land	24,417	9,369	6,000
Manufactured home	1,305	1,666	2,144
Other consumer	1,961	2,323	2,525
Commercial business	5,866	7,949	3,272
Total fixed-rate	231,070	109,261	107,395
Adjustable rate:			
One- to four-family (1)	-	-	483
Home equity	-	1,254	1,157
Commercial and multifamily	22,821	17,454	17,698
Construction and land	2,280	943	190
Other consumer	24	106	26
Commercial business	1,979	3,258	3,146
Total adjustable-rate	27,104	23,015	22,700
Total loans originated	258,174	132,276	130,095
Purchases by type:			
Commercial and multifamily	-	-	3,400
Commercial business	4,500	-	-
Total loans purchased	4,500	-	3,400
Sales and Repayments:			
One- to four-family	95,055	53,684	61,908
Total loans sold	95,055	53,684	61,908
Total principal repayments	140,764	76,861	64,025
Total reductions	235,819	130,545	125,933
Net increase	$26,855	$1,731	$7,562

(1) These loans include $0, $0 and $483,000 of adjustable rate mortgage loan originations to employees at December 31, 2012, 2011 and 2010, respectively.

The increase in originations in 2012 compared to 2011 and 2010, particularly in one-to four-family real estate loans, was due to an increase in relative demand compared to the prior periods. The ability of borrowers to refinance their existing first mortgage loans was positively impacted by the economic environment, the housing market and market interest rates and the rate of unemployment both in our markets and nationwide. The Bank also hired two additional lenders in 2012 in order to increase loan production.

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 mailed to the borrower. All delinquent accounts are reviewed by a loan account executive 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 Collections Department provides support for continuing its 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 in charge of the loan, who is responsible for contacting the borrower. The Collections Department also works with the loan officers to see that the necessary steps are taken to collect delinquent loans. In addition, management meets with all of the loan officers weekly 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, 2012:

	Loans Delinquent For:								
	60-89 Days			90 Days and Over			Total Delinquent Loans		
	Number	Amount	Percent of Loan Category	Number	Amount	Percent of Loan Category	Number	Amount	Percent of Loan Category
	(Dollars in thousands)								
One- to four-family	4	$572	0.60 %	7	$917	0.96 %	11	$1,489	1.55 %
Home equity	5	364	1.03	6	332	0.94	11	696	1.97
Construction and land	-	-	-	1	471	1.85	1	471	1.85
Manufactured homes	1	2	0.01	-	-	-	1	2	0.01
Other consumer	5	2	0.02	1	1	0.01	6	3	0.03
Commercial business	-	-	-	3	80	0.56	3	80	0.56
Total	15	$940	0.29 %	18	$1,801	0.55 %	33	$2,741	0.83 %

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Nonperforming Assets. The table below sets forth the amounts and categories of nonperforming assets in our loan portfolio. 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 no accruing loans 90 days or more delinquent for the periods reported.

	December 31,				
	2012	2011	2010	2009	2008
Nonperforming loans(1):	(Dollars in thousands)				
One- to four- family	$1,143	$4,401	$2,729	$2,175	$258
Home equity	717	873	517	1,100	340
Commercial and multifamily	1,347	1,219	-	222	471
Construction and land	471	80	-	1,231	59
Manufactured homes	29				
Other consumer	8	64	-	19	64
Commercial business	197	-	-	-	60
Total	3,912	6,637	3,246	4,747	1,252
OREO and repossessed assets:					
One- to four-family	$1,318	478	1,102	901	1,250
Commercial and multifamily	1,073	2,225	1,302	-	-
Construction and land	-	-	70	115	-
Manufactured homes	112	118			
Other consumer	-	-	151	368	284
Commercial business	-	-	-	-	190
Total	2,503	2,821	2,625	1,384	1,724
Total nonperforming assets	$6,415	$9,458	$5,871	$6,131	$2,976
Nonperforming assets as a percentage of total assets	1.68 %	2.78 %	1.75 %	1.81 %	1.01 %
Performing restructured loans:					
One- to four- family	$3,198	$2,508	$2,836	$3,996	$-
Home equity	356	812	967	1,290	-
Commercial and multifamily	776	785	-	708	-
Construction and land	100	-	230	230	-
Manufactured homes	602	-	-	-	-
Other consumer	19	4	15	111	-
Commercial business	564	26	-	174	-
Total	$5,614	$4,135	$4,048	$6,509	$-

(1) Nonperforming loans include $828,000, $2.8 million and $348,000 in nonperforming troubled debt restructurings as of December 31, 2012, 2011 and 2010, respectively. There were no nonperforming loans as of December 31, 2008.

For the year ended December 31, 2012, gross interest income that would have been recorded had the nonaccrual loans been current in accordance with their original terms amounted to $269,000, all of which was excluded from interest income for the year ended December 31, 2012. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Financial Condition at December 31, 2012 Compared to December 31, 2011 -- Delinquencies and Nonperforming Assets" for more information on troubled assets.

Troubled Debt Restructured Loans. Troubled debt restructurings, 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 troubled debt restructurings 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 troubled debt restructuring from nonperforming status. At December 31, 2012, we had $5.6 million of loans that were classified as troubled debt restructurings and still on accrual. Included in nonperforming loans at December 31, 2012 and 2011 were troubled debt restructured loans of $828,000 and $2.8 million, respectively.

OREO and Repossessed Assets. OREO and repossessed assets include assets acquired in settlement of loans. At December 31, 2012 OREO and repossessed assets consisted of ten single family residences totaling $1.3 million, one commercial real estate property totaling $1.1 million secured by a mobile home park consisting of 28 lots and one commercial parcel with a recorded value of $1.1 million located in Spanaway, Washington, and five manufactured homes totaling $112,000.

Other Loans of Concern. In addition to the nonperforming assets set forth in the table above, as of December 31, 2012, there were 36 loans totaling $2.7 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. These loans have been considered individually in management's determination of our allowance for loan losses. The largest loan relationship of concern at December 31, 2012, totaled $219,000 and was secured by single family residence in Clallam County, Washington. The remaining loans of concern consist of $1.9 million in residential first mortgages, $658,000 in home equity loans, $79,000 in commercial business loans and $50,000 in consumer loans. Loans of concern had specific loan loss reserves of $199,000 at December 31, 2012.

Classified Assets. Federal regulations provide for the classification of lower quality loans and other assets (such as other real estate owned 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, 2012 special mention assets, consisting solely of loans, totaled $1.6 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, 2012, we had classified $11.2 million of our assets as substandard, which represented a variety of outstanding loans, non-agency mortgage backed securities, OREO and repossessed assets. At that date, we had no assets classified as doubtful or loss. This total amount of classified assets represented 25.7% of our equity capital and 2.9% of our assets at December 31, 2012. Classified assets totaled $15.6 million, or 54.3% of our equity capital and 4.6% of our assets at December 31, 2011.

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, 2012, our allowance for loan losses was $4.2 million, or 1.3% of our total loan portfolio, compared to $4.5 million, or 1.5% of our total loan portfolio in 2011. Specific valuation reserves totaled $1.0 million and $1.3 million at December 31, 2012 and 2011, 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 in our loan portfolio. See Notes 1 and 6 of the Notes to Consolidated Financial Statements. The following table sets forth an analysis of our allowance for loan losses at the dates indicated:

	December 31,				
	2012	2011	2010	2009	2008
	(Dollars in thousands)				
Balance at beginning of period	$4,455	$4,436	$3,468	$1,306	$828
Charge-offs:					
One-to four-family	2,740	834	843	104	114
Home equity	1,084	1,652	1,291	1,368	62
Commercial and multifamily	503	1,353	940	74	37
Construction and land	222	159	-	-	-
Manufactured homes	152	239	-	-	-
Other consumer	286	255	649	577	505
Commercial business	44	310	221	149	71
Total charge-offs	5,031	4,802	3,944	2,272	789
Recoveries:					
One-to four-family	4	11	-	-	2
Home equity	158	10	222	-	-
Commercial and multifamily	83	96	-	22	-
Construction and land	-	-	-	-	-
Manufactured homes	11	8	-	-	-
Other consumer	33	53	38	128	140
Commercial business	10	43	2	9	15
Total recoveries	299	221	262	159	157
Net charge-offs	4,732	4,581	3,682	2,113	632
Additions charged to operations	4,525	4,600	4,650	4,275	1,110
Balance at end of period	$4,248	$4,455	$4,436	$3,468	$1,306
Net charge-offs during the period as a percentage of average loans outstanding during the period	1.55 %	1.53 %	1.22 %	0.75 %	0.26 %

Net charge-offs during the period as a percentage of average nonperforming assets	35.15	%	48.04	%	31.22	%	46.40	%	29.77	%
Allowance as a percentage of nonperforming loans	110.88	%	67.12	%	136.66	%	73.06	%	104.31	%
Allowance as a percentage of total loans (end of period)	1.30	%	1.47	%	1.48	%	1.18	%	0.49	%

Weak economic conditions and ongoing strains in the financial and housing markets which began in 2008, generally started to improve in 2012 in most major regions 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, during 2012 housing prices and unemployment rates are generally improving. Prior to 2012, our market area had experienced substantial home price declines, historically low levels of existing home sale activity, high levels of foreclosures and above average unemployment rates negatively affecting the values of real estate collateral supporting our loans and resulting in increased loan delinquencies and defaults and net charge-offs during these periods.

The increase in our allowance for loan losses as a percentage of nonperforming loans was a result of a decrease in nonperforming loans during the period. The allowance for loan losses as a percentage of total loans was 1.30% and 1.47% as of December 31, 2012 and 2011, respectively.

The distribution of our allowance for losses on loans at the dates indicated is summarized as follows:

	December 31,									
	2012		2011		2010		2009		2008	
	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
	(Dollars in thousands)									
Allocated at end of period to:										
One- to four-family	$1,417	29.09 %	$1,117	31.86 %	$909	33.01 %	$589	36.63 %	$321	34.33 %
Home equity	997	10.74	1,426	13.12	1,380	14.91	2,220	17.22	240	20.61
Commercial and multifamily	492	40.58	969	35.07	659	30.96	220	24.58	153	18.41
Construction and land	217	7.72	105	5.89	205	5.54	-	3.41	55	4.62
Manufactured homes	260	4.93	290	6.10	321	6.67	-	7.33	-	8.58
Other consumer	146	2.63	213	3.61	381	4.03	243	4.76	272	6.78
Commercial business	218	4.31	254	4.35	163	4.88	164	6.07	158	6.67
Unallocated	501	-	81	-	418	-	32	-	107	-
Total	$4,248	100.00 %	$4,455	100.00 %	$4,436	100.00 %	$3,468	100.00 %	$1,306	100.00 %

Investment Activities

Federal savings 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, federal savings 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, 2012, we owned $2.4 million in Federal Home Loan Bank of Seattle ("FHLB") stock. As a condition of membership at the FHLB, we are required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB and is calculated in accordance with the Capital Plan of the FHLB. Our FHLB stock has a par value of $100, is carried at cost, and is subject to recoverability testing. The FHLB announced that it had a risk-based capital deficiency under the regulations of the Federal Housing Finance Agency (the "FHFA"), its primary regulator, as of December 31, 2008, and that it would suspend future dividends and the repurchase and redemption of outstanding common stock. As a result, the FHLB has not paid a dividend since the fourth quarter of 2008. The FHLB has communicated that it believes the calculation of risk-based capital under the current rules of the FHFA significantly overstates the market risk of the FHLB's private-label mortgage-backed securities in the current market environment and that it has enough capital to cover the risks reflected in its balance sheet. As a result, we have not recorded an impairment on our investment in FHLB stock. However, further deterioration in the FHLB's financial position may result in impairment in the value of those securities. In addition, on October 25, 2010, the FHLB received a consent order from the FHFA. The FHLB of Seattle reported, in its Form 10-K for the year ended December 31, 2012, that it continues to address the requirements of the consent order and that, as of December 31, 2012, it met all minimum financial metrics required under the consent order. Further, the FHLB of Seattle reported that in September, 2012 that the FHFA reclassified the FHLB of Seattle to be adequately capitalized. Any dividends on, or repurchases of, the FHLB of Seattle stock continue to require the consent of the FHFA pursuant to the consent order. The FHFA recently approved the FHLB of Seattle to repurchase a portion of its stock and $43,000 of FHLB of Seattle stock was purchased from the Bank in September, 2012. We will continue to monitor the financial condition of the FHLB as it relates to, among other things, the recoverability of our investment.

The following table sets forth the composition of our securities portfolio and other investments at the dates indicated. At December 31, 2012, 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,					
	2012		2011		2010	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Securities available for sale			(In thousands)			
Agency mortgage-backed securities	$20,378	20,127	$53	$59	$54	$61
Non-agency mortgage-backed securities(1)	3,273	2,773	3,939	2,933	5,543	4,480
Total available for sale	23,651	22,900	3,992	2,992	5,597	4,541
FHLB stock	2,401	2,401	2,444	2,444	2,444	2,444
Total securities	$26,052	$25,301	$6,436	$5,436	$8,041	$6,985

(1) The non-agency mortgage backed securities have an unrealized loss of $519,000 as of December 31, 2012. These securities were purchased at a discount in 2008 and 2009. Each of these securities has performed and paid principal and interest each month as contractually committed.

The composition and maturities of our investment securities portfolio at December 31, 2012, excluding FHLB stock, are as follows: Federal agency mortgage-backed securities with an amortized cost of $20.4 million and a fair value of $20.1 million and a final maturity greater than ten years and non-agency mortgage-backed securities with an amortized cost of $3.3 million and a fair value of $2.8 million 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, 2012, we recognized $164,000 of non-cash OTTI charges on four non-agency mortgage-backed securities. At December 31, 2012, the fair value of these four securities was $2.1 million. Management concluded that the decline of the estimated fair value below the cost of the securities was other than temporary and recorded this credit loss through non-interest income. We determined the remaining decline in value was not related to specific credit deterioration. We do not intend to sell these securities and it is more likely than not that we will not be required to sell the 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 these securities by selling them. Accordingly, if market conditions deteriorate further and we determine our holdings of these or other investment securities are OTTI, our future earnings, shareholders' equity, regulatory capital and continuing operations could be materially adversely affected.

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, demand accounts and certificates of deposit. We solicit deposits primarily in our market area; however, at December 31, 2012, approximately 3.6% of our deposits were from persons outside the State of Washington. As of December 31, 2012, core deposits, which we define as our non-time deposit accounts and time deposit accounts less than $250,000, represented approximately 86.5% of total deposits, compared to 89.0% and 91.6% as of December 31, 2011 and December 31, 2010, 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 conscious. 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:

	For the year ended December 31,
2012	2011